

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

**September 25, 2009**

On September 25, 2009, the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a meeting at 8:30 a.m. at TMRS Headquarters, located at 1200 North IH 35 in Austin, Texas, with the following members present:

**Board of Trustees**

Carolyn Linér, Chair  
Ben Gorzell, Jr., Vice Chair  
Pat Hernandez  
April Nixon  
Roel ("Roy") Rodriguez  
H. Frank Simpson

Present also were:

David Gavia, Acting Executive Director  
Ian Allan, Director of Internal Audit  
Rhonda Covarrubias, Director of Finance  
Eric Davis, Deputy Executive Director  
Bernie Eldridge, Director of Human Resources  
Nancy Goerdel, Acting CIO/Director of Public Investments and Asset Allocation  
Leslee Hardy, Staff Actuary  
Robert Klausner, Klausner & Kaufman  
Dan Krivinskas, R. V. Kuhns & Associates, Inc.  
Russ Kuhns, R. V. Kuhns & Associates, Inc.  
Holly Macki, Director of Fixed Income  
Michelle Mellon-Werch, Associate General Counsel  
Cindy Morse, Executive Assistant  
Debbie Munoz, Director of Member Services  
Joe Newton, Gabriel, Roeder, Smith and Company  
Mark Randall, Gabriel, Roeder, Smith and Company  
Todd Shupp, R. V. Kuhns & Associates, Inc.  
Eddie Solis, Director of Government Relations  
Bill Wallace, Director of Communications  
Nancy Williams, Ennis Knupp + Associates, Inc.  
Scott Willrich, Director of Information Resources

Guests:

Sherry Chapman, Investment Accountant  
David Crow, President, Arlington Professional Fire Fighters  
Debbie Farahmandi, Investment Operations Specialist  
Mary Hobson, Executive Vice President, EFL Associates  
Randle Meadows, City of Arlington Police Department  
Anthony Mills, Regional Manager, City Services  
Candace Nolte, Controller  
Jim Parrish, Texas Municipal Human Resources Assoc.  
Kristin Qualls, Assistant Investment Officer

Kate Reed, Investment Analyst  
Katie Reissman, Investment Analyst, Fixed Income  
David Rodriguez, Regional Manager, City Services  
Bob Scott, Director of Finance, City of Carrollton  
Sean Thompson, Regional Representative, City Services  
Greg Vick, Texas City Managers Association  
Mohamed A. El-Erian, CEO and Co-CIO, PIMCO  
Saumil H. Parikh, Executive Vice President, PIMCO  
Mark Romano, Senior Vice President, PIMCO  
Jeffrey Gundlach, Chief Investment Officer, The TCW Group, Inc.  
Lisa Higa, Senior Vice President, Institutional Client Relations, The TCW Group, Inc.  
Barbara VanEvery, Senior VP over Fixed Income Communications, The TCW Group, Inc.

The meeting was called to order by Ms. Linér at 8:32 a.m., and Ms. Hernandez gave the invocation.

1. **Executive Session**

At 8:33 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 10:15 a.m. All members of the Board who had been present when the Board went into Executive Session were again present.

2. **Consider and Act on Consent Agenda**

Mr. Gavia introduced this item and gave a brief overview of what is contained in the Consent Agenda. There were no questions and no revisions to the proposed Minutes from the August 20, 2009 and the August 21, 2009 meetings of the Board.

Mr. Simpson moved that the Consent Agenda be adopted. Ms. Nixon seconded the motion, which passed unanimously.

3. **Consider and Act on Recommendation for Core Plus Manager(s)**

Ms. Goerdel introduced Russ Kuhns and Todd Shupp (R. V. Kuhns & Associates, Inc.) to discuss the process they went through in selecting the two Core Plus Manager finalists that are being recommended to the Board. Mr. Shupp briefly discussed how Core Plus fits in with the diversification of the fixed income asset class. Mr. Shupp then walked the Board through the very detailed selection process including development of the minimum criteria and detailed questionnaire, in-person interviews and on-site visits. Mr. Shupp discussed the specifics of the minimum criteria including assets under management, years of experience and performance. He mentioned that there was a great deal of both quantitative and qualitative factors to consider. He presented a high level score sheet regarding the potential managers. He next highlighted key factors regarding the two finalists: Pacific Investment Management Company (PIMCO) and TCW Asset Management Company (TCW). He showed a portfolio characteristics snapshot as of 6/30/2009, and pointed out the differences in both firms' strategies. He also gave a snapshot of both firms' Core Plus performance. He mentioned that the correlations are slightly negative between the two managers, meaning that the firms' performance should be slightly different. Mr. Shupp also discussed the fee structures of the two managers. He concluded that the Core Plus strategy provides additional diversification in

the fixed income asset class, along with potentially improved risk-adjusted returns. Mr. Shupp then gave the Board some background on the presenters from both firms.

