

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

September 7-8, 2007

On September 7, 2007, the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a regular meeting at 10:00 a.m. at the Renaissance Austin Hotel, located at 9721 Arboretum Blvd., Austin, Texas, with the following members present:

Board of Trustees

Pat Hernandez, Chair
Roel 'Roy' Rodriguez, Vice Chair
Carolyn Linér
Rick Menchaca
April Nixon
H. Frank Simpson

Present also were: Eric Henry, Executive Director & Chief Investment Officer
Eric Davis, Deputy Executive Director
Rhonda Covarrubias, Director of Finance
Gary Craig, Director of Investments
Bernie Eldridge, Director of Human Resources
David Gavia, General Counsel
Nancy Goerdel, Investment Officer
Debbie Muñoz, Director of Member Services
Eddie Solis, Director of Government Relations
Bill Wallace, Director of Communications
Scott Willrich, Director of Information Resources
Patricia Brown, Executive Assistant
Jose Fernandez, Cavanaugh Macdonald Consulting, LLC
Steve Harding, Independent Fiduciary Services
Terrence Kendall, Legal Counsel
Rocky Joyner, The Segal Company
Bob Klausner, Klausner & Kaufman, PA
Malichi Waterman, The Segal Company

Guests: Eduardo De La Rosa, CLEAT Austin
Jim Moore, City of Mesquite
Bob Scott, City of Carrollton
Mike W. Self, APFFA

Ms. Hernandez called the meeting to order at 10:00 a.m. and gave the invocation.

Update on Actuarial Issues

Mr. Joyner reported on the ongoing discussions to date and the progress made regarding the change in the actuarial funding method.

Mr. Henry announced that the second mailing on funding would be going out to the cities today. This mailing would focus on the results of the experience study as well as update the cities on the second opinion regarding changing the actuarial cost method from traditional Unit Credit (UC) to Projected Unit Credit (PUC). A third mailing to the cities is scheduled for the middle of October. The third mailing will provide cities with projections on the impact on individual city rates and funding ratios of the proposed change in actuarial cost method from UC to PUC cost method.

Consider and Act on Experience Investigation

Mr. Joyner explained that the reason for the investigation is to review recent experience and trends and compare them against current actuarial assumptions and policies. He stated that the investigation will assure that all plan liabilities are being accounted for appropriately; new methods and policies will be examined to stabilize employer contribution rates in future years; and new assumptions will be recommended based on actual experience. He then commented on the reasons for the change from a five-year experience investigation period in the past to a four-year experience investigation period for this study.

The assumptions consist of two categories, economic and demographic. With regard to the inflation rate, the range, after reviewing market and national statistics, was determined to be between two and a half percent to four and a half percent, with the recommendation being three percent.

Mr. Joyner discussed the different investment return assumptions and recommendations that would be made if the System continues to invest in fixed income; alternatively, he discussed those investment return assumptions that would be made if the System changes its investment portfolio to a more diversified allocation. Mr. Joyner recommended changing the investment return assumption from seven percent to five and a half percent if the System continues to invest only in fixed income securities. Mr. Joyner then noted that if the Board adopts changes to the investment policy that result in a more diversified portfolio such as a 60%/40% split between equities and fixed income, the investment return assumption might remain at seven percent. An increase in investment returns could cushion increases in contribution rates that will result from changing the actuarial cost method and recognizing the full cost of automatic annual COLAs. Mr. Henry stated that using a thirty-year amortization period for unfunded liabilities could also provide some relief to cities from contribution rate increases due to changing to PUC. Mr. Henry noted that setting an eighty-five percent funding level target would also have a positive impact on contribution rates.

Mr. Joyner noted that the interest credit rate used to project the value of employee accounts would be adjusted to five percent. If investment returns exceed five percent, these returns could be accumulated in the interest reserve fund and perhaps used to stabilize contribution rates and prevent future reductions in retirement benefits. Mr. Simpson asked what the rationale would be for providing more of the investment return to employers. Mr. Henry stated that the rationale would be that it would help cities to maintain benefits to employees at current levels. Mr. Menchaca also noted that understandable member communications would need to be developed.

Mr. Henry said that we were beginning to get this message out to our members and that those efforts would continue.

