

INVESTMENT MANAGEMENT & OVERSIGHT WORKSHOP



OCTOBER 6, 2011

**TITO P. VILLEGAS, JR., CPA, CFA
CONTROLLER**

**TEXAS MUNICIPAL LEAGUE INTERGOVERNMENTAL
RISK POOL**

TVILLEGAS@TMLIRP.ORG

(512) 491-2314

GASB Statement No. 31

(Accounting and Reporting for Investments)



- Report investments at fair value in the balance sheet.
- Cost basis information can be presented parenthetically on the balance sheet.
- Report all investment income, including changes in fair value, as revenue in the income statement.
- Can separate components of investment income into (1) interest income and (2) change in fair value.
- Cost-based records are acceptable, provided that fair value adjustments are made for financial statements.

Texas Pool Makes Decisions Excluding Unrealized Gains (Losses)

- Unrealized gains/losses distort financial statements
- Volatility of markets flow through the income statement
- Exclude unrealized gains (losses) in rate making
- Consider Members' equity without unrealized gains (losses):
 - For adequacy of members' equity
 - For equity returns to members

Components of Investment Income

- Interest income
- Amortization (Accretion) of Premium (Discount)
- Realized gains (losses)
- Change in fair value

Options:

Report all together as "investment income"

Separate and report "interest income" and everything else as "Change in fair value"

(See Handouts – Page 1)

How Texas Pool Reports Investments on Interim (Monthly) Statements

On interim reports and for all financial decisions:

- Report investments at market value on the balance sheet
- Separate Members' Equity into two components
 - Members' Equity excluding unrealized gains (losses)
 - Members' Equity including unrealized gains (losses)
- Report "Revenues over Expenses" without unrealized gains / losses
 - Revenues over (under) expenses before unrealized gains (losses)
 - Change in unrealized gains (losses)
 - Revenues over (under) expenses after unrealized gains (losses)

See Handouts – Page 2

How Texas Pool Reports Investments on Annual (Audited) Statements

On Annual (audited) Financial Statements:

- Separate investment income into (1) Interest Income, and (2) Change in Market Value
- Report investment income as operating income
- Report investment at **market value** on balance sheet
- Include amortized cost amounts parenthetically

(See Handouts – Page 3-4)

Certificate of Achievement for Excellence in Financial Reporting (CAFR)

- The Pool received the award 14 consecutive years.
- The Pool did not apply for the award after 2007.
- The issue was whether investment income was operating revenue or non-operating revenue.

Pool Reports Investment Income as Operating Revenue

GASB 34 defines operating revenues and expenses:

- If investing is the entity's principal ongoing operation, investment earnings could be reported as operating.

In the GASB implementation guide:

- Question: For a risk pool, can interest be considered operating revenue because those earnings are needed to pay claims?
- Answer: **No**, for pools the principal ongoing activity is not likely investing, but rather risk financing.

Reporting Investment Income as Operating

From GASB 34

- ❑ “For example, interest revenue and expense transactions should be reported as operating revenue and expense by a proprietary fund **established to provide loans to first-time homeowners.**”

By substituting this, “**established to provide risk financing to government entities,**” what’s the difference between the two?

Investing is an integral and essential function of risk financing.

Investment income is revenue in setting rates

Investments are 98% of total assets.

GASB STATEMENT NO. 40 (Deposit and Investment Risk Disclosures)

Establishes disclosure requirements related to *investment risks*:

- ❑ Credit risks
 - Custodial credit risk
 - Concentrations of credit risk
- ❑ Interest rate risk
- ❑ Foreign currency risk

Establishes disclosure requirements for *deposit risks*:

- ❑ Custodial credit risk
- ❑ Foreign current risk

Need to describe deposit and investment policies that relate to these risks.

Foreign Currency Risk Disclosure

Disclose U.S. dollar balances of deposits or investments exposed to foreign currency risk

Investment	Currency	Maturity	Fair Value
Investment 1	British Pound	5/31/2015	\$1,000,000
Investment 2	Canadian Dollar	1/31/2020	<u>2,000,000</u>
Total			<u>\$3,000,000</u>

Credit Risk Disclosure

- Disclose credit ratings
- U. S. government obligations are not considered to have credit risk (Yeah, right!)
- Concentration of Credit Risk
 - Disclose amount and issuer, if 5% or more of total investments.
- Disclose credit ratings of external pools and money market funds

CUSTODIAL CREDIT RISK



Deposits

- Disclose **only if** exposed to custodial credit risk:
 - Uninsured and uncollateralized
 - Collateralized with securities held by pledging bank
 - Collateralized with securities held by bank's trust department

Disclose actual cash balance at the bank

- Reported balance on balance sheet includes outstanding checks

Investments

- Disclose **only if** exposed to custodial credit risk:
 - Uninsured and;
 - Not registered in the name of government entity, and;
 - Held by either:
 - The counterparty or its trust department/agent

Interest Rate Risk Disclosure



Disclose interest rate risk by using one of the following:

- Segmented time distribution
- Specific identification
- Weight average maturity
- Duration
- Simulation model

INTEREST RATE RISK



- Use method used in managing interest rate risk
 - Disclose assumptions about timing of cash flows and interest rate changes

- Disclose terms of investments that may cause the value to be highly sensitive to interest rate changes
 - If not considered in the method used
 - Examples
 - Variable-rate investments
 - Asset-backed securities

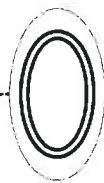
(See Handouts – Page 5-7)

OTHER TOPICS



- The Pool calculates book value return on investments (handout-page 8).
- The Pool reports 8 major funds on the financial statements (handout - pages 9-10).
- The Pool has “restricted” Members’ Equity for its unfunded actuarial liability at Texas Municipal Retirement System (TMRS) (handout – page 10).
- Why does the Pool file a corporate tax return (Form 1120)? (pages 11-14)
- How much members’ equity is adequate? (page 15)
- How does the Pool return members’ equity? (pages 16-17)

