

**MINUTES OF THE
TEXAS MUNICIPAL RETIREMENT SYSTEM
Regular Meeting of the Board of Trustees**

September 21, 2011 – 1:30 p.m.

September 22, 2011 – 9:00 a.m.

On September 22, 2011, the Board of Trustees of the Texas Municipal Retirement System (TMRS) reconvened for a regular meeting at 9:00 a.m. at TMRS Headquarters, located at 1200 North IH 35 in Austin, Texas, with the following members present:

Board of Trustees

April Nixon, Chair

Frank Simpson, Vice Chair

Ben Gorzell

Julie Oakley

Jim Parrish

Roel (“Roy”) Rodriguez (*departed at approx. 11:30 a.m.*)

Present also were:

David Gavia, Executive Director

Rhonda Covarrubias, Director of Finance

Eric Davis, Deputy Executive Director

Bernie Eldridge, Director of Human Resources

Nancy Goerdel, Chief Investment Officer

Leslee Hardy, Staff Actuary

Cindy Morse, Executive Assistant

Christine Sweeney, General Counsel

Holly Macki, Director of Real Estate

Michelle Mellon-Werch, Associate General Counsel

Debbie Munoz, Director of Member Services

Dev Outlaw, Director of Fixed Income

Dimitry Shishkoff, Director of Risk Management

Bill Wallace, Director of Communications

Dan Wattles, Director of Governmental Relations

Scott Willrich, Director of Information Resources

Mark Randall, Gabriel Roeder Smith & Company

Joe Newton, Gabriel Roeder Smith & Company

Marcia Beard, R. V. Kuhns & Associates

Jim Voytko, R. V. Kuhns & Associates

Lynn Schultz Kehoe, ORG Portfolio Management LLC

Robert Klausner, Klausner & Kaufman, P. A.

Nancy Williams, Hewitt EnnisKnupp, Inc.

Also in attendance: Michael Dane, City of San Angelo
 Colin Davidson, Regional Representative – City Services
 Debbie Farahmandi, Investment Operations Specialist
 Juan Garcia, Office of the Governor - Budget, Planning and Policy
 Scott Hofstrom, Arlington Professional Fire Fighters
 Glenn Johnson, City of Garland Fire Fighters
 Chris Jones, Combined Law Enforcement Associations of Texas
 George Kauffman, City of Garland
 Scott Kerr, Texas State Association of Fire Fighters
 Randall Meadows, Arlington Police Association
 Anthony Mills, Regional Manager – City Services
 Candace Nolte, Controller
 Kate Reed, Investment Risk Analyst
 Katie Reissman, Investment Analyst - Fixed Income
 David Rodriguez, Regional Manager – City Services
 Melanie Thomas, Editor
 Sean Thompson, Regional Representative – City Services
 Kristin Qualls, Assistant Investment Officer for Equities
 Greg Vick, City of Elgin

Ms. Nixon called the meeting to order at 9:02 a.m. At 9:03 a.m., the Board entered into Executive Session, pursuant to Texas Government Code §§551.071 and 551.074 to consult with Legal Counsel to receive legal advice, and to discuss personnel matters. No action was taken during the Executive Session and the meeting was opened to the public again at 9:31 a.m. All members of the Board who had been present when the Board went into Executive Session were again present.

3. Consider and Act on the Consent Agenda

Mr. Gavia presented the items in the Consent agenda, which included the Minutes from the July 22, 2011 Joint Meeting of the Board and the Advisory Committee on Retirement Matters and the August 18-19, 2011 Special Meeting of the Board, along with quarterly reports on service retirements, disability retirements, death benefits and financial statements. He asked if the Board has any questions or revisions to the Minutes. There were none.

Mr. Parrish moved that the Board adopt the Consent agenda as presented. Ms. Oakley seconded the motion, which passed unanimously.

4. TMRS Investment Risk Management Program Presentation

Mr. Gavia introduced Mr. Shishkoff. Ms. Goerdel discussed Mr. Shishkoff's role as Director of Risk Management. Mr. Shishkoff began his presentation with a review of the Guiding Principles regarding risk management. He said that risk is defined as the chance of not meeting the objectives of the retirement system. He identified the key risk areas in a pension system and then outlined the components within the risk areas, highlighting the role of governance, and describing pension liability risk, strategic risk, investment risk and operational risk. He explained that all of these factors must be studied, planned for and

balanced with mitigating strategies. He discussed the key inputs for defining strategy in the investment arena. First are representations of capital market risks and opportunities; second are the pension system financial measures used to evaluate the consequence of risk in different investment strategies.