With regard to the demographic assumptions, Mr. Joyner discussed the mortality assumptions. The experience study indicates that the System needs to adopt mortality tables that account for increased life expectancy. Adopting these tables will result in increased actuarial liabilities. However, Mr. Joyner does not recommend immediately changing the mortality table currently used to calculate the annuity purchase rate which in turn is used to calculate retirement benefits for members. The Board has some time to decide how to address that issue. Mr. Henry suggested that changes in investment strategy may help pay for increased costs due to changes in the mortality tables. If there are ultimately changes to the annuity purchase rate, these changes would be phased in slowly so as to not disrupt retirement patterns. Disability retirements are not a big part of the plan, so this factor will only be modified slightly.

Withdrawals have been about fifteen percent less than expected. Adding two additional withdrawal-rate levels will allow for a smoother progression for cities. Turnover is a new assumption that was not needed in the past under traditional UC, but would be needed under PUC because of the liability exposure. This is the probability that people will leave a vested benefit in the System.

In connection with the actuarial funding policy review, Mr. Joyner suggested that the Board consider a switch to a 'closed' twenty-five year amortization period, rather than 'open'; it was suggested that TMRS might consider a thirty-year amortization period and set a funding ratio target of eighty-five percent.

Mr. Henry asked what the next step was. Mr. Joyner suggested taking final action to adopt these changes at the Board's December meeting. Mr. Joyner then discussed how much of a move must be made toward equities for the actuary to use the different investment rate assumption. Mr. Henry suggested that this could be discussed further at the December meeting.

Mr. Fernandez suggested some ways to phase in the PUC approach over a five-year period; initially, this would cause a decrease in the funded ratio. This might create a net pension obligation during the phase-in period. The Board discussed how this change might be seen by rating agencies. There were two phase-in approaches reviewed as illustrated in the Segal report. Mr. Fernandez explained that if more cities go to an ad hoc adoption to postpone prefunding their benefits, the System should consider amortizing the cost over a shorter amortization period, maybe ten to fifteen years. A second alternative would be to recognize the additional costs if a regular pattern of adoption emerges.

No action was taken on this item; it will be considered for adoption at the December Board meeting.

Report on Actuarial Second Opinion

Mr. Fernandez explained that his company, Cavanaugh Macdonald Consulting, was hired to review The Segal Company's recommended change in actuarial funding methods from UC to PUC. Mr. Fernandez agreed that changing from UC to PUC is a good option for all TMRS cities, not just the cities with annually repeating updated service credit and annuity increases. Mr. Fernandez then explained how the different methods allocate the costs over time. PUC makes for a more level year-to-year funding approach. Even for cities that do not have repeating features, the PUC approach provides a more level progression. Mr. Fernandez suggested phasing

changes in contribution rates due to changes in actuarial cost method over five years. Mr. Fernandez described two ways of phasing in the increase in rates.

Changing cost methods may result in initially lower funding ratios for cities and may also result in the cities having to recognize a net pension obligation. Mr. Fernandez stated that bond rating agencies are favorably disposed to employers disclosing all their liabilities provided there is a sound plan to address the liabilities. In response to questions by Mr. Simpson and Mr. Menchaca, Mr. Fernandez did review the possibility of other cost methods such as Entry Age Normal, but concluded that PUC was a more appropriate method under the circumstances. Mr. Kendall asked how trustees can know when it is appropriate to consider changes in actuarial methods or other assumptions. Mr. Fernandez said it was difficult to know when changes should be made. Trends, such as how long employers have had repeating updates in place without repeal, should be examined.

Mr. Fernandez also stated that it was advisable for the System to consider accelerating funding for those cities that adopt updated service credit and annuity increases on an ad hoc basis by amortizing that liability in a shorter time frame such as ten to fifteen years. Mr. Joyner said that having two separate amortization periods would make calculation more complex. Board members then discussed the effects of the recommendations and how such changes could be communicated to members and cities.

Discuss Additional Contribution Rule and Updated Service Credit Rule

Mr. Gavia reported on rules to be proposed by the Board.

The additional contribution rule authorized by HB 1244 and presented to the Board for review will allow TMRS cities considerable discretion in making extra contributions to fund city liabilities. Under the rule, the Executive Director is permitted to not accept contributions that might cause an unreasonable administrative or investment burden.

