

MINUTES OF THE
TEXAS MUNICIPAL RETIREMENT SYSTEM
Investment Committee of the Board of Trustees

March 14, 2008

On March 14, 2008, the Investment Committee (Committee) of the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a meeting at 1:00 p.m. at TMRS Headquarters, located at 1200 North IH 35, Austin, Texas, with the following members present:

Investment Committee

H. Frank Simpson, Chair
Pat Hernandez
Rick Menchaca

Present also were:

Eric Henry, Executive Director & CIO
Rhonda Covarrubias, Director of Finance
Debbie Farahmandi, Investment Operations Specialist
David Gavia, General Counsel
Nancy Goerdel, Investment Officer
Leslee Hardy, Staff Actuary
Michelle Mellon-Werch, Associate General Counsel
Kristin Qualls, Assistant Investment Officer
Kate Reed, Investment Analyst
Eddie Solis, Government Relations Director
Bill Wallace, Director of Communications
Patricia Brown, Executive Assistant
Russ Kuhns, R.V. Kuhns & Associates, Inc.
Pete Madsen, R.V. Kuhns & Associates, Inc.

Absent:

Terrence Kendall, Legal Counsel

Guests:

Dean Frigo, City of Amarillo
Jim Parrish, City of Amarillo
Blake Rocap, House Committee on Pensions & Investments
Monty Wynn, TML

The meeting was called to order at 1:00 p.m. and Mr. Simpson gave the invocation.

Discussion of Duration of Bond Portfolio

Mr. Henry gave a brief description of this item, explaining the status of TMRS' bond portfolio and the desire to reduce its duration because of a large exposure to interest rate risk. Mr. Kuhns stated that the bonds TMRS holds are very complex instruments, and if interest rates go up, the market value of TMRS' portfolio goes down.

Mr. Simpson asked for an explanation of the statutorily guaranteed 5% interest, and Mr. Henry provided this information. He also explained the goal of diversifying the portfolio away from bonds and managing it to a total return objective. The idea is to begin the diversification in 2008 so that staff can demonstrate to the 2009 Legislature that diversification works for TMRS.

Mr. Kuhns described the term 'duration' to the group, explaining that it represents a measure of risk that a bond has. He stated that TMRS will ask Hillswick Asset Management LLC to help TMRS find a solution to shorten the bond duration and maintain income by changing the structure of the portfolio. Four other fixed income firms were asked to provide TMRS and R.V. Kuhns similar information. Of the four, two were asked to make formal presentations to the Committee. Those two firms were BlackRock and NISA.

Mr. Simpson asked how and when the issue of duration became a concern. Mr. Henry stated that this issue was raised in August. It is the consensus of staff and R.V. Kuhns that TMRS should consider a customized duration management solution to protect the portfolio from adverse movements in interest rates.

At this time, Bill Marshall and Robert Krebs of NISA Investment Advisors, LLC, began their presentation. Mr. Marshall gave a general overview of the firm, and then discussed interest rates, duration, and derivatives, including information about different types of derivatives.

BlackRock was the second firm to make a presentation to the Committee, and was represented by David Sayles and Doug Waggoner. After brief introductions and an overview of their firm, Mr. Sayles began the presentation by describing derivatives as very useful tools, and by discussing interest rates and why they fluctuate the way they do. He then discussed the difficulty in shortening the duration of the bond portfolio at this time, but stated that once that is done, the portfolio's value will improve. Mr. Sayles and Mr. Waggoner then summarized the material provided to the meeting attendees that addressed different measures of duration and different kinds of derivatives. Upon being asked the question by Mr. Simpson as to how BlackRock would conduct its business with TMRS, Mr. Waggoner assured him that all business would be interactive. The Committee thanked the two gentlemen for their presentation.

After the two presentations had been made, Mr. Simpson asked what the next steps in this process would be. Mr. Henry explained that next, R.V. Kuhns will compare the two firms for compatibility with TMRS and report on why one might be better suited to the System than the other. The Committee will then make its decision at the next meeting, then take its recommendation to the full Board at its March meeting. After that, the portfolio will begin to be restructured.

