

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

**February 18, 2016 – 1:30 p.m.**

On February 18, 2016, the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a meeting at 1:30 p.m. at Hilton Garden Inn, 500 North Interstate 35, Austin, Texas, with the following members present:

**Board of Trustees**

Jim Parrish, Chair  
Bill Philibert, Vice Chair  
Roel “Roy” Rodriguez  
Julie Oakley  
Jim Jeffers  
David Landis

**Present also were:**

David Gavia, Executive Director  
Eric Davis, Deputy Executive Director  
TJ Carlson, Chief Investment Officer  
Bill Wallace, Director of Communications  
Kristie O’Hara, Director of Human Resources  
Dan Wattles, Director of Governmental Relations  
Leslee Hardy, Director of Actuarial Services  
Debbie Munoz, Director Member Services  
Robert Klausner, Klausner, Kaufman, Jensen & Levinson  
Kristin Qualls, Director of Public Equity  
Marc Leavitt, Director of Absolute Return  
Chris Schelling, Director of Private Equity  
Jason Weiner, Director of Fixed Income  
Karen Jackson, Executive Assistant  
Marcia Beard, RVK  
Jonathan Kowolik, RVK  
Amy McDuffee, Aon Hewitt Investments  
Brian Borton, StepStone

**Also in attendance:**

Michelle Mellon-Werch, Assistant General Counsel  
David Rodriquez, Regional Manager – City Services  
Carol Leung, Equities Investment Analyst  
Chris Tindell, Private Equity Investment Analyst  
Cindy Morse, Investment Support Analyst  
Debbie Farahmandi, Investment Operations Specialist  
Peter Jeske, Project Specialist

Michael Schaff, Assistant General Counsel  
Kate Reed, Compliance Officer  
Martha deLivron, Absolute Return Investment Analyst  
Rachel Cleak, Alternatives Investment Analyst  
German Gaymer, Fixed Income Analyst  
Bob Scott, City of Carrollton  
Greg Shipley, Combined Law Enforcement Associations of Texas  
Alex Cramer, Arlington Professional Fire Fighters  
David Crow, Arlington Professional Fire Fighters  
George Kaufman, City of Garland  
David Russell, Texas Municipal Police Association  
Andrea Cockrell, City of Plano  
Billy Whitson, City of Richardson  
Ashley Rendon, Pension Review Board  
Eloisa Mata, Pension Review Board  
David Riggs, Texas State Association of Fire Fighters  
Sandra Vice  
Neil Patel, Fin-News.com

Mr. Parrish called the meeting to order at 1:33 p.m. Ms. Oakley gave the invocation.

1. **Private Equity Annual Class Review**

Mr. Carlson introduced Mr. Schelling and Brian Borton of StepStone to review the private equity portfolio activities to date. Mr. Schelling discussed general private equity deal flow, fundraising and exits. He reviewed private equity performance which is currently performing as expected. The long term policy objective is Russell 3000 + 3% over periods of five years and greater. Mr. Schelling highlighted the allocations as well as the called and unfunded committed amounts as of December 31, 2015. The unfunded commitments that are pending for private equity investments are currently held in TMRS' public equity portfolio. He reviewed the private equity allocation by strategy, target diversification, manager diversification and geographic diversification. T.J. clarified for the Board the terms "approved" versus "committed" versus "invested."

Mr. Schelling discussed the private equity pacing plan and manager searches that will be forth coming. He reviewed the "J-curve" as a reminder of how the life cycle of an individual private equity fund works. Managers typically never call 100% of the commitment. Since capital is not put to work immediately in private equity funds, investors must run what is known as an over-commitment strategy in order to hit their target allocation. That is, the cumulative value of the funds committed to private equity exceeds the value of the target private equity portfolio at any given time. Mr. Schelling discussed the interim targets noting that focus will be more on "buy-out" and "growth" managers going forward as opposed to "special situations."

The monitoring process was discussed and Mr. Schelling noted that comprehensive reviews are to be conducted and documented at least annually. The private equity team took 197 individual meetings in 2015 and added 246 distinct private equity managers to the internal

database. The manager report cards showed all managers are performing in accordance with expectation and currently there are no concerns or open issues.