**INVESTMENT
MANAGEMENT &
OVERSIGHT WORKSHOP**



HANDOUTS

OCTOBER 6, 2011

TEXAS MUNICIPAL LEAGUE INTERGOVERNMENTAL RISK POOL
2009 - 2010 INVESTMENT INCOME

	INTEREST INCOME	AMORT. OF DISC./PREM.	GAIN (LOSS)	MONEY MKT INTEREST	INVESTMENT INCOME	GASB 31 ADJUSTMENT	INVESTMENT INCOME PER GASB 31
OCT 09	2,302,859.07	(168,240.26)	34,360.40	465.86	2,169,445.07	25,983.53	2,195,428.60
NOV 09	2,347,157.57	(163,427.69)	496,025.58	747.62	2,680,503.08	4,463,582.85	7,144,085.93
DEC 09	2,374,360.64	(169,852.89)	0.00	430.31	2,204,938.06	(10,530,159.24)	(8,325,221.18)
JAN 10	2,386,350.14	(218,721.81)	0.00	357.21	2,167,985.54	6,078,984.44	8,246,969.98
FEB 10	2,336,153.91	(167,853.06)	1,218,667.70	367.98	3,387,336.53	(1,509,510.76)	1,877,825.77
MAR 10	2,298,975.10	(187,130.89)	56,047.29	357.88	2,168,249.38	(2,082,871.41)	85,377.97
APR 10	2,280,289.21	(210,652.66)	353,313.54	337.22	2,423,287.31	1,331,454.08	3,754,741.39
MAY 10	2,294,012.07	(170,522.64)	0.00	330.19	2,123,819.62	4,620,631.72	6,744,451.34
JUN 10	2,264,401.92	(137,620.18)	332,343.25	602.59	2,459,727.58	3,938,804.42	6,398,532.00
JUL 10	2,232,407.14	(151,111.05)	169,061.96	724.88	2,251,082.93	2,333,673.87	4,584,756.80
AUG 10	2,195,738.78	(181,445.48)	56,476.81	941.06	2,071,711.17	986,480.43	3,058,191.60
SEP 10	2,139,033.43	(243,842.07)	277,237.90	996.26	2,173,425.52	(3,158,339.47)	(984,913.95)
TOTALS	27,451,738.98	(2,170,420.68)	2,993,534.43	6,659.06	28,281,511.79	6,498,714.46	34,780,226.25

COMBINED BALANCE SHEET

	September 30, 2010	September 30, 2009
ASSETS		
Cash, investments and accrued investment income (Note 3)	\$630,364,755	\$601,621,054
Contributions and other receivables	4,113,781	4,112,663
Reinsurance recoverable on paid losses (Note 4)	1,549,275	1,089,886
Property and fixed assets, net of accumulated depreciation (Note 2)	2,965,481	3,092,303
Prepaid reinsurance	4,322,134	4,878,082
Other assets (Note 6)	1,070,339	1,075,527
Total Assets	<u>\$644,385,765</u>	<u>\$615,869,515</u>
LIABILITIES AND MEMBERS' EQUITY		
Claim Reserves:		
Reserve for reported claims (net of deductibles)	\$176,009,935	\$183,372,712
Reinsurance recoverable on reported but not yet paid claims	(23,877,318)	(31,444,377)
Reserve for incurred but not reported claims (net of reinsurance)	94,125,000	94,125,000
Reserve for unallocated loss adjustment expense	5,000,000	5,000,000
Estimated future investment income (discount) for lifetime benefit claims	(18,799,986)	(18,685,631)
Estimated ultimate unpaid losses and loss adjustment expenses	<u>232,457,631</u>	<u>232,367,704</u>
Contract service fees payable	0	226,097
Outstanding loss drafts	3,333,294	4,051,167
Payable to Administrative Services Only contracts and large deductible members (Note 5)	1,187,750	1,286,500
Unearned contribution reserve (Note 2)	2,615,784	2,347,025
Funds invested for TML	5,526,191	5,281,733
Other liabilities (Note 2)	<u>19,354,001</u>	<u>19,617,237</u>
	<u>264,474,651</u>	<u>265,177,463</u>
Restricted Members' Equity - Texas Municipal Retirement System (Note 2)	13,117,097	12,229,384
Unrestricted Members' Equity	<u>338,405,169</u>	<u>316,572,535</u>
Members' Equity before unrealized investment gains (losses)	351,522,266	328,801,919
Increase/(Decrease) In Members' Equity due to unrealized investment gains (losses)	<u>28,388,848</u>	<u>21,890,133</u>
Members' Equity	<u>379,911,114</u>	<u>350,692,052</u>
Total Liabilities and Members' Equity	<u>\$644,385,765</u>	<u>\$615,869,515</u>

COMBINED STATEMENT OF OPERATIONS AND CHANGES IN MEMBERS' EQUITY

	Period Ended September 30, 2010	Period Ended September 30, 2009
REVENUES		
Earned contributions, net of adjustment factors allowed	\$144,923,188	\$152,768,310
Return of contributions	0	(11,173,156)
Service fee and other income (Note 7)	195,780	170,471
Investment income (Note 3)	<u>28,281,511</u>	<u>33,904,854</u>
Total Revenues	<u>173,400,479</u>	<u>175,670,479</u>
EXPENSES		
Paid losses and loss adjustment expenses	100,433,455	125,122,153
Claim recoveries (Note 2)	(4,487,144)	(4,319,886)
Change in reserve for reported claims (net of deductibles)	(7,364,123)	(23,590,538)
Change in reinsurance recoverable	2,275,167	(2,782,729)
Change in reserve for incurred but unreported claims (net of reinsurance)	0	(100,000)
Change in reserve for unallocated loss adjustment expense	0	1,611,000
Change in discount for lifetime benefits claims	(114,355)	(2,349,020)
Total losses and loss adjustment expenses	<u>90,743,000</u>	<u>93,590,980</u>
Payments from Employers Casualty Company in Receivership	0	(3,632,159)
Payment from Mission	0	(9,495)
Reinsurance expense (Note 4)	8,610,040	7,581,614
Contract service fees	3,383,434	3,763,588
General and administrative expense	<u>31,909,026</u>	<u>30,638,216</u>
Total Expenses	<u>134,645,500</u>	<u>131,932,744</u>
Revenues over expenses before unrealized investment gains (losses) & return of members' equity	<u>38,754,979</u>	<u>43,737,735</u>
Return of members' equity - current year	(16,078,244)	(16,103,344)
Adjustment to prior year equity return	43,612	2,773,655
Revenues over expenses before unrealized investment gains (losses) & after return of members' equity	<u>22,720,347</u>	<u>30,408,046</u>
Investment income (unrealized investment gains (losses))	6,498,715	20,578,081
Revenues over expenses after unrealized investment gains (losses)	<u>29,219,062</u>	<u>50,986,127</u>
Members' Equity, beginning of year	<u>350,692,052</u>	<u>299,705,925</u>
Members' Equity, end of period	<u>\$379,911,114</u>	<u>\$350,692,052</u>