Mr. Gavia stated that HB 1244 also gives the Board authority to adopt rules to limit the increase in the average updated service compensation used in the calculation of a member's Updated Service Credit (USC). The rule presented to the Board for review would reduce the likelihood that a large member deposit would result in a USC which is disproportionate to a member's compensation and tenure.

To become effective January 1, 2008, the rules must be published in the Texas Register by October 22, 2007; the Board could take action (adopt the rules) at its December meeting.

After discussion by the Board, Ms. Nixon moved to publish the additional contribution and updated service credit rules in the Texas Register to be eligible for adoption by the Board at its December meeting. Mr. Simpson seconded the motion, which carried. Mr. Menchaca abstained from the vote.

Review of 2007 Operating Budget Year-to-Date and Discussion of Budget Priorities for 2008

Ms. Covarrubias presented the year-to-date operating budget and the anticipated budget for the remainder of the year 2007. Vacant positions are the major reason the System anticipates being under budget this year. Ms. Nixon suggested that TMRS look into employing a vacancy factor when budgeting for personnel costs. Mr. Menchaca discussed utilizing the surplus in the

expense fund to reduce next year's budget transfer. He also suggested that the System consider taking the unspent portion of the operating budget allocated to TMRS retirement contributions and use it to make extra contributions to the System's own municipal accumulation account to pay down its own unfunded liabilities. Mr. Henry suggested working with the Finance & Audit Committee in this regard.

At this time, Mr. Simpson and Mr. Menchaca commented on the undesignated reserve. It was requested that, in the future, a more comprehensive report of this amount be presented in the regular agenda material, possibly the consent agenda.

Quarterly Investment Report

Mr. Craig reported that TMRS has been building reserves and has about \$200 million in cash, and that its returns are comparable to the Lehman Index. A new chart was added to the Investment Report that shows the concentration of holdings by duration. Mr. Henry pointed out that the long duration of TMRS' portfolio has helped as interest rates have declined, but if interest rates rise, the duration would work against TMRS.

Consider and Act on Conforming Changes to Board Bylaws and Administrative Governance Policy to Reflect Adoption of Charter for the Advisory Committee on Retirement Matters

Mr. Gavia explained that the proposed changes in this item conform the Board Bylaws and Administrative Governance Policy to the changes made when the charter for the Advisory Committee on Retirement Matters was adopted by the Board at its last meeting.

With regard to the Advisory Committee, Mr. Menchaca suggested training for the Committee to keep them more engaged than just having them attend two joint meetings per year with the Board. Mr. Henry responded that staff was working on ways to provide training to the Committee members.

Mr. Menchaca moved to adopt changes to the Board Bylaws and Administrative Governance Policy to conform these documents to the changes made by the charter adopted by the Board at its August 17, 2007 meeting. Ms. Linèr seconded the motion, which carried unanimously.

Consider and Act on Resolution Regarding Distributive Benefits (Extra Payments) to Annuitants and Supplemental Interest to Certain Funds and Accounts

Mr. Henry introduced this item, recommending no distributive benefit (extra payment) for retirees and no supplemental interest to members.

At this time, Mr. Menchaca asked about TMRS' two percent interest reserve. Mr. Henry suggested that TMRS not allocate funds in the interest reserve fund until future System needs are determined.

It was the consensus of the Board that the present financial condition did not warrant distributive benefits to annuitants or supplemental interest credit to members.

Consider and Act on Amendments to Finance & Audit Committee Charter

Mr. Henry stated that the attached charter includes suggested changes such as an increase in membership from two to three and a requirement of a unanimous vote of the Committee in matters relating to the internal auditor position. Also discussed was the appointment of a vice chair to the Committee in the event the chair is not able to attend a meeting.

Mr. Rodriguez moved to adopt the Committee's recommendations and amend its charter accordingly, with the additional amendment to appoint a vice chair of the Committee.

Mr. Menchaca seconded the motion, which carried unanimously.

Consider and Act on Amendment to Investment Committee Charter

Mr. Henry commented that this item expands the Investment Committee to three members. The addition of a third member to the Committee will make it easier for the Committee to have a quorum and conduct business. As in the Finance & Audit Committee charter, it is requested that a vice chair be appointed to serve with this Committee.

Mr. Menchaca moved to adopt the Committee's recommendations and amend its charter accordingly, with the additional amendment to appoint a vice chair of the Committee.