Update on Equity Strategy

Mr. Henry turned this item over to Ms. Goerdel, and she provided an update on equity allocation. She presented a report provided by Northern Trust, the passive equity manager for TMRS, which summarized activity to date on equity allocation. Equity markets continue to offer attractive tradeoffs, particularly as risk premiums have increased. Stocks remain the asset of choice in portfolio construction. After brief discussion, it was determined that Northern Trust is performing the duties it was hired to perform by TMRS.

There being no further business to come before the Committee, the meeting was adjourned at 3:30 p.m.

**MINUTES OF THE
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March 27, 2008

On March 27, 2008, the Investment Committee (Committee) of the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a meeting at 2:03 p.m. at TMRS Headquarters, located at 1200 North IH 35, Austin, Texas, with the following members present:

Investment Committee

H. Frank Simpson, Chair
Pat Hernandez
Rick Menchaca

The following member of the Board of Trustees was present but did not participate in discussions or deliberations:

April Nixon

Present also were:

Eric Henry, Executive Director & CIO
Bernie Eldridge, Director of Human Resources
David Gavia, General Counsel
Nancy Goerdel, Investment Officer
Michelle Mellon-Werch, Associate General Counsel
Debbie Muñoz, Director of Member Services
Kristin Qualls, Assistant Investment Officer
Kate Reed, Investment Analyst
Eddie Solis, Government Relations Director
Bill Wallace, Director of Communications
Scott Willrich, Director of Information Resources
Patricia Brown, Executive Assistant
Terrence Kendall, Legal Counsel
Bob Klausner, Klausner & Kaufman, PA
Anders Ekernas, Hillswick Asset Management LLC
Jonathan Kowolik, R.V. Kuhns & Associates, Inc.
Russ Kuhns, R.V. Kuhns & Associates, Inc.
Pete Madsen, R.V. Kuhns & Associates, Inc.

Guests:

Natalie Foerster, Governor's Office
Dean Frigo, City of Amarillo
Mike Higgins, TSAFF
Obie Knapp, State Street
Jim Moore, Mesquite
Jim Parrish, City of Amarillo
Monty Wynn, TML

The meeting was called to order at 2:03 p.m. and Mr. Menchaca gave the invocation.

Consider and Act on Adoption of Minutes of December 7, 2007 Board of Trustees Investment Committee Meeting

Mr. Simpson announced that he had no corrections to the minutes of the December 7, 2007 meeting, and asked for comment. There were no questions or comments.

Mr. Menchaca moved to adopt the minutes of the December 7, 2007 Board of Trustees Investment Committee meeting; Mr. Simpson seconded the motion, which carried unanimously.

2007 Investment Performance Review

Mr. Henry announced this item and then turned it over to Mr. Madsen of R.V. Kuhns, who (with assistance from Ms. Goerdel) summarized TMRS' 2007 investment performance. The average quality of the portfolio is high, with over 54% in U.S. Treasury and U.S. government guaranteed securities. Another 12% is in U.S. government agency securities that are not guaranteed but are still considered highly rated securities. In total, 66.7% of TMRS securities are rated AAA or better.

At the end of 2007, the total portfolio income return was 5.49% and was comprised of ordinary income, realized gains, and income from securities lending. Zero coupon securities comprise 37% of the portfolio.

TMRS' net trading strategy was suspended in March 2007. Its income return of 5.5% reflects both ordinary interest income and realized gains of \$2.8 million generated by its active trading strategy.

The securities lending program at TMRS generated income of \$21.4 million, an increase of almost four times over the prior year. This income represents additive performance of .147%.

Mr. Madsen discussed target allocation and explained the performance of the fund's investments after starting the plan to diversify into equities.

Economic Outlook and Discussion of Bond Portfolio

Mr. Ekernas of Hillswick Asset Management next presented to the Committee his company's report on the economy as it relates to TMRS' investments. Mr. Ekernas reported that the salient point to make at this time is that the economy is now in the early stages of a deleveraging cycle. Credit is growing at a more rapid rate than income. Debt to income is rising at a dramatic rate over a short period of time. A defining characteristic of this will be if the propensity to spend remains stable. Easy credit fueled inflation and rising prices provided additional collateral for borrowing. The process is now reversing. The Fed funds rate may go to 1% by this summer, but it is doubtful whether it will provide much stimulus to consumers.