**TEXAS MUNICIPAL LEAGUE INTERGOVERNMENTAL RISK POOL
BALANCE SHEETS**

	Totals	
	September 30, 2010	September 30, 2009
ASSETS	Current Year	Prior Year
Current Assets		
Cash and cash equivalents	\$ 25,276,398	\$ 22,714,016
Short-term investments	18,782,418	7,732,857
Long-term fixed income investments	583,254,134	568,112,137
Accrued investment income	3,051,805	3,062,044
Total cash and investments (cost basis \$601,975,907 for 2010 and \$579,730,921 for 2009) (notes 3 and 4)	630,364,755	601,621,054
Contributions and other receivables	4,113,781	4,112,663
Reinsurance recoverable on paid losses (note 9)	1,549,275	1,089,886
Prepaid reinsurance	4,322,134	4,878,082
Total Current Assets	640,349,945	611,701,685
Noncurrent Assets		
Capital assets (land, building, furniture and equipment) (note 6)	2,965,481	3,092,303
Other assets (note 7)	1,070,339	1,075,527
Total noncurrent assets	4,035,820	4,167,830
Total Assets	\$ 644,385,765	\$ 615,869,515
LIABILITIES AND MEMBERS' EQUITY		
Current Liabilities		
Claim Reserves:		
Reserve for reported claims - net	\$ 152,132,617	\$ 151,928,335
Reserve for incurred but not reported claims - net (note 2)	94,125,000	94,125,000
Reserve for unallocated loss adjustment expense	5,000,000	5,000,000
Estimated future investment income at 5%	(18,799,986)	(18,685,631)
Estimated ultimate unpaid losses & loss adjustment expenses	232,457,631	232,367,704
Payable to administrative service only contracts (note 5)	1,187,750	1,286,500
Contract service fees payable	-	226,097
Outstanding loss drafts	3,333,294	4,051,167
Unearned contribution reserve (note 2)	2,615,784	2,347,025
Reinsurance payable	715,953	1,181,924
Members' Equity return payable	16,078,244	16,103,344
Other liabilities (note 2)	2,559,804	2,331,969
Total current liabilities	258,948,460	259,895,730
Noncurrent Liabilities		
Funds invested for TML (note 10)	5,526,191	5,281,733
Total noncurrent liabilities	5,526,191	5,281,733
Total Liabilities	264,474,651	265,177,463
MEMBERS' EQUITY		
Invested in capital assets (net)	2,965,481	3,092,303
Restricted Members' Equity - Texas Municipal Retirement System (Note11)	13,117,097	12,229,384
Unrestricted Members' Equity	363,828,536	335,370,365
Total Members' Equity (Includes net unrealized investment gains of \$28,388,848 for 2010 and \$21,890,133 for 2009) (note 2)	379,911,114	350,692,052
Total Liabilities and Members' Equity	\$ 644,385,765	\$ 615,869,515

**TEXAS MUNICIPAL LEAGUE INTERGOVERNMENTAL RISK POOL
STATEMENTS OF OPERATIONS AND CHANGES IN MEMBERS' EQUITY**

	Totals	
	September 30, 2010	September 30, 2009
	Current Year	Prior Year
Operating Revenues		
Earned Contributions	\$ 144,923,188	\$ 152,768,310
Return of Contributions (note 2)	-	(11,173,156)
(less: cost of reinsurance - outside reinsurers) (note 9)	(8,734,591)	(7,701,775)
(less: cost of reinsurance - reinstatement) (note 9)	124,551	120,161
(less: cost of reinsurance - reinsurance fund) (note 9)	-	-
Net Contributions	136,313,148	134,013,540
Investment Income (Interest Income) (note 4)	27,458,398	29,187,679
Investment Income (Change in Market Value) (note 4)	7,321,828	25,295,256
Service Fee and Other Income (note 5)	195,780	170,471
Reinsurance Revenue	-	-
Large Loss Revenue	-	-
Annuity Revenue	-	-
Interest Income - Line of Credit	-	-
Total Operating Revenues	171,289,154	188,666,946
Operating Expenses		
Net Paid Losses and Loss Adjustment Expenses	90,653,073	104,909,028
Change in Reserve for Reported Claims (Net)	204,282	(10,480,028)
Change in Reserve for Incurred But Not Reported Claims	-	(100,000)
Change in Estimated Future Investment Income at 5%	(114,355)	(2,349,020)
Change in Unallocated Loss Adjustment Expense	-	1,611,000
Total Losses and Loss Adjustment Expenses	90,743,000	93,590,980
Payment Received from Employers Casualty Company	-	(3,632,159)
Payment Received from Mission	-	(9,495)
Large Loss Expense	-	-
Contract Service Fees (note 8)	3,383,434	3,763,588
Interest Expense - Line of Credit	-	-
General and Administrative Expense	31,909,026	30,638,216
Total Operating Expenses	126,035,460	124,351,130
Revenues Over Expenses Before Return of Members' Equity	45,253,694	64,315,816
Return of Members' Equity - current year (note 2)	(16,078,244)	(16,103,344)
Adjustment to Prior Year Equity Return (note 2)	43,612	2,773,655
Revenues Over Expenses After Return of Members' Equity	29,219,062	50,986,127
Transfer of equity from the Property Fund to the Coastal Storm Fund	-	-
Members' Equity, beginning of year	350,692,052	299,705,925
Members' Equity, end of period	\$ 379,911,114	\$ 350,692,052

NOTE 3 - CASH AND CASH EQUIVALENTS:

The bank balances of the Pool's cash and cash equivalents are \$26,310,827 and \$24,148,174 at September 30, 2010 and 2009, respectively. The difference between the bank balances and the recorded cash balances on the balance sheet is due to the outstanding checks issued and deposits in transit.

NOTE 4 - INVESTMENTS:

Investing is a primary ongoing operation of the Pool and it is the Pool's policy to consider investment income as an important component of operating income. Under provisions of the Pool's investment policy, and in accordance with regulations for investment of public funds in the State of Texas (i.e., the Public Funds Investment Act), the Pool may invest in the following types of investments:

1. Obligations of the United States or its agencies and instrumentalities;
2. Direct obligations of the State of Texas or its agencies and instrumentalities;
3. Mortgage-backed securities directly issued by federal agency or instrumentality except for collateralized mortgage obligations;
4. Obligations of states, agencies, counties, cities, and other political divisions of any state having been rated as to investment quality by a nationally recognized investment rating firm and having received a rating of not less than A or its equivalent;
5. Certificates of Deposit issued by state or national banks domiciled in the State of Texas, a savings bank domiciled in the State of Texas, or a state or federal credit union domiciled in the State of Texas;
6. Fully collateralized direct repurchase agreements having a defined termination date, secured by obligations of the United States or its agencies and instrumentalities;
7. Investment pools, no-load money market mutual funds and no-load mutual funds authorized by the Texas Public Funds Investment Act.