**2. Consider and Act on Private Equity Manager Recommendation(s)**

T.J. introduced the item and commented that staff was originally scheduled to bring three managers to the Board, but two managers fell out during the due diligence process. Mr. Schelling briefly reviewed the private equity search process timeline and scoring matrices. He discussed the manager selection portfolio considerations and geographic diversification. GSO Capital Opportunities Fund III L.P. (GSO COF III) scored significantly higher than the next closest managers. GSO COF III is a special situations strategy. Mr. Schelling listed reasons to invest in the fund noting the stability of the team, strong credit underwriting and focus on downside protection, top quartile performance and that they are very well resourced operationally with strong operational due diligence.

The recommendation is to approve the selection of GSO COF III with an allocation of \$75 million contingent upon the final investment committee approval from StepStone Group, favorable background checks and successful negotiation of the investment agreements. Ms. Oakley requested a memo be brought to the Board at the next meeting noting the final due diligence. Mr. Borton discussed StepStone's recommended action memo and he reviewed the key risk factors.

Mr. Landis moved that the Board allocate \$75 million to GSO Capital Opportunities Fund III L.P. (GSO COF III), a Special Situations Strategy, as proposed and in accordance with the TMRS Investment Policy Statement, at fees no greater than presented, contingent upon final Investment Committee approval from the StepStone Group, favorable background checks and successful negotiation of the investment agreements. Once due diligence is completed and final approval is given by the StepStone Investment Committee, their updated investment memo will be sent to all Board members for review with a request for ratification at the next Board meeting.

Mr. Landis also moved (i) that the allocation may include the option to participate in the fund's distribution reinvestment program, if any, and may exceed the authorized commitment to the fund by the value of the distribution reinvestments, when TMRS Staff and its private equity consultant determine that it is economically advantageous to do so and in accordance with the TMRS IPS Private Equity guidelines, and (ii) to authorize the Executive Director to negotiate, execute, acknowledge, and deliver any and all contracts, agreements, and other documents or instruments on such terms and conditions as are satisfactory to the System, such satisfactory terms and conditions to be conclusively evidenced by the execution thereof by the Executive Director; and to do any and all other acts deemed by the Executive Director in his judgment to be necessary or appropriate in the best interests of TMRS to give effect to such investments. Management and incentive fees in the fund are exclusive of the capital allocation and may be paid through cash flow of the investment, capital calls, or via invoice. Mr. Philibert seconded the motion, which passed 6-0.

**3. Consider and Act on Changes in the Securities Lending Program Including Changes to the Investment Policy Statement**

Mr. Carlson and Jonathan Kowolik from RVK presented a Securities Lending program update. Mr. Carlson began by noting that at their last annual review, Deutsche Bank (DB) was in compliance with the Investment Policy Statement (IPS) credit rating requirements; however, at the end of January 2016, DB was downgraded to less than an "A" by Moody's. DB had already been downgraded by Standard & Poors (June 2015) to BBB+. Under the current IPS, the lending agent is required to be rated "at least an A" by two or more of the Nationally Recognized Statistical Rating Organizations (NRSRO's, Moody's, Fitch and S&P). Based on this requirement, with the latest downgrade by Moody's, DB is out of compliance with our IPS. As a result, staff ordered new lending to stop and ordered a partial wind-down of existing loans. Mr. Carlson reported that the outstanding loans have been cut by two-thirds in the past week. The term loans and legacy program were maintained.

Mr. Carlson reviewed the securities lending process and discussed the securities lending flow diagram as well as the indemnifications built into the process. TMRS earned \$1.95 million during 2015 through the Securities Lending program. He discussed year-to-date earnings, the top five borrowers and their loan amounts and he reviewed the program statistics through January 2016.

Mr. Carlson presented three possible options to the Board to consider: 1) Accept increased potential risks and modify the program to expand lending. Potential increase in earnings may be offset by further financial/credit exposure. 2) Accept current potential risks and maintain the program. For this option, the Board may want to grant a temporary exemption from the credit requirements of the IPS, but require higher capital ratios. 3) Reduce potential risks and wind down the securities lending program. Mr. Carlson noted that TMRS will be doing a custody search in 2017 which will present an opportunity to re-examine security lending's place in the portfolio.

The Board, Mr. Klausner, Mr. Carlson and Mr. Kowolik discussed these three options and the actions that could be taken. Mr. Parrish asked Mr. Carlson for his recommendation. Ms. Oakley stated she did not like any of the three options, but she wants to take action and not incur a loss. Mr. Carlson stated that option 2 calls for accepting the program, but increasing the capital ratio requirements.