He then began a discussion of where TMRS currently stands, including a statement of the objective of the risk management function and the responsibilities of the risk management team. He outlined the general requirements for success, and outlined where TMRS stands with respect to each key risk.

Mr. Shishkoff then discussed the hierarchy of Investment decisions. The top level decision is the asset allocation decision, which together with the definition of asset class benchmarks becomes the Policy Index. Total fund performance is measured against the Policy Index. The next decision levels focus on sub-asset classes and the managers, respectively. Each decision at these levels should improve either the risk profile or the return. All decisions taken together should be within the risk profile of the asset class, with superior performance to the class as a whole. These areas are what staff monitors, manages (if necessary) and reports on. Mr. Shishkoff reported that staff will be implementing an internal analytical system so that we can measure our risks internally, report on it and determine that we are being compensated for the risks we are taking.

Mr. Parrish asked when the first risk report to the Board will be prepared. Mr. Shishkoff replied that the first report should be available in early 2012.

5. Asset Liability Study Results

Mr. Gavia introduced Mr. Voytko and Ms. Beard with R. V. Kuhns & Associates. Ms. Goerdel described Mr. Voytko's background, pointing out that he has broad experience relevant to TMRS. Mr. Voytko began his presentation by thanking everyone who worked on the Asset Liability Study. He said that public funds have been doing these studies at an accelerated pace due to changes in the market value of assets, changing demographics, changing assumptions and changes in liabilities and the measurement thereof. He reported that TMRS' outlook is much better than many other public funds.

Mr. Voytko said that the goal of the Study is to determine the System's health, given all assumptions from a deterministic view, which assumes all assumptions are met each year, and a stochastic view, which assumes variability in meeting these assumptions. He then described the process that the team went through in conducting the Study.

He reported that the current status of the System is 88% funded on a market value basis. He mentioned that TMRS is a relatively youthful plan by measure of the ratio of actives versus retirees. He added that TMRS has a strong Actuarially Required Contribution (ARC) based contribution policy.

He then reviewed the deterministic analysis of the System. He indicated that this approach is understood to be flawed simply because no one exactly meets all of the assumptions but that it is useful for understanding the sensitivity to the financial health of the plan to changes in

individual assumptions. On a demographic basis, as stated earlier, the System is youthful, with the ratio of actives to inactives not crossing over until well out into the future. He discussed projected benefit payments and payout ratios, as well as projected contributions. He reviewed the liquidity demands on the plan, which he reported are strongly in TMRS' favor at this time. A projected payout ratio of 7% points to the strong condition of the fund. Mr. Simpson asked whether the recent fund restructuring impacts the results. Ms. Goerdel asked Joe Newton of Gabriel, Roeder & Smith to respond, and he stated that the data provided to R.V. Kuhns for this Study already considered the restructuring. Mr. Gorzell asked how sensitive these deterministic results are to lower than expected returns. Mr. Voytko answered that even assuming a 50 basis point short fall every year still puts the System ahead of where it began, which tells us that there is some margin of error before the System would be affected. Ms. Goerdel pointed out that the contribution policy also supports a shortfall in returns.

Mr. Voytko then reviewed the stochastic analysis, which injects uncertainty of meeting assumptions into the Study and so produces more realistic outcomes. He outlined the portfolios that were used in this analysis and the risk/return properties of each. Mr. Gavia asked how the "aggressive portfolio" matched up to the "mature" public fund that is out there today. Mr. Voytko answered that there are funds like the "aggressive portfolio" out there, but the point of his modeling is to determine the outcome of change. He said that all of the indicators point to the fact that the direction the System is currently taking is moving in a positive direction on all financial measures, i.e., the direction the System is taking portends positive progress for a small additional risk, whereas, an ultra conservative approach would not make progress and would actually create movement in the opposite direction. Mr. Voytko said the bottom line is that going ultra conservative over the next two decades is a risky strategy with poor expected outcomes for TMRS, just as going completely aggressive likewise has major risks. He mentioned that stress-testing the results was also part of the process and that the Study with its conclusions has been reviewed with staff.