Mr. Ekernas next discussed the TMRS bond portfolio, noting that volatility in rates has increased substantially. He presented three scenarios to the Board, showing the portfolio's total return over an 18-month holding period. The Committee discussed those three possible scenarios.

Consider and Act on Proposal to Shorten Duration of Bond Portfolio

Mr. Henry initiated the presentation on this item by stating that TMRS is looking into reducing the duration of its bond portfolio to a more prudent level, and that, going into this Investment Committee Meeting, staff was prepared to recommend choosing one of two firms that are highly

experienced in derivatives to work with staff to develop a strategy to further reduce the duration of the portfolio. However, the issue of whether TMRS has the authority to use certain derivative instruments has been and is continuing to be researched by legal staff. That research indicates that TMRS lacks the authority to enter into swaps (one type of derivative) but can use treasury futures, another type of derivative; unfortunately, the latter option is not as effective as swaps. TMRS' best option, therefore is to go to the cash market to reduce duration.

Mr. Henry suggested that, in addition to continuing due diligence and research on the derivatives issue, staff come back to the Committee, and then to the Board, at their April meetings with a plan to find a firm to assist TMRS in making the most prudent decisions regarding a solution to the duration issue. The firm should be a large, fixed-income firm that is not affiliated with a large investment bank. It will serve as a fiduciary and will have professional oversight and expertise in technology and work as a consultant to provide customized solutions.

Mr. Menchaca moved to accept staff's recommendation to continue to research the issue of whether TMRS has the authority to enter into the derivative market, specifically swaps, and research fixed income firms for the purpose of serving as a fiduciary for the fixed income portfolio, develop and execute an effective strategy designed to reduce the duration of the portfolio, and assist in the transition process as TMRS begins diversification of the portfolio pending passage of legislation in 2009. Ms. Hernandez seconded the motion, which carried unanimously.

Custody and Securities Lending Review

Jonathan Kowolik of R.V. Kuhns next discussed with the Committee his firm's review of the TMRS securities lending program. Mr. Kowolik gave a brief explanation of the securities lending concept, and continued with a review of the history of securities lending. Securities lending is a risk-managed activity. TMRS' earnings have been extremely strong. Fixed income is a lendable asset class, but not as much as equity markets. The program is adding value to TMRS' overall portfolio. Mr. Kowolik then explained the securities lending process, and discussed the importance of monitoring the lending programs.

The conclusion of Mr. Kowolik's review was that the TMRS securities lending program is delivering value to the investment program through the prudent use of otherwise idle system assets, thereby potentially offsetting administration costs such as custody fees. Mr. Simpson, at this time, inquired as to diligent monitoring of the program. Ms. Goerdel assured him and the rest of the Committee that communication is open and frequent between Ms. Qualls, who spearheads this program at TMRS, and Mr. Knapp, who oversees the securities lending program at State Street.

Any Other Business

Mr. Menchaca asked Mr. Solis for a brief summary or overview of the interim joint Senate Finance and State Affairs Committees' charge to study the feasibility and advisability of establishing an investment policy that is consistent across all state trust funds. Mr. Solis stated that the state is trying to find a way to fund its infrastructure, and a brief discussion on this issue followed.

There being no further business to come before the Committee, the meeting was adjourned at 4:42 p.m.

**MINUTES OF THE
TEXAS MUNICIPAL RETIREMENT SYSTEM
Investment Committee of the Board of Trustees**

April 24, 2008

On April 24, 2008, the Investment Committee (Committee) of the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a meeting at 9:04 a.m. at TMRS Headquarters, located at 1200 North IH 35, Austin, Texas, with the following members present:

Investment Committee

H. Frank Simpson, Chair
Pat Hernandez
Roel 'Roy' Rodriguez, PE

The following members of the Board of Trustees were present but did not participate in discussions or deliberations:

Ben Gorzell, Jr.
Carolyn Linér

Present also were:

Eric Henry, Executive Director & CIO
Eric Davis, Deputy Executive Director
Rhonda Covarrubias, Director of Finance
Bernie Eldridge, Director of Human Resources
David Gavia, General Counsel
Nancy Goerdel, Investment Officer
Michelle Mellon-Werch, Associate General Counsel
Debbie Muñoz, Director of Member Services
Kate Reed, Investment Analyst
Eddie Solis, Government Relations Director
Bill Wallace, Director of Communications
Scott Willrich, Director of Information Resources
Patricia Brown, Executive Assistant
Terrence Kendall, Legal Counsel
Bob Klausner, Klausner & Kaufman, PA
Russ Kuhns, R.V. Kuhns & Associates, Inc.
Pete Madsen, R.V. Kuhns & Associates, Inc.