Ms. Nixon seconded the motion, which carried unanimously.

Consider and Act on Appointment of Third Member to Finance & Audit and Investment Committees

Mr. Henry introduced this agenda item and explained that adding a third member to each Board Committee will make it easier to have a quorum and conduct Committee business.

Ms. Hernandez then appointed Ms. Linèr to the Finance & Audit Committee and herself to the Investment Committee.

Mr. Rodriguez moved to ratify the appointments of Ms. Linèr and Ms. Hernandez to the Finance & Audit Committee and the Investment Committee, respectively. Ms. Nixon seconded the motion, which carried unanimously.

Reconsider Selection and Hiring of Investment Consultant

Mr. Henry summarized the history of the selection of EnnisKnupp as TMRS' investment consultant, subject to contract negotiation. Mr. Henry stated that while contract negotiations were being conducted with EnnisKnupp, EnnisKnupp informed TMRS that Mr. Guy Cooper had resigned from the firm. Mr. Cooper had been a major factor in the proposed hiring of that firm. Mr. Henry reported that EnnisKnupp proposed to staff the engagement with Steve Cummings, CEO and Mary Bates, associate as the primary consultants. TMRS staff met with EnnisKnupp to discuss the personnel changes. After consulting with the Committee, TMRS staff reviewed the investment consulting firms who had responded to the earlier Request for Information and selected R.V. Kuhns & Associates, Inc. (RVK) for further review.

A site visit to RVK was conducted by a team consisting of Mr. Henry, Mr. Craig, and Ms. Goerdel. Russ Kuhns, founder of the firm, would be the lead consultant for TMRS. Staff found that the consultant and support team that RVK put together to service this engagement was

experienced and quite deep and that RVK has sufficient resources to service the TMRS account. The firm demonstrated experience in transitioning organizations from a portfolio such as the TMRS portfolio to a more diversified portfolio. RVK is completely independent and has no conflicts. RVK's revenues come solely from investment consulting, and they receive no fees directly or indirectly from investment managers. The consultant and support team proposed by RVK was superior to the teams put together by the competing firms.

Mr. Simpson stated that, since the circumstances surrounding the original selection have changed, and since TMRS might be diversifying its investment portfolio in the near future, he believes RVK to be the best consultant for TMRS.

Mr. Menchaca moved that the Board adopt the recommendation by the Investment Committee and rescind its selection of EnnisKnupp as investment consultant because of subsequent changes in that firm and authorize staff to enter into negotiations with R.V. Kuhns & Associates, Inc.; that a draft of the proposed contract be provided to the Committee members; and that the Executive Director be authorized to sign such a contract on behalf of the System. Ms. Liner seconded the motion, which carried unanimously.

At 2:43 p.m., the Board entered into Executive Session to discuss personnel matters pursuant to Texas Government Code, §551.074. No action was taken during the Executive Session and the meeting was opened to the public again at 3:00 p.m. All members of the Board who had been present when the Board went into Executive Session were again present.

At 3:00 p.m., Ms. Hernandez declared the meeting recessed until 9:00 a.m. Saturday, September 8, 2007.

On September 8, 2007, the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a regular meeting at 9:00 a.m. at the Renaissance Austin Hotel, located at 9721 Arboretum Blvd., Austin, Texas, with the following members present:

Board of Trustees

Pat Hernandez, Chair
Carolyn Liner
Rick Menchaca
April Nixon
H. Frank Simpson

Absent: Roel 'Roy' Rodriguez, Vice Chair

Present also were: Eric Henry, Executive Director & Chief Investment Officer
Eric Davis, Deputy Executive Director
Rhonda Covarrubias, Director of Finance
Gary Craig, Director of Investments

Bernie Eldridge, Director of Human Resources
David Gavia, General Counsel
Nancy Goerdel, Investment Officer
Debbie Muñoz, Director of Member Services
Eddie Solis, Director of Government Relations
Bill Wallace, Director of Communications
Scott Willrich, Director of Information Resources
Patricia Brown, Executive Assistant
Terrence Kendall, Legal Counsel
Bob Klausner, Klausner & Kaufman, PA
Jerry Schmahl, EnnisKnupp
Malichi Waterman, The Segal Company
Nancy Williams, EnnisKnupp

Guest: Eduardo De La Rosa, CLEAT Austin

Ms. Hernandez called the meeting to order at 9:00 a.m. and gave the invocation.