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. In accordance with the Pool's investment policy and State law, preservation and safety of principal is the primary objective of the Pool's investment program and is addressed by purchasing the highest quality and creditworthy investments (list of authorized investments above). In 2010 and 2009, 84% and 88% of the Pool's cash equivalents were invested in a government money market fund at the Northern Trust Company. The remainder of the cash equivalents was invested in a money market fund account at Frost Bank.

Neither the Pool's investment policy nor State law places a limit on the amount the Pool may invest in a single authorized issuer. The following presents the ratings for each investment type at September 30, 2010:

ANNUAL (Audited)

	<u>Market Value</u>	<u>S&P Rating</u>
U.S. Treasury	\$ 10,837,953	Exempt
Government Agencies:		
FNMA Notes	26,001,101	AAA
FHLB Notes	18,557,362	AAA
FHLMC Notes	24,054,463	AAA
Other Agency Notes	2,147,552	AAA
FDIC – Guaranteed Bonds	19,253,470	AAA
Municipal Bonds:		
Muni Bonds-A	7,493,071	A
Muni Bonds-AA	27,145,220	AA
Muni Bonds-AAA	18,500,102	AAA
Mortgage-Backed Securities:		
*GNMA Mortgage-Backed Securities	200,400,130	Exempt
*FNMA Mortgage-Backed Securities	155,345,679	AAA
*FHLMC Mortgage-Backed Securities	92,300,448	AAA
Total Investments	<u>\$ 602,036,551</u>	

*Accounts for 5% or more of total investments.

The Pool's gross unrealized gains and losses on investments were as follows:

<u>September 30, 2010</u>	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Estimated Market Value</u>
U.S. Treasury obligations	\$ 9,610,796	\$ 1,227,156	\$ 0	\$ 10,837,952
Municipal Bonds	49,319,707	3,818,724	(38)	53,138,393
FDIC – Guaranteed Bonds	18,692,024	561,447	0	19,253,471
U.S. Agency obligations	496,025,176	22,902,655	(121,096)	518,806,735
Total Investments	<u>\$ 573,647,703</u>	<u>\$ 28,509,982</u>	<u>\$ (121,134)</u>	<u>\$ 602,036,551</u>
<u>September 30, 2009</u>	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Estimated Market Value</u>
U.S. Treasury obligations	\$ 7,355,972	\$ 587,091	\$ 0	\$ 7,943,063
Municipal Bonds	33,386,959	2,955,932	0	36,342,891
FDIC – Guaranteed Bonds	18,695,665	464,801	0	19,160,466
U.S. Agency obligations	494,516,265	18,510,577	(628,268)	512,398,574
Total Investments	<u>\$ 553,954,861</u>	<u>\$ 22,518,401</u>	<u>\$ (628,268)</u>	<u>\$ 575,844,994</u>

At September 30, 2010 and 2009, there were no declines in the market value of investments held by the Pool that were considered other than temporary.

The amortized cost and estimated market value of long-term fixed income investments at September 30, 2010, by expected maturities, are shown below. Actual maturities will vary from expected maturities as borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

September 30, 2010	Amortized Cost	Estimated Market Value
Due in one year or less	\$ 18,749,296	\$ 18,782,417
Due after one year through five years	83,083,412	85,839,388
Due after five years through ten years	22,275,900	24,848,121
Due after ten years	30,674,833	33,827,859
Mortgage-backed securities due after one year	418,864,262	438,738,766
Total Investments	\$ 573,647,703	\$ 602,036,551

Net realized gains from sales of long-term fixed income investments were \$2,993,534 and \$5,996,377 for 2010 and 2009, respectively, and are included in investment income (change in market value).

Investment income is included in the Statement of Operations and Changes in Members' Equity and consisted of the following for the years ended September 30:

	2010	2009
Investment Income (interest income)	\$ 27,458,398	\$ 29,187,679
Unrealized gains (losses)	\$ 6,498,715	\$ 20,578,081
Amortization of discounts (premiums)	(2,170,421)	(1,279,202)
Realized gains (losses)	2,993,534	5,996,377
Investment Income (change in market value)	\$ 7,321,828	\$ 25,295,256

Interest rate risk is the risk that changes in interest rates will adversely affect the market value of an investment. The Pool's investment policy addresses interest rate risk by establishing a custom benchmark based on the intent and ability to buy investments and hold them until they mature. Hence, fluctuations in market values have little financial impact on the Pool and are considered temporary since all the Pool's investments are of the highest credit rating. To guide the buying and holding of investments, the Pool utilizes a custom benchmark that takes into account expected payments of liabilities and the Pool's objectives for utilizing Members' Equity. The Pool's custom benchmark is the following:

- 25% weighting of the Barclays Capital Intermediate Government Index
- 75% weighting of the Barclays Capital GNMA 30 Year Index

The benchmark was changed from a 50-50 blend effective November 1, 2008. In addition, the Pool essentially prohibits the sale of an investment that results in a realized loss.

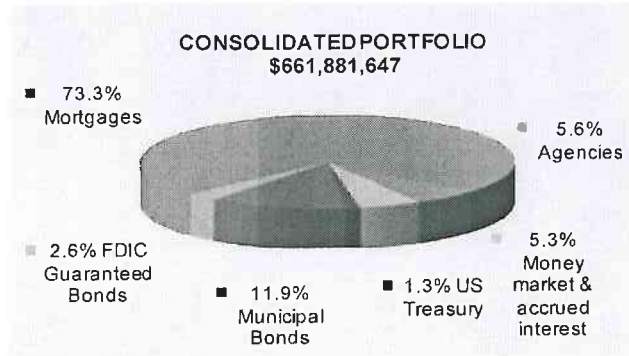
The effective duration is used to assess interest rate risk by estimating the sensitivity of fixed income securities to interest rate changes. The effective duration estimates the percentage change in the market value of an investment (or an investment portfolio) for a one percent change in interest rates. It makes assumptions regarding the most likely timing and amounts of variable cash flows for investments that are highly sensitive to interest rate changes, such as mortgage-backed securities, callable bonds, and variable-rate debt. The following were the effective durations of investments held by the Pool:

Duration	Market Value	Effective Duration
Treasuries	\$ 10,837,953	6.96
Agencies	70,760,478	2.18
FDIC – Guaranteed Bonds	19,253,470	1.51
Municipal Bonds	53,138,393	7.25
Mortgage-Backed Securities	448,046,257	2.19
Total Investments	\$ 602,036,551	2.70

The effective duration of the custom benchmark at September 30, 2010 was 3.48.