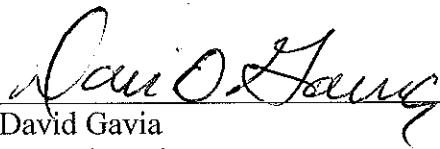
Mr. Rodriguez moved that the Board proceed with option three, reduce potential risks and wind down the securities lending program. He emphasized that the Custody RFP process in 2017 presents a natural opportunity to re-examine market conditions and securities lending benefits and risks, as well as its place within the TMRS Investment Portfolio. Mr. Philibert seconded the motion, which passed 6-0.

**4. Executive Session**

At 3:38 p.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 all members of the

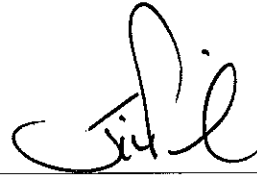
Board that were present before the executive session were still present. The meeting was opened to the public again at 6:00 p.m.

Mr. Philibert made a motion to recess the meeting for the day at 6:01 p.m. until 9:00 a.m. on Friday, February 19, 2016. Ms. Oakley seconded the motion, which passed 6-0.



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David Gavia  
Executive Director



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Jim Parrish  
Chair, Board of Trustees

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

**February 19, 2016**

On February 19, 2016 the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a meeting at 9:00 a.m. at the Hilton Garden Inn, 500 North Interstate 35, Austin, Texas, with the following members present:

**Board of Trustees**

Jim Parrish, Chair  
Bill Philibert, Vice Chair  
Roel "Roy" Rodriguez  
Julie Oakley  
David Landis  
Jim Jeffers

**Present also were:**

David Gavia, Executive Director  
Eric Davis, Deputy Executive Director  
Kristie O'Hara, Director of Human Resources  
TJ Carlson, Chief Investment Officer  
Rhonda Covarrubias, Director of Finance  
Leslee Hardy, Director of Actuarial Services  
Robert Klausner, Klausner, Kaufman, Jensen & Levinson  
Debbie Munoz, Director of Member Services  
Bill Wallace, Director of Communications  
Dan Wattles, Director of Governmental Relations  
Scott Willrich, Director of Information Resources  
Marc Leavitt, Director of Absolute Return  
Karen Jackson, Executive Assistant  
Marcia Beard, RVK  
Amy McDuffee, Aon Hewitt Investments

**Also in attendance:**

Michelle Mellon-Werch, Assistant General Counsel  
David Rodriquez, Regional Manager – City Services  
Michael Schaff, Assistant General Counsel  
Vikki Vasquez, Member Services Manager  
Chad Nichols, Member Services Manager  
Cindy Morse, Investment Support Analyst  
Peter Jeske, Project Specialist  
Bob Scott, City of Carrollton  
Greg Shipley, Combined Law Enforcement Associations of Texas  
Alex Cramer, Arlington Professional Fire Fighters

David Crow, Arlington Professional Fire Fighters  
George Kaufman, City of Garland  
David Russell, Texas Municipal Police Association  
Tadd Phillips, Texas Municipal Human Resources Association  
Andrea Cockrell, City of Plano  
Ashley Rendon, Pension Review Board  
Eloisa Mata, Pension Review Board  
David Riggs, Texas State Association of Fire Fighters  
Neil Patel, Fin-News.com

Mr. Parrish called the meeting to order and the meeting was reconvened at 9:00 a.m.

Mr. Gavia gave an update on the search process for an Internal Audit Director. After interviewing candidates for the position of Internal Auditor, the Board has determined a need for further information. Mr. Landis moved that Jim Parrish be authorized to discuss those information issues with candidates and to report back to the Board at the March meeting for the purpose of enabling the Board to take action in open session on the appointment of an Internal Auditor. Mr. Jeffers seconded the motion, which passed 6-0.

**5. Consider and Act on Adoption of Minutes from the December 3-4, 2015 Meeting of the Board of Trustees (formerly #4 on the Thursday, February 18, 2016 agenda)**

Mr. Gavia stated that Staff had nothing to add to the minutes as presented. There were no changes suggested by the Board.

Mr. Philibert made a motion that the Board adopt the minutes from the December 3-4, 2015 Meeting of the Board of Trustees. Mr. Landis seconded the motion, which passed 6-0.