Update on Strategic Planning Process

Ms. Williams began her presentation by introducing her associate, Mr. Schmahl, and then highlighted key elements of the workshop she conducted with TMRS staff on August 28. She stated the need for overarching goals from the Board. Mr. Henry commented that the development of this strategic plan needs to be an iterative process between the Board and staff.

The first part of the session dealt with discussion of the current mission statement, suggestions for a new mission statement, and mission statements of other entities. Some suggestions were made to the current mission statement. The group then discussed the vision statement.

Mr. Simpson commented that the vision statement should say where you want to be.

Mr. Simpson commented that cities use TMRS as an incentive to attract quality employees and that this should be reflected in the vision statement. The result should be a retirement system that others want to emulate and that represents the best value for cities. Mr. Henry at this time explained that the group should not lose sight of whom the focus of a strategic plan for TMRS is – the members. Mr. Menchaca stated that it is important that TMRS maintain good benefits, enjoy a fine reputation, and deliver services efficiently. The Board and staff then discussed several possible vision statements.

The group then discussed important core values, including integrity, teamwork, accountability, and continuous improvement. After finishing the discussion regarding core values, the group proceeded to discuss goals for the System, including (1) addressing actuarial issues, (2) developing an investment strategy that considers diversification, (3) developing a culture that values open and honest communication between the Board, management, and staff, and (4) improving TMRS communications to members and cities.

The group discussed the importance of communication, especially as TMRS deals with complex funding issues and considers diversifying its investment portfolio. Mr. Simpson discussed the importance of the Board portal as a communications tool.

At 11:23 a.m., the Board entered into Executive Session to discuss personnel matters pursuant to Texas Government Code, §551.074. No action was taken during the Executive Session and the meeting was opened to the public again at 12:15 p.m. All members of the Board who had been present when the Board went into Executive Session were again present.

Consent Agenda

Mr. Henry introduced the Consent Agenda. This included: (1) the minutes of the June 20-21, 2007 Regular Meeting of the Board of Trustees and the minutes of the August 17, 2007 Joint Meeting of the Board of Trustees and the Advisory Committee on Retirement Matters; (2) the lists of 600 service retirement applications, 22 disability retirement applications, 24 active member and 84 retired member applications for supplemental death benefits, and 1 application for extended supplemental death benefits coverage (attached hereto as Exhibit "A"); (3) the financial statements including: Statement of Plan Net Assets as of July 31, 2007 and 2006, the Statement of Changes in Plan Net Assets for the Seven Months Ending July 31, 2007 and 2006, the Unrealized Gain or Loss on Investments as of July 31, 2007, the Net Appreciation/Depreciation in Fair Value of Investments for the Seven Months Ending July 31, 2007 and 2006, the Expense Fund Balance Sheet as of July 31, 2007, and the Schedule of Administrative Expenses for the Seven Months Ending July 31, 2007.

Mr. Henry provided an overview of the items included in the Consent Agenda and advised the Board that all of the foregoing applications and reports met the requirements of the Act governing the System for the particular action sought.

Mr. Menchaca moved that the Consent Agenda be adopted. Ms. Linér seconded the motion, which carried, with Ms. Nixon abstaining from the vote.

Reports by Executive Director and Staff

At this time, Mr. Henry announced that planning was currently underway with regard to selection of a host hotel for the 2008 Board meetings. The hotels from which staff has asked estimates are:

- the Sheraton Austin;
- the Omni Austin Hotel Downtown;
- the Intercontinental Stephen F. Austin Hotel; and
- the Hilton Austin.

Once staff receives cost estimates from the above hotels, a decision will be made based on quality, location, and price.

Mr. Davis explained the different plans for the proposed Board room, noting that locating the room on the east side of the fourth floor results in optimal use of the space. He then discussed cost, seating, and Board table configuration.

Mr. Henry announced that the Board portal is up and running and that staff will give a demonstration at the December Board meeting.

Report from Legal Counsel

None.

Any Other Business

None.

There being no further business to come before the Board, the meeting was adjourned at 12:20 p.m.

Eric Henry
Executive Director
& Chief Investment Officer

Pat Hernandez
Chair