September 15, 2011

The Pool's investment income for the eleven months ending August 31, 2011 was \$27.6 million (compared to \$26.1 million last year). The Pool's realized gains were \$4.3 million through eleven months compared to \$2.7 million for the same period last year. The Pool's return on investment was 4.8% for the last twelve months and the total rate of return was 5.3%.



INVESTMENT PERFORMANCE

The performance of an investment manager is measured by (1) return on investment and (2) total rate of return.

- **Return on Investment** is a measurement of investment income which includes interest income (including amortization of premiums and discounts) and realized gains. It is calculated in the same manner as total rate of return except that it does not include the fluctuation in unrealized gains and losses. The Pool makes financial decisions based on this measurement.



Returns	Aug. 11	3-Mo	6-Mo	9-Mo	1-Year	2-Year	3-Year	4-Year	5-Year
*Consolidated	0.7%	1.5%	2.7%	3.7%	4.8%	4.8%	5.1%	5.2%	5.1%
Mesirow	0.3%	1.2%	2.4%	3.5%	4.7%	4.7%	5.0%	N/A	N/A
Conning	0.4%	1.2%	2.3%	3.4%	4.5%	4.7%	5.1%	N/A	N/A
Manulife	0.4%	1.3%	2.4%	3.5%	4.6%	4.7%	4.9%	5.1%	5.1%
TML-IRP	1.5%	2.1%	3.5%	4.5%	5.4%	4.9%	5.3%	5.4%	5.2%

- **Total Rate of Return** is a measurement used by the investment industry to measure portfolio management performance and includes fluctuations in unrealized gains and losses. Under GASB 31, the fluctuation in unrealized gains and losses is recognized as a component of investment income.

Returns	Aug. 11	3-Mo	6-Mo	9-Mo	1-Year	2-Year	3-Year	4-Year	5-Year
*Consolidated	1.5%	2.6%	5.3%	5.0%	5.3%	6.0%	6.9%	6.9%	6.6%
Index (Benchmark)	1.5%	2.9%	5.9%	5.3%	5.7%	6.7%	7.4%	7.4%	7.0%
Mesirow	1.1%	2.2%	4.7%	4.1%	4.2%	5.7%	6.9%	N/A	N/A
Conning	1.2%	2.2%	4.6%	4.3%	4.7%	5.7%	7.0%	N/A	N/A
Manulife	1.5%	2.6%	5.4%	5.3%	5.6%	6.4%	7.0%	7.0%	6.7%
TML-IRP	2.2%	3.5%	6.7%	6.3%	6.7%	6.0%	6.7%	6.7%	6.5%

The index or benchmark for the Pool is a 20-70-10 blend of the Barclays Capital Intermediate Government Index, the Barclays Capital GNMA 30 Year Index, and the Barclays Capital Intermediate Taxable Municipal Index. The benchmark was changed from a 50-50 blend effective November 1, 2010.

*Consolidated returns include the performance of all current and past investment managers.

**TEXAS MUNICIPAL LEAGUE INTERGOVERNMENTAL RISK POOL
BALANCE SHEETS**

ASSETS	Workers' Compensation		Liability		Property		Coastal Storm	
	2010	2009	2010	2009	2010	2009	2010	2009
Current Assets								
Cash and cash equivalents	\$ 8,923,588	\$ 8,307,874	\$ 7,200,165	\$ 6,491,066	\$ 2,109,422	\$ 1,779,403	\$ 199,967	\$ 155,021
Short-term investments	6,630,951	2,828,369	5,350,308	2,209,846	1,567,472	605,788	148,591	52,776
Long-term fixed income investments	205,912,233	207,792,607	166,144,169	162,351,435	48,675,008	44,505,573	4,614,238	3,877,303
Accrued investment income	1,077,410	1,119,973	869,329	875,051	254,685	239,878	24,143	20,898
Total cash and investments (cost basis \$601,975,907 for 2010 and \$579,730,921 for 2009) (notes 3 and 4)	222,544,182	220,048,823	179,563,971	171,927,398	52,606,587	47,130,642	4,986,939	4,105,998
Contributions and other receivables	1,687,591	1,984,137	1,132,179	1,204,461	1,293,308	923,844	703	221
Reinsurance recoverable on paid losses (note 9)	130,003	124,864	10,272	—	1,409,000	965,022	—	—
Prepaid reinsurance	4,330	—	—	—	4,317,804	4,878,082	—	—
Total Current Assets	224,366,106	222,157,824	180,706,422	173,131,859	59,626,699	53,897,590	4,987,642	4,106,219
Noncurrent Assets								
Capital assets (land, building, furniture and equipment) (note 6)	1,808,943	1,855,382	1,008,264	1,082,306	148,274	154,615	—	—
Other assets (note 7)	372,351	348,194	381,792	408,034	316,196	319,299	—	—
Total noncurrent assets	2,181,294	2,203,576	1,390,056	1,490,340	464,470	473,914	—	—
Total Assets	\$ 226,547,400	\$ 224,361,400	\$ 182,096,478	\$ 174,622,199	\$ 60,091,169	\$ 54,371,504	\$ 4,987,642	\$ 4,106,219
LIABILITIES AND MEMBERS' EQUITY								
Current Liabilities								
Claim Reserves:								
Reserve for reported claims - net	\$ 48,443,548	\$ 51,694,085	\$ 48,303,375	\$ 45,686,733	\$ 12,752,880	\$ 10,464,690	\$ 115,821	\$ 65,821
Reserve for incurred but not reported claims - net (note 2)	70,600,000	70,600,000	22,700,000	22,700,000	25,000	25,000	—	—
Reserve for unallocated loss adjustment expense	—	—	—	—	—	—	—	—
Estimated future investment income at 5%	—	—	—	—	—	—	—	—
Estimated ultimate unpaid losses & loss adjustment expenses	119,043,548	122,294,085	71,003,375	68,386,733	12,777,880	10,489,690	115,821	65,821
Payable to administrative service only contracts (note 5)	1,187,750	1,286,500	—	—	—	—	—	—
Contract service fees payable	—	135,658	—	79,134	—	11,305	—	—
Outstanding loss drafts	1,017,511	1,166,191	1,206,994	1,440,501	1,108,789	1,444,475	—	—
Unearned contribution reserve (note 2)	578,529	421,345	851,577	812,116	1,184,882	1,113,564	796	—
Reinsurance payable	24,168	19,759	22,148	5,664	669,637	1,156,501	—	—
Members' Equity return payable	7,349,975	8,299,341	4,080,245	3,722,831	4,648,024	4,081,172	—	—
Other liabilities (note 2)	1,685,742	1,537,924	756,839	694,935	117,223	99,110	—	—
Total current liabilities	130,887,223	135,160,803	77,921,178	75,141,914	20,506,435	18,395,817	116,617	65,821
Noncurrent Liabilities								
Funds invested for TML (note 10)	3,370,977	3,169,040	1,878,905	1,848,606	276,309	264,087	—	—
Total noncurrent liabilities	3,370,977	3,169,040	1,878,905	1,848,606	276,309	264,087	—	—
Total Liabilities	134,258,200	138,329,843	79,800,083	76,990,520	20,782,744	18,659,904	116,617	65,821
MEMBERS' EQUITY								
Invested in capital assets (net)	1,808,943	1,855,382	1,008,264	1,082,306	148,274	154,615	—	—
Restricted Members' Equity - Texas Municipal Retirement System (Note 11)	—	—	—	—	—	—	—	—
Unrestricted Members' Equity	90,480,257	84,176,175	101,288,131	96,549,373	39,160,151	35,556,985	4,871,025	4,040,398
Total Members' Equity (includes net unrealized investment gains of \$28,388,848 for 2010 and \$21,890,133 for 2009) (note 2)	92,289,200	86,031,557	102,296,395	97,631,679	39,308,425	35,711,600	4,871,025	4,040,398
Total Liabilities and Members' Equity	\$ 226,547,400	\$ 224,361,400	\$ 182,096,478	\$ 174,622,199	\$ 60,091,169	\$ 54,371,504	\$ 4,987,642	\$ 4,106,219