Mr. Voytko concluded his presentation by referring to the Final Comment of the Executive Summary, which states that the System is well funded and that continued measured diversification into additional asset classes is optimal. He reported that the Study is not supportive of either an ultra conservative or completely aggressive approach. Progress should be monitored periodically through similar studies.

Ms. Goerdel asked Mr. Newton, with Gabriel, Roeder Smith & Company, to comment on the Study. Mr. Newton stated that one indirect benefit of this Study is that although an actuarial audit was not performed, R. V. Kuhns' actuary did replicate GRS' numbers within reasonable standards. He pointed out that this Study, when compared to the System's peers, points out that the System's actuarial policies produce tight results, and suggested that other systems would see significantly different results. He concurred that the report did overwhelmingly point to moving toward the final target asset allocation.

Mr. Simpson commented that the results of this Study and analysis should be communicated to our membership in order to show that the System is doing the right things. Mr. Gavia thanked TMRS staff, R.V. Kuhns and GRS for their work on the Study.

The Board took a break at 11:10 a.m. The meeting reconvened at 11:30 a.m.

6. Investment Report: June Quarterly Report and August Performance Update

Ms. Beard began her presentation of the June 30 quarterly report, by cautioning that this does not reflect the subsequent political upheaval over the nation's debt limit which significantly impacted the markets. She reported that the System is methodically moving to the target allocation at a measured pace, while continuing to review the asset allocation. She reviewed TMRS' asset allocation compared to the final target and "universe" median. She reviewed the asset allocation by theme and liquidity. She also compared total fund performance versus the benchmarks, stating that we were ahead of the benchmark across all time periods. She also compared total fund performance versus peers and the risk/return profile of the portfolio. She then reviewed the asset class performance and reported that for the periods ending June 30, 2011, the System was in compliance with policy.

Ms. Goerdel gave an update on the current market environment, reporting that in spite of the downgrade of U.S. government debt by Standard & Poor's rating agency, the 10-year treasury is still the "safe haven" of choice. She pointed out the daily volatility in the domestic and international equity markets as reflected in a daily price graph. She reviewed the global linkers market which currently represents TMRS' real return allocation noting the recent change in market concern from inflation to global growth. She pointed out that the real estate market downturn over the past few years has been fortuitous for the System to enter this market. She then reviewed the managers' outlook in the different market sectors. She pointed out that since Moody's had downgraded Ireland to below investment grade, Colchester was instructed to liquidate the Ireland sovereign debt from the global inflation-linked portfolio (about 2.5% of this portfolio). Ms. Goerdel then provided an update to the June performance as reported by R.V. Kuhns, stating that given the market turmoil since that time, the System's year-to-date return is barely positive. She commented on the status of the portfolio diversification implementation to date, and the current activities moving the System toward the target allocation.

Mr. Rodriguez departed the meeting during this report.

7. Ratify Temporary Waiver of Credit Requirements to U. S. Government Securities Held in Core Bond Portfolio

Mr. Gavia began the discussion on the recent downgrade of U. S. debt by one rating agency, Standard & Poor's, and reminded the Board that TMRS' Investment Policy Statement (IPS), in regards to the Core Fixed Income portfolio, requires a AAA rating for the U.S. Treasury/U.S. Government-Related Debt sector. He reported that BlackRock, the Core Fixed Income manager, in anticipation of a downgrade, had previously recommended a waiver of this requirement for ninety (90) days following a downgrade pending a permanent resolution, in order to prevent disruption in the prudent management of the portfolio. R.V. Kuhns also issued a recommendation that clients should not force sell their Treasury holdings due to the downgrade. Staff concurred that this waiver should be granted and Mr. Klausner confirmed that this was a prudent action and within the Executive Director's authority. The waiver was granted and the Board was immediately notified of this action. The Board is now being

asked to ratify that action and grant a continued waiver of this qualification until a permanent revision is brought to the Board by way of proposed amendments to the Investment Policy Statement.

Mr. Gorzell moved that the Board ratify the suspension of the TMRS Investment Policy Statement AAA-Rating requirement for U. S. Treasury and Government-Related debt pending permanent revision of the Investment Policy Statement guideline. Mr. Parrish seconded the motion, which passed with no opposition from the five Board members present.