**6. Consider and Act on Amendment to the Actuarial Funding Policy (formerly #5 on the Thursday, February 18, 2016 agenda)**

Ms. Hardy presented changes to the actuarial funding policy. With the implementation of the new Governmental Accounting Standards Board (GASB) Statement Nos. 67 and 68, a written funding policy, consolidated into a single document, became even more important as actual funding patterns and funding policy disclosures were required. Ms. Hardy discussed the red-line document noting the change recommended by GRS to the smoothing policy. Also discussed were the three changes to the amortization period policy. The changes include new loss periods not greater than 25 years, ad hoc adoptions will be amortized over the shorter of 15 years or remaining working life of the group and the third is consolidation of smaller changes. All of these changes are a result of actions previously adopted by the Board.

Mr. Philibert moved that the Board adopt the Actuarial Funding Policy effective December 31, 2015. Mr. Jeffers seconded the motion, which passed 6-0.

7. **Consider and Act on Ratifications of Ordinances Adopting Updated Service Credit and/or Annuity Increases (formerly #6 on the Thursday, February 18, 2016 agenda)**

Mr. Gavia noted the Board previously approved the Updated Service Credit and/or Annuity Increase ordinances at the December 2015 Board meeting that were received before the Board meeting. This action ratifies the ordinances received after the December 2015 Board meeting. These ordinances met all the requirements of the TMRS Act.

Mr. Philibert moved that the Board ratify those ordinances adopting Updated Service Credit and/or Annuity Increases that were not included on the listing presented at the December 4, 2015 Board meeting. Mr. Landis seconded the motion, which passed 6-0.

8. **Review Advisory Committee Strategic Plan Initiative**

Ms. McDuffee from Aon Hewitt Investments and Mr. Wattles began this discussion on the structure and function of the Advisory Committee. Mr. Wattles reviewed the history of the Advisory Committee which began in 1994. Composition of the Advisory Committee has changed four times and terms limits have also changed four times since inception. He walked the Board through various changes made regarding composition and term limits. Mr. Wattles highlighted the important outcomes that have been achieved from the Advisory Committee including vetting and support of two critical pieces of TMRS legislation, HB 360 and SB 350.

Ms. McDuffee discussed the research efforts regarding the Advisory Committee. Mr. Wattles noted that other statewide systems in Texas do not have a committee similar to the Advisory Committee. They have committees, but none that use volunteers in a similar context. The larger local plans in Texas do not have similar committees. Ms. McDuffee noted out of a universe of twenty plans nationally that are similar in size and purpose to TMRS, that only four plans had a similar committee. She surveyed these plans and presented the results of this survey regarding structure and functions of these other committees. The function of the other committees is to provide additional input to the Systems' Boards.

Mr. Wattles reviewed the Advisory Committee survey of members and former members. He highlighted members' experiences on the Committee, discussions about the length of meetings and the Committee members' communications to constituents. Mr. Wattles reviewed the survey comments regarding strengths, weaknesses, suggestions for improvement and other comments. Mr. McDuffee suggested making a survey of the Advisory Committee a regular occurrence.

Ms. McDuffee discussed the key themes from her trustee interviews regarding the Advisory Committee. The themes included the ability to inform the Board and gain input on topics, the purpose of the Committee having drifted over time, the composition needing to be reevaluated, and that the Board was unanimous on term length, but mixed on the issue of term limits.

Ms. McDuffee moved to questions for consideration from the Board. Mr. Philibert noted that the charter was broad and the composition should be reviewed. Mr. Rodriguez discussed "charges" similar to legislative committee charges. A process is needed to determine the



charges which may include Advisory Committee input. Mr. Landis suggested that the Committee have a manageable size, but with Board flexibility. Ms. Oakley suggested flexibility to possibly have a larger group during the interim and smaller during the legislative year. She also noted that term limits were acceptable, but she does not want to “hamstring” the Board. Group members should have statewide constituencies. With regard to committee outcomes, Ms. McDuffee asked what the Board is looking for, pros and cons or consensus. Mr. Jeffers suggested creating a committee of the Board to take a deep look at the use of all of the committees.

Ms. McDuffee reviewed the answers she heard during the discussion. First, a process should be created to focus on the direction of the Committee. Second, the purpose of the Advisory Committee is to provide input to the Board, both pros and cons. Third, the current size of the Advisory Committee is too large and should be limited, but still allow for Board input. And fourth, the composition will be further reviewed with recommendations brought back to the Board. The Chair and Vice Chair of the Advisory Committee should be selected by the Chair of the Board of Trustees. And finally, there should be term lengths and limits with Board discretion.

Mr. Parrish requested input from the audience. George Kaufman, City of Garland representative, commented on term lengths. He indicated that the length of the term should be four years instead of three to coincide with the legislative process. David Riggs, Texas State Firefighters representative, suggested the use of ad hoc committees.