Texas Municipal League Intergovernmental Risk Pool

								Totals	
								September 30,	September 30,
Reinsurance		Large Loss		Stability		Lifetime Benefits		2010	2009
2010	2009	2010	2009	2010	2009	2010	2009	Current Year	Prior Year
\$ 2,861,346	\$ 2,406,664	\$ 1,423,795	\$ 1,288,305	\$ 1,551,067	\$ 1,384,402	\$ 1,007,048	\$ 901,281	\$ 25,276,398	\$ 22,714,016
2,126,213	819,335	1,057,995	438,596	1,152,569	471,311	748,319	306,836	18,782,418	7,732,857
66,025,699	60,194,333	32,854,140	32,222,472	35,790,954	34,626,011	23,237,693	22,542,403	583,254,134	568,112,137
345,471	324,439	171,906	173,675	187,272	186,630	121,589	121,500	3,051,805	3,062,044
71,358,729	63,744,771	35,507,836	34,123,048	38,681,862	36,668,354	25,114,649	23,872,020	630,364,755	601,621,054
-	-	-	-	-	-	-	-	4,113,781	4,112,663
-	-	-	-	-	-	-	-	1,549,275	1,089,886
-	-	-	-	-	-	-	-	4,322,134	4,878,082
71,358,729	63,744,771	35,507,836	34,123,048	38,681,862	36,668,354	25,114,649	23,872,020	640,349,945	611,701,685
-	-	-	-	-	-	-	-	2,965,481	3,092,303
-	-	-	-	-	-	-	-	1,070,339	1,075,527
-	-	-	-	-	-	-	-	4,035,820	4,167,830
\$ 71,358,729	\$ 63,744,771	\$ 35,507,836	\$ 34,123,048	\$ 38,681,862	\$ 36,668,354	\$ 25,114,649	\$ 23,872,020	\$ 644,385,765	\$ 615,869,515
\$ 1,249,059	\$ 1,883,969	\$ 896,172	\$ 2,846,506	-	-	\$ 40,371,762	\$ 39,286,531	\$ 152,132,617	\$ 151,928,335
800,000	800,000	-	-	-	-	-	-	94,125,000	94,125,000
-	-	-	-	5,000,000	5,000,000	-	-	5,000,000	5,000,000
-	-	-	-	-	-	(18,799,986)	(18,685,631)	(18,799,986)	(18,685,631)
2,049,059	2,683,969	896,172	2,846,506	5,000,000	5,000,000	21,571,776	20,600,900	232,457,631	232,367,704
-	-	-	-	-	-	-	-	1,187,750	1,286,500
-	-	-	-	-	-	-	-	-	226,097
-	-	-	-	-	-	-	-	3,333,294	4,051,167
-	-	-	-	-	-	-	-	2,615,784	2,347,025
-	-	-	-	-	-	-	-	715,953	1,181,924
-	-	-	-	-	-	-	-	16,078,244	16,103,344
-	-	-	-	-	-	-	-	2,559,804	2,331,969
2,049,059	2,683,969	896,172	2,846,506	5,000,000	5,000,000	21,571,776	20,600,900	258,948,460	259,895,730
-	-	-	-	-	-	-	-	5,526,191	5,281,733
-	-	-	-	-	-	-	-	5,526,191	5,281,733
2,049,059	2,683,969	896,172	2,846,506	5,000,000	5,000,000	21,571,776	20,600,900	264,474,651	265,177,463
-	-	-	-	-	-	-	-	2,965,481	3,092,303
-	-	-	-	13,117,097	12,229,384	-	-	13,117,097	12,229,384
69,309,670	61,060,802	34,611,664	31,276,542	20,564,765	19,438,970	3,542,873	3,271,120	363,828,536	335,370,365
69,309,670	61,060,802	34,611,664	31,276,542	33,681,862	31,668,354	3,542,873	3,271,120	379,911,114	350,692,052
\$ 71,358,729	\$ 63,744,771	\$ 35,507,836	\$ 34,123,048	\$ 38,681,862	\$ 36,668,354	\$ 25,114,649	\$ 23,872,020	\$ 644,385,765	\$ 615,869,515

Internal Revenue Service

Department of the Treasury

Index No. 0115.00-00

Washington, DC 20224

Texas Municipal League Workers'
Compensation Joint Insurance Fund
Attn: Mr. William I. Martin, Jr.,
Secretary
1020 Southwest Tower
Austin, Texas 78701

Person to Contact:
George Grindle
Telephone Number:
(202) 566-3851
Refer Reply to:

T:C:C:2: FEB 22 1980
Date:

Dear Mr. Martin:

This is in reply to a request for a federal income tax ruling submitted on your behalf by your authorized representative. We have been asked to rule whether your income is excludible from gross income under section 115(1) of the Internal Revenue Code of 1954.

You were organized because in 1973 the Texas workmens' compensation law was amended and for the first time provided that certain common law defenses were not available to political subdivisions that did not provide a system of coverage for their employees. The 1973 amendments also provided for the establishment of a joint insurance fund, to serve as a mechanism to administer a system of coverage. However, the law also provides that a joint insurance fund shall not be considered insurance for the purpose of any other state statute and shall not be subject to the regulations of the State Board of Insurance.