Guests:

Natalie Foerster, Governor's Office
Christopher Hanson, PRB
Robert S. Kapito, BlackRock
Martin McCaulay, PRB
Paul Nicholson, PRB
Bradley K. Perkins, BlackRock
Bob Scott, GFOAT
Douglas B. Waggoner, BlackRock

The meeting was called to order at 9:04 a.m. and Mr. Rodriguez gave the invocation.

Interview Finalist for Fixed Income Manager

Mr. Simpson asked Mr. Kuhns and Mr. Madsen to summarize the process that was exercised in R.V. Kuhns' research to find a good match for TMRS in a fixed income manager. Mr. Madsen explained that at its March 28, 2008 meeting, the Board of Trustees authorized TMRS staff and R.V. Kuhns to conduct a search for a fixed income management firm that would provide oversight for the fixed income portfolio, develop and execute an effective strategy designed to reduce the duration of the portfolio in view of the yield requirements necessary to pay interest credits, and assist in the transition process as TMRS begins diversification of the portfolio, pending passage of legislation in 2009. In this process, staff and R.V. Kuhns asked four fixed income firms, along with Hillswick Asset Management, LLC to provide information to TMRS and R.V. Kuhns. Of the four, two were asked to make formal presentations to the Committee. Those two firms were BlackRock and NISA; it was concluded that BlackRock was best suited to serve TMRS in this capacity and its representatives were invited to appear before the Investment Committee. After discussion of what shortening the duration entails, the experience of the firm in shortening duration, and the firm's fee in relation to the other firms, Mr. Madsen introduced the BlackRock representatives.

At this time, Mr. Kapito, Mr. Perkins, and Mr. Waggoner began their presentation by giving an overview of BlackRock's commitment to its clients, particularly to TMRS. The team reviewed its customization philosophy, stating that this union will result in a collaboration of TMRS and BlackRock to manage the bond duration issue. Mr. Simpson at this time asked if TMRS is protected; Mr. Waggoner assured the Board that BlackRock has an in-house risk management division and that there are two other parts of a compliance process that are used in transactions made by BlackRock on behalf of its clients. Mr. Gorzell asked BlackRock to explain the restructuring of the portfolio as the duration is shortened so that book yield is not lost. The Committee was advised that, if the market were to continue to improve, TMRS' portfolio will perform optimally as duration is shortened. The process (with the most favorable result) should take approximately eight weeks, with a ramp-up time (operation time in the office) of about four weeks.

Consider and Act on Fixed Income Manager Recommendation

Mr. Rodriguez asked how TMRS' concerns will be overseen, and what guarantees there are for TMRS. Mr. Kuhns answered that TMRS would be a significant client, and BlackRock would be a fiduciary, so there are legal responsibilities associated with its actions.

Mr. Rodriguez moved that the Investment Committee recommend to the Board of Trustees the selection of BlackRock to serve as a fiduciary over the entire fixed income portfolio and to provide fixed income advisory services to include: analysis, trade recommendations and trade execution based on consultation with TMRS staff and the portfolio's needs under the current framework of legislation and statutes, as well as critical services of monitoring risk, and making changes, including reducing the duration of the portfolio in the context of BlackRock's proposal, in anticipation of the total return framework and the plan for diversification. Ms. Hernandez seconded the motion, which carried unanimously.

Consider and Act on Proposed Investment Policy Revisions

Mr. Henry presented an overview of the proposed changes to the Investment Policy necessary to make the engagement of a fixed income manager effective.

Ms. Hernandez moved that the Investment Committee recommend to the Board of Trustees adoption of the proposed revisions to the Investment Policy. Mr. Simpson seconded the motion, which carried unanimously.

There being no further business to come before the Committee, the meeting was adjourned at 10:24 a.m.