**9. Chief Investment Officer Management Update, Including Governance, Personnel, Manager Updates and Other Investment Related News or Matters**

Mr. Carlson introduced the newest member of the Investment team, Rachel Cleak, Investment Analyst for Alternatives. He reported that the Investment team took 263 manager meetings during the last quarter and completed two investment manager transitions. He reported that the SEC review of Wellington was completed with no action taken.

**10. RVK Quarterly Investment Report**

Ms. Beard reviewed performance for the quarter ending December 2015. The calendar year 2015 was a tough year globally with a tremendous amount of volatility. She noted the volatility in both market performance and economic indicators. In general, the best performance in 2015 was in core real estate while commodities have performed the worst. The TMRS portfolio had a year-to-date gross return of 0.34%. Ms. Beard discussed the portfolio over weights and under weights and noted great headway has been made toward diversification.

Ms. Beard reviewed asset allocation vs. peers and discussed the five key areas of allocation: Equity, Fixed Income, Real Estate, Alternatives and Unallocated Cash. TMRS’ Total Fund Composite returned 5.63% over the trailing five-year period ending December 31, 2015, lagging the Policy Index of 5.95%, but at the seven year period, the Policy Index was exceeded. Other performance measurements and comparisons were discussed. Ms. Beard reviewed the risk/return characteristics of the portfolio noting that TMRS has seen a lot less

volatility than its peers. She discussed asset class composite performance highlighting domestic and international equity.

Mr. Parrish asked about the impact of “negative interest rates.” Mr. Carlson answered that we get charged only if we hold cash in the negative rate markets, however we hold very little cash in the markets that have negative rates.

#### **11. Education: Asset Liability Study Presentation**

Ms. Beard and Mr. Carlson reported that an asset-liability study will occur later this year as it currently does every five years. Each year, TMRS does an asset allocation review and a “deep dive” review occurs every three years. Mr. Carlson made a recommendation to change the timing of this study to every sixth year in order to coincide with the deep dive Asset Allocation Study.

Ms. Beard began with an introduction of what an Asset Liability Study is (and is not), and why it is performed. It is a tool used to examine how well alternative investment strategies address the objectives served by the fund. Asset-liability studies also are a “guide post” for the target asset allocation and a gold standard for assessing the health of a pension plan. Asset-liability studies are not an actuarial study, a prescription for plan benefits, an assessment of the affordability of contribution levels, an implementation plan for specific asset classes, a sole determinant of the final asset allocation adopted by a fund, or a determinant of the target rate of investment return.

The objective is to present projected valuation results of the Plan with respect to the funded status of the Plan, to present projected benefit payments of the Plan, to estimate liquidity demands on the Plan’s assets and to investigate asset allocation mixes to determine those which best serve to protect or increase funding levels while providing adequate liquidity for benefit payments and minimizing associated risks.

Ms. Beard described how the study is conducted and noted that both deterministic and stochastic forecasting will be used. Ms. Beard reviewed the proposed project timeline for the asset-liability study.

#### **12. Executive Director Update**

Mr. Gavia introduced Debbie Munoz, Director of Member Services, to give an overview of the Member Services Department. Ms. Munoz discussed the Member Services management team as well as its structure. She outlined the call center, the membership team, the retirement team and the support services team. Ms. Munoz provided the Board with many of the work metrics used within the Department to measure performance.

#### **13. Discuss Dedication of TMRS Board Room in Honor of H. Frank Simpson**

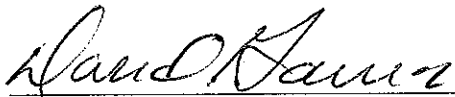
Mr. Gavia reviewed Mr. Simpson’s service as a Trustee and highlighted his service during a critical period in TMRS’ history. He asked the Board for their input regarding the formal dedication ceremony. Mr. Rodriguez suggested having the room dedication in May and any other dedication as a separate event. Ms. Oakley suggested a reception with Texas Aggie

themed accoutrements. The Board asked Mr. Gavia to reach out to Mrs. Simpson to determine her and the family's availability to attend.

**14. Call for Future Agenda Item**

Mr. Parrish would like further discussion on the use of committees of the Board.

Mr. Philibert made a motion to adjourn the meeting. Mr. Rodriguez seconded, which passed 6-0. The meeting was adjourned at 12:05 p.m.



David Gavia  
Executive Director



Jim Parrish  
Chair, Board of Trustees