You are an unincorporated association, comprised solely of Texas municipalities and other political subdivisions, jointly providing workers' compensation benefits to their employees. You are governed by a board of trustees, elected by your members. Your continued existence is not affected by the withdrawal of any member. It is contended that you are an association taxable as a corporation for federal income tax purposes.

A municipality becomes a member by executing an Interlocal Agreement. Membership is in a fund pool of self-insured employer members. You represent that you are a self-insurance association and do not intend to operate as an insurance company.

Members are charged annual premiums based on a standard rate for the coverage offered, less a discount of twenty-five percent which assumes a savings of commerial acquisition costs, premium taxes and profits. Premiums are payable in twelve equal monthly installments. The liability of each municipality is limited to its premiums.

Texas Municipal League Workers' Compensation Joint Insurance Fund

Managerial, clerical and investment service are provided for you by a contract with a service organization. Billing and premium collection are also covered under that contract. A contract has been entered into with a second organization to provide claims management, injury investigation and certain related services.

In four of your five years of operation you have returned some excess premiums to your members. This is independent of the amounts to be returned from the reserve described below.

You have maintained a Reserve for Return of Contributions (premiums) since you began operation. This reserve totaled \$4,686,383 as of the end of your fifth year of operation. The reserve is held by you to provide a means of providing for adverse claims development in excess of ordinary reserves for claims. An amount for each member each year is calculated. The reserve is not an actuarial reserve, but is a percent of the standard premium charged each member. The amount of the reserve that is intended to be appropriated for the reserve is available to pay claims arising in the year of receipt immediately upon receipt. Once an amount is placed in the reserve, it may be used at any time thereafter to pay claims related to the year the amount was reserved for. A given year's reserve will be returned to your members gradually over a twelve year period, if it is not used to pay adverse claims. Each year each member will receive a certificate for that year showing how much will be returned from the reserve (subject to adverse claims developments for the year) over the following twelve year period.

Section 115(1) of the Code provides that gross income does not include income accruing to a State or political subdivision thereof derived from the exercise of any essential governmental function or from a public utility.

Rev. Rul. 77-261, 1977-2 C.B. 45 illustrates a comprehensive application of section 115(1) of the Code. It brings out four main points that have relevance here.

Section 115(1) of the Code was intended to refer, not to the income of a state or municipality resulting from its own direct participation in industry, but rather to that part of the income of a corporation engaged in the operation of a public utility or the performance of some governmental function that accrued to a state or municipality. Since you have asserted that you are an association taxable as a corporation, this requirement will be assumed for purposes of this letter to be met.

Texas Municipal League Workers' Compensation Joint Insurance Fund

Rev. Rul. 77-261 also points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out those projects desirable from the standpoint of the state government which on a broad consideration of the question, may be the function of the sovereign to conduct. We can conclude that compensating injured employees of a governmental unit is an essential governmental function for purposes of section 115(1) of the Code.

Rev. Rul. 77-261 also points out that section 115(1) of the Code does not provide that the income in question must accrue only to a single political subdivision of a state. The accrual to a number of political subdivisions of a state is therefore not inconsistent with the statute.

The meaning of "accruing to" as used in section 115(1) of the Code was addressed in Rev. Rul. 77-261. It was found that income of a corporation accrued to a state and its political subdivisions when they had an unrestricted right to receive in their own right their proportionate share of the corporation's income as it was earned.

In Omaha Public Power District v. O'Malley, 232 F. 2d 804 (8th Cir. 1956) the Circuit Court of Appeals observed that income accrues to a municipality or political subdivision if it possesses a vested right or an enforceable claim to receive the income.

In City of Bethel, Alaska, and Community Liquor Sales, Inc. v. U.S., 594 F. 2d 1301 (9th Cir. 1979) the United States Court of Appeals recognized that income could accrue to the city if there was a present obligation by the payor to the city.

In addition, Troy State University v. Commissioner, 62 T.C. 493 (1974), discusses whether inurement is equivalent of "accrual" and concludes that:

The requirement that income accrue to a State is not satisfied when income or a benefit merely "inures" to a State or when unused earnings may, at some future time, accrue to a State. (Emphasis added.)

Based on the foregoing cases income may accrue to a political subdivision if there is a present obligation to pay the income to the political subdivision, it possesses an enforceable claim to the income, or if it receives some economic benefit from the income.

Texas Municipal League Workers' Compensation Joint Insurance Fund

It is represented that the self insurance provisions of the Interlocal Agreement obligate you to return to the participating municipalities the excess of contributions and other income over costs, expenses and losses. Such excess is defined in terms of net income determined for federal income tax purposes.

In the present situation you are obligated at all times to either provide insurance coverage or return the income to the municipalities. To the extent that income is not returned annually you must provide coverage for extraordinary losses with that portion of your income allocated to the Reserve for Return of Contributions. At all times the municipalities possess an enforceable claim to that coverage. Finally, no income or benefit may accrue to any party other than your members.

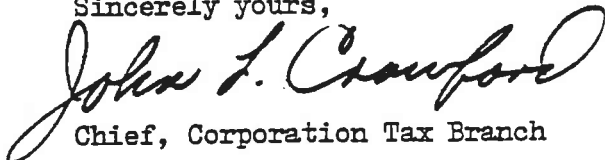
Accordingly, your income is excludible from gross income under section 115 of the Code.

Our holding is subject to the following conditions:

- (1) You are an association taxable as a corporation.
- (2) All your members are "political subdivisions" of a state within the meaning of section 115(1) of the Code.