Mohamed El-Erian, Mark Romano and Saumil Parikh presented for PIMCO. Mr. El-Erian began by stating that everything PIMCO does begins with the client. PIMCO looks to deliver returns and manage risk. Mr. Romano pointed out how PIMCO's philosophy matches the TMRS Investment Policy. He highlighted the fact that PIMCO is growing and thriving in the current environment. Mr. Romano then discussed their activities in the "Plus" environment, including Municipals, Emerging Markets, Global and Real Return. He stated that PIMCO already has a significant presence in the markets that TMRS would be looking at. Mr. Parikh then discussed PIMCO's portfolio management approach centering on the team of "generalists," with the "specialists" supporting them, and with information flowing both upwards and downwards. PIMCO's investment philosophy is to provide above-benchmark returns with benchmark-like risk, while focusing on strong risk management. Mr. El-Erian pointed out that PIMCO has provided "out performance" in 64 of the last 67 rolling three-year periods, net of fees.

Lisa Higa, Jeffrey Gundlach and Barbara VanEvery presented for TCW. Ms. Higa gave a very high level review of TCW's approach. Mr. Gundlach began by stating that their teams' stability is almost unmatched. He also mentioned that TCW does not use derivatives in their approach. TCW's philosophy is to actively allocate away from risk when risk is perceived to be high. Mr. Gundlach discussed TCW's investment process and briefly discussed TCW's risk controls. He recapped the five step strategy used by TCW. He then discussed TCW's returns and volatility, and pointed out that they have been able to preserve capital better than an indexed approach.

Mr. Shupp and Mr. Kuhns returned to discuss manager selection. Mr. Simpson asked in general, why add this asset class; in other words, is the additional return worth the cost? Mr. Kuhns and Ms. Goerdel stated that they believe the increased returns will justify the cost and that we will also benefit from additional diversification within the asset class. Ms. Goerdel mentioned that the goal is consistent outperformance. Mr. Gorzell asked how this allocation would be funded. Ms. Goerdel stated that the preferred method would be a staged approach. Mr. Gavia stated that the managers could be staggered, starting with TCW first, then moving to PIMCO.

Mr. Simpson moved that PIMCO and TCW be selected for non-discretionary investment management services in a Core Plus Fixed Income mandate, and that the Board of Trustees authorize the Acting Executive Director to negotiate contracts satisfactory to the System with fees no more than the fees described in the R. V. Kuhns presentation, for a term of three (3) years with TMRS having the right to terminate the contract with thirty (30) days notice. Ms. Hernandez seconded the motion which passed unanimously.

#### **4. Consider and Act on Authorization to Begin Real Estate Consultant Search**

Ms. Goerdel began this agenda item by reminding the Board of the allocation to Real Estate in the Investment Policy. Dan Krivinskis from R. V. Kuhns began with a brief recap on real estate as an asset class. He discussed the different sectors within the asset class as well as how real estate produces portfolio returns via income and appreciation. He described the two types of investments (equity interest and debt interest), as well as several reasons why TMRS should invest in real estate. He discussed both public and private real estate investment options. He

indicated that with regard to real estate, one must have a long-term approach—several years are needed to fully invest in real estate.

With regard to starting a real estate program, Mr. Krivinskas stated that significant due diligence is required. He said that R. V. Kuhns recommends that TMRS retain a real estate consultant to help implement the real estate allocation and design a real estate program tailored to fit TMRS' needs. He also outlined the real estate consultant's duties. Mr. Simpson asked how "blind" the Board would be with regard to specific real estate investments. Mr. Kuhns answered that it will depend upon the Board's pleasure. Mr. Simpson also noted the difference in hiring a specialty consultant versus hiring managers. This process was discussed, as well as the fact that R. V. Kuhns would not be submitting a proposal to become the real estate consultant, since they are the General Investment Consultant that recommended the inclusion of the real estate investment class in the first place. This will help the consultant selection process avoid potential conflicts.

Mr. Rodriguez moved that the Board authorize TMRS staff and R. V. Kuhns to conduct a search for a real estate consultant. Mr. Gorzell seconded the motion, which passed unanimously.

5. **Discuss Memorandum on Municipal Securities**

Ms. Goerdel stated that the memorandum included in the Board's notebook is in response to a Board question. Mr. Kuhns stated that there is an appropriate place for these instruments in a portfolio. This is a high quality, low default instrument, but he said that they are more appropriate in an actively managed portfolio. The memorandum concludes that the credit quality guideline for municipal securities should be changed to investment grade.

Mr. Gavia pointed out that staff will be bringing a change in the credit quality guidelines for these instruments in the Investment Policy at the December board meeting.

6. **Investment Report**

Mr. Kuhns stated that it is good to see positive, strong returns based on this initial diversification of the portfolios. He added that these returns are not the norm right now.