8. Strategic Plan Review; Update on Strategic Plan Initiatives

Mr. Gavia reviewed the process that was used to refresh and update Strategic Plan being presented. He introduced Ms. Williams, who facilitated the Strategic Planning meeting that was held in August in McAllen, Texas. Ms. Williams asked if the updated Strategic Plan, as presented, accurately captures the discussions that were held in August as well as the direction that the Board intended. She mentioned that this is a rolling 3 to 5 year plan that will be reviewed annually. She indicated that she and staff will present project starting and ending dates to the Board for approval at the December Board meeting. Ms. Williams encouraged the Board to add this document to the TMRS website in order to show the strategic thinking of the Board. She also mentioned that the Strategic Plan is a good management tool to allow the less senior members of the staff to step forward and take ownership of some of the items in the Plan in preparation and training for future leadership roles.

9. Consider and Act on Appointment to the Advisory Committee on Retirement Matters

Mr. Gavia reviewed the membership of the Subcommittee of the Board responsible for creating and utilizing the process by which applicants are reviewed and interviewed for vacancies on the Advisory Committee on Retirement Matters (Advisory Committee). The Subcommittee includes Mr. Parrish, Ms. Oakley and Mr. Gavia. He also reviewed the goals to be considered when reviewing applicants for the Advisory Committee. Mr. Parrish added that the process that has been developed is a good process which adds more formality and due diligence to the overall application, interview and selection process.

Mr. Gavia presented a brief biographical background on the two final candidates. Mr. Parrish stated that both candidates are very qualified to serve on the Advisory Committee. Mr. Parrish reported that the Subcommittee recommends Mayor Garry Watts (City of Shenandoah) to fill the current vacancy in the Individual Class membership. Mr. Simpson moved that the Board accept the recommendation of Mayor Watts. Mr. Gorzell seconded the motion, which passed with no opposition from the five Board members present.

10. Discuss Advisory Committee Future Meetings and Topics During the Legislative Interim

Ms. Nixon began by stating that she has asked Mr. Simpson to chair the Advisory Committee during 2012, with Ms. Oakley serving as Vice-Chair. Ms. Nixon also stated that Ms. Williams has been asked to facilitate some of these meetings. The next meeting of the Advisory Committee is tentatively scheduled for December 1, prior to the December 1-2

Board meeting. Ms. Nixon then reviewed the items previously identified by the Advisory Committee as areas of interest for the interim.

11. Consider and Act on Adoption of Rule Amendments to Administration Rule Sections 127.3 and 127.4

Mr. Gavia presented an overview of the rule amendment relating to USERRA and the rule amendment relating to Section 415 compliance. Ms. Sweeney reviewed the steps that had been taken in amending the rule, including publishing the rule amendments in the Texas Register.

Mr. Parrish moved that the Board approve the orders and adopt the amended Rules §127.3 and §127.4, each to be effective 20 days after it is filed with the Texas Register, without changes to the proposed language. Mr. Simpson seconded the motion, which passed with no opposition from the five Board members present.

12. Consider and Act on Meeting Dates and Locations for 2012 Board of Trustees Meetings

Mr. Gavia presented the recommended meeting dates for 2012, stating that these would be two-day meetings. He pointed out that there is an alternative date for the optional meeting in October/November. He explained that recently, the October meeting has been scheduled to coincide with the annual TML Conference and has been held in the TML host city. Given that TML is being held in November in 2012, Mr. Gavia indicated that the Board has the choice of holding this Board meeting in Austin in October or in the TML host city in November.

Mr. Simpson asked if the two-day meeting format still worked for everyone and the Board responded affirmatively. There was discussion on the October/November meeting and the Board's preference was to have the meeting in October in Austin.

Mr. Gorzell moved that the Board set the following dates as the 2012 meeting dates, noting that all of the meetings will be held in Austin: February 16-17, March 29-30, May 3-4, June 21-22, August 16-17, September 20-21, October 25-26 and December 6-7. Ms. Oakley seconded the motion, which passed with no opposition from the five Board members present.

13. Executive Director and Staff Reports

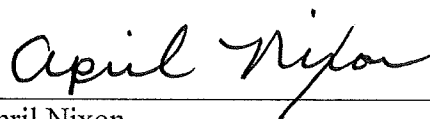
Mr. Gavia presented the Staff Reports and asked if the Board has any questions. There were none.

14. Call For Future Agenda Items

Ms. Nixon asked the Board if there were any future agenda items to discuss. As there was none, the meeting adjourned at 12:18 p.m.



David Gavia
Executive Director



April Nixon
Chair, Board of Trustees