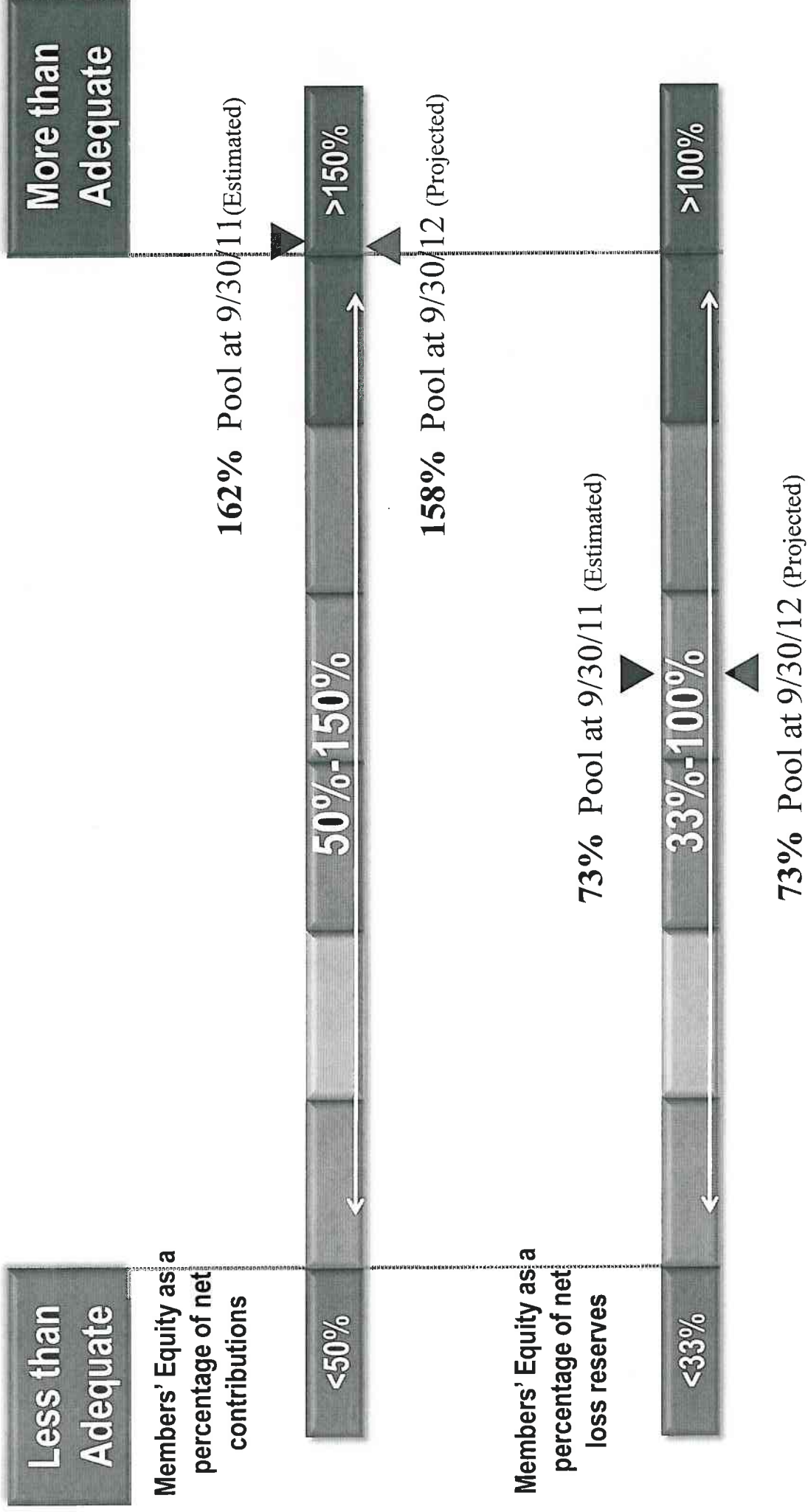
In accordance with the power of attorney on file, a copy of this letter is being sent to your authorized representative.

Sincerely yours,


Chief, Corporation Tax Branch

Workers' Compensation Fund Estimated & Projected Equity Adequacy

(Before Equity Return)



WORKERS' COMPENSATION, LIABILITY, AND PROPERTY EQUITY RETURNS

The Pool's Board of Trustees has adopted Equity Return Policies for the Workers' Compensation, Liability, and Property Funds. The policies state that when the following conditions are met at the end of a given year, the Pool will return at least 50% and up to 75% of equity gained that year, depending on the overall adequacy of each fund's equity level.

1. Members' Equity as a percent of net contributions is at least 75 percent,
2. Members' Equity as a percent of net loss reserves is at least 50 percent,
3. Members' Equity increased during the prior fund year, and
4. The increase in Members' Equity is at least \$1 million.

At the end of 2006-07, all three Funds satisfied the criteria for an equity return. One-half of the equity gained in the Workers' Compensation and Property Funds and 75% of the equity gained in the Liability Fund will be returned to the Pool's members. Returns of \$6.7 million from the Workers' Compensation Fund, \$9.2 million from the Liability Fund, and \$570,000 from the Property Fund will be distributed to qualifying Members.

The Pool's Board of Trustees approved the following criteria for returning equity from the Workers' Compensation, Liability, and Property Funds. Distribution will be made to Members that;

1. Have participated in the individual Fund for at least one complete year on September 30, 2007.
2. Have a loss ratio for that Fund that is less than 100% since joining the Fund or for the last 10 years,
and
3. Continue to be a Member of that Fund on April 1, 2008.

Loss ratios will be calculated by dividing losses incurred by contributions paid. The equity return calculation also recognizes the length of time a Member has participated in the Fund.

Workers' Compensation

The Workers' Compensation Fund has met all the criteria for a return of equity. Approximately 1,951 Workers' Compensation Fund Members will receive some portion of the \$6.7 million equity return and 1,106 Members will receive the largest percentage credit, 13%, plus a credit for longevity.

Liability

For the second year in a row, the Liability Fund has satisfied all criteria necessary to trigger a return. Approximately 2,212 Liability Fund Members will receive some portion of the \$9.2 million equity return and 1,524 Members will receive a distribution of at least 24% plus a credit for longevity.

Property

For the third year in a row, the Property Fund has satisfied all criteria necessary to trigger a return. Approximately 1,713 Members will receive a return from the Property Fund with 1,412 Members receiving a distribution of 1.5% before considering longevity.

History of Equity Returns

<i>Year</i>	<i>Workers' Comp.</i>	<i>Liability</i>	<i>Property</i>	<i>Total</i>
93-94	\$ 0	\$ 1,100,000	\$ 0	\$ 1,100,000
94-95	2,000,000	0	0	2,000,000
95-96	2,700,000	0	0	2,700,000
96-97	4,900,000	0	0	4,900,000
97-98	1,400,000	2,800,000	0	4,200,000
98-99	1,400,000	3,500,000	0	4,900,000
99-00	1,500,000	3,100,000	0	4,600,000
00-01 thru 02-03	0	0	0	0
03-04	0	4,500,000	0	4,500,000
04-05	0	4,900,000	4,300,000	9,200,000
05-06	0	11,700,000	3,200,000	14,900,000
06-07	6,800,000	9,100,000	600,000	16,500,000
07-08	8,100,000	7,800,000	0	15,900,000
08-09	8,300,000	3,700,000	4,100,000	16,100,000
09-10	7,350,000	4,050,000	4,600,000	16,000,000
10-11	2,500,000	5,500,000	TBD	8,000,000
Total	46,950,000	61,750,000	16,800,000	125,500,000