7. **Consider and Act on Proposed Communication Policy**

Mr. Gavia introduced this item and provided a brief history of the item. He indicated that at the April 24, 2008 Board meeting, Ms. Williams conducted a Board governance workshop for the Board. One of the areas discussed was a Board Communication Policy for the purpose of ensuring that communications between the Board, staff and external stakeholders are accurate, consistent and reflect the policies of the Board as a whole. This Policy was adopted at the June 25, 2008 Board meeting. He reported that Ms. Williams subsequently identified three different areas that she thought the Board might want to consider adding to the Policy which related to publications and speaking engagements, communications between TMRS and the media and communications between TMRS and the Legislature. The Board discussed these items and suggested a few changes to a revised draft of the Policy at the June 19, 2009 Board meeting.

Mr. Gavia then introduced Ms. Williams and she reviewed for the Board the minor changes made to the earlier draft of the policy. Mr. Simpson moved that the Board adopt the revised Communication Policy as presented. Ms. Nixon seconded the motion, which passed unanimously.

8. **Update on Strategic Plan and Strategic Plan Review**

Mr. Gavia began by stating that it is the Board's policy to annually review the Strategic Plan and receive an update on staff's progress. Mr. Gavia walked the Board through each goal and objective, highlighting both the completed and on-going objectives, and noting the target completion dates for those objectives with a longer timeline. Mr. Gavia pointed out that suggestions for additional objectives within each goal were noted in the progress report's executive summary.

Mr. Gorzell complimented staff on the amount of work that has been accomplished. Ms. Williams agreed that both the staff and the Board have made tremendous progress. She noted that in the future, staff and Board members can expect to see fewer but harder-to-achieve objectives.

Ms. Williams also mentioned that about a year from now is likely the time to do a significant review of the System and this Strategic Plan. Mr. Simpson noted that Objective G of Goal 5 called for a formal outline and milestones for the legislative process to be developed very soon.

9. **Education Session: Actuarial Smoothing**

Mr. Randall stated that most systems use asset smoothing and he then outlined the key points of this discussion. He began by discussing why asset smoothing is used. He said that short term changes in the markets can have a dramatic affect on asset valuations. Smoothing provides a longer term perspective and provides consistency in funding, reporting and benefit provisions. Smoothing does not impact long term costs or funded positions; it only impacts the timing of contributions. He gave an example of market value and actuarial value of assets. He showed how different smoothing periods would reduce volatility in contribution rates and funded ratios. Mr. Randall defined asset smoothing period, corridors and amortization period. He reviewed the Actuarial Standards of Practice regarding asset smoothing, and mentioned what other public plans are doing. He reiterated that this is an important issue for TMRS going forward because, with diversification of the portfolio, there is more market risk, so smoothing will help maintain year to year contribution rate consistency.

Mr. Newton then discussed the use of corridors, explaining the rationale for corridors, how corridors relate to the smoothing period, and the difference between "hard" and "soft" corridors. Mr. Newton then gave an example to show how corridors work and explained that it provides downside protection to the funded status. He said that the use of a corridor results in more volatility in contribution rates. He discussed the reward vs. risk/cost of asset smoothing. He showed examples of different smoothing periods, both with and without corridors, for different retirement systems. The longer the smoothing period, the more downside risk there is. He then showed the cost implications of different smoothing periods.

Mr. Gavia asked what other clients (who use smoothing) are wanting to do after the recent downturn. Mr. Newton stated that some have asked to either widen or remove the corridor, but he said that no one has asked to extend the smoothing period.

Mr. Gavia asked about the timeline for making recommendations. Mr. Randall stated that they would like to make a recommendation in October, with final discussion at the December Board meeting. Mr. Gavia added that reserve guidelines would likewise need to be adopted before the February 2010 Board meeting.

**10. Consider and Act on Board of Trustee Meeting Dates and Locations**

After some discussion, the Board decided on the following meeting dates and locations for their 2010 Board meetings:

<u>Date</u>	<u>Meeting Type</u>	<u>Location</u>
February 19, 2010	Special Meeting	Austin TX
March 12, 2010	Regular Meeting	Austin TX*
May 7, 2010	Joint Meeting w/Advisory Comm	Austin TX
June 18, 2010	Regular Meeting	Austin TX
August 27, 2010	Joint Meeting w/Advisory Comm	Austin TX
September 24, 2010	Regular Meeting	Austin TX
October 27, 2010	Special Meeting	Corpus Christi TX (in conjunction w/TML)
December 3, 2010	Regular Meeting	Austin TX

\* location of meeting might change depending on hotel availability in Austin


**11. Acting Executive Director and Staff Reports**

Mr. Gavia introduced this item and asked if there were any questions or comments regarding the staff reports. There were none.

**12. Call For Future Agenda Items**

As there was no further business, Ms. Linér adjourned the meeting at 2:45 p.m.

  
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David Gavia, Acting Executive Director

  
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Carolyn Linér, Chairman, Board of Trustees