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

March 28, 2019 – 1:00 p.m.

On March 28, 2019, 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 in Austin, Texas, with the following members present:

Board of Trustees
Bill Philibert, Chair
David Landis, Vice Chair
Jim Parrish
Julie Oakley
Jesus Garza

Absent: Jim Jeffers

Present also were:

David Gavia, Executive Director
Eric Davis, Deputy Executive Director
TJ Carlson, Chief Investment Officer
Christine Sweeney, General Counsel
Bill Wallace, Director of Communications
Dan Wattles, Director of Governmental Relations
Debbie Munoz, Director of Member Services
Scott Willrich, Director of Information Resources
Rhonda Covarrubias, Director of Finance
Jesse Pittman, Senior Project Manager
Sandra Vice, Director of Internal Audit
Leslie Ritter, Director of Human Resources
Kristin Qualls, Director of Public Equity
Chris Schelling, Director of Private Equity
Tom Masthay, Director of Real Assets
Marc Leavitt, Director of Absolute Return Strategies
Jason Weiner, Director of Fixed Income
Dimitry Shishkoff, Director of Risk Management
Karen Jackson, Executive Assistant
Stacy White, Executive Assistant
Robert Klausner, Klausner, Kaufman, Jensen & Levinson
Marcia Beard, RVK
Amy McDuffee, Mosaic Governance Advisors
Ron Lewis, Ron Lewis and Associates
Jason Ostroski, CLA
Mark Randall, Gabriel, Roeder, Smith & Company

Joe Newton, Gabriel, Roeder, Smith & Company
Janie Shaw, Gabriel, Roeder, Smith & Company

Also in attendance:

Eric Obermier, Assistant Director of Information Resources
Madison Jechow, Assistant General Counsel
Michelle Mellon-Werch, Assistant General Counsel
David Rodriquez, Senior Regional Manager – City Services
Sean Thompson, Regional Manager – City Services
Melanie Thomas, Process and Content Management Specialist
Donna Neal, Senior Technology Design Specialist
Eddie Schultz, Assistant Director of Real Assets
Cindy Morse, Investment Support Analyst
Debbie Farahmandi, Investment Operations Specialist
Nick O'Keefe, Lead Investment Attorney
Susan Jacques, Investment Performance Analyst
Geldon Vllahu, Investment Operations Analyst
Melissa Jerkins, Quantitative Analyst II
Ryan Conner, Risk Management Analyst
Kurt Cressotti, Compliance Officer
German Gaymer, Fixed Income Analyst
Jacob Bowland, Fixed Income Analyst
Kevin Notaro, Absolute Return Analyst
Peter Teneriello, Private Equity Analyst
Yvonne Huang, Real Assets Analyst
Peter Jeske, Business Process Analyst
Paula Nguyen, Investment Accountant
Natalie Garza, Communications Analyst
Kenneth Oliver, Actuarial Analyst
Pete Krnavek, Information Systems Manager
George Kauffman, City of Garland Retiree
David Riggs, Texas State Association of Fire Fighters
Greg Shipley, Combined Law Enforcement Associations of Texas
Casey Srader, Government Finance Officers Association of Texas
Scott Leeton, Combined Law Enforcement Associations of Texas

Mr. Philibert called the meeting to order at 1:00 p.m. and Mr. Landis gave the invocation.

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

   Mr. Gavia stated that Staff had nothing to add to the minutes as presented.

   Mr. Parrish moved that the Board adopt the consent agenda as presented. Mr. Landis seconded the motion, which passed 4-0. (Ms. Oakley arrived after the vote at 1:07 p.m.)

2. <u>Consider and Act on 2018 Interest Credit Allocation to the TMRS Benefit Accumulation Fund and Interest Reserve Account</u>

Mr. Newton and Mr. Randall from Gabriel, Roeder, Smith & Company (GRS) and Ms. Hardy presented the interest credit allocation to the TMRS Benefit Accumulation Fund (BAF) and Interest Reserve Account. Ms. Hardy gave a brief overview of the annual procedures completed by the Investment, Finance, and Actuarial Services departments as well as GRS with regard to crediting interest. After TMRS Fund Restructuring, beginning in calendar year 2011, the Board elected to credit the Benefit Accumulation Fund (BAF) with the interest rate which represented the estimated investment income for the year remaining after adjustments for the statutory interest credit requirements and budget transfers, while maintaining an initial $100 million balance in the Interest Reserve Account. Subsequently, in 2013, estimated fourth quarter private investment fund valuation adjustments were included in the allocated investment income. In 2017, the Board elected to increase the initial Interest Reserve Account balance from $100 million to $290 million. Maintaining an initial $290 million Interest Reserve Account balance in 2018 allows for an approximate 12% negative adjustment in the actual versus estimated private investments.

(Ms. Oakley joined the meeting at this time)

After adjusting for the statutory interest credits and the 2018 budget transfer as well as maintaining an initial $290 million balance in the Interest Reserve Account, for the year ending December 31, 2018, the estimated net investment income eligible for distribution to the BAF is negative $871.3 million. This represents a -3.08% interest credit to the January 1, 2018 BAF balance for each city. On an actuarial basis, this produces a smoothed return of 6.06% for 2018 due to the partial recognition of deferred losses.

Mr. Randall noted that the asset smoothing method and amortization policy provides substantial dampening in year to year contribution rate volatility, associated with investment performance from any one year. The historical BAF Interest Credits were reviewed as well as the historical Market versus Actuarial Value of Assets.

The current smoothing and amortization policy was highlighted. Each year, the difference between the actual and expected interest credits at 6.75% is smoothed over a 10 year period to determine the amount of gain or loss to recognize in that year's valuation. The recognized gain or loss is then amortized over a new amortization base as an actuarial gain or loss. In general, new losses are amortized over a closed twenty-five year period while gains are amortized over the period for the largest loss base. A -3.08% BAF interest credit generates $2,726.3 million in actuarial losses for 2018 which first offsets the $835.8 million in deferred gains remaining as of December 31, 2017. Of the remaining $1,890.5 million in losses, $189.0 million (10%) will be recognized in 2018 with the remaining $1,701.5 million (90%) to be reflected in future valuations. Employer contribution rates will increase on average (will vary by individual city) by 0.18% due to investment performance.

GRS' recommendation, in which staff concurs, is to credit approximately -3.08%, which represents the investment income remaining after all administrative and investment expenses have been paid and the statutory requirements have been fulfilled, includes any estimated fourth quarter private investment fund valuation adjustments provided to TMRS by March 13, 2019 and maintains the $290 million Interest Reserve Account balance as of December 31, 2018.

Mr. Parrish moved that the Board allocate, effective as of December 31, 2018, (i) a credit of 5% interest to each of the Supplemental Disability Benefits Fund and the Supplemental Death Benefits Fund, and (ii) a credit of approximately -3.08% interest to the Benefit Accumulation Fund, which represents the estimated net investment income/(loss) remaining after all administrative and investment expenses have been paid and the statutory interest credit requirements have been fulfilled; includes any estimated fourth quarter private investment fund valuation adjustments provided to TMRS by March 13, 2019; and maintains an Interest Reserve Account balance of $290 million. Mr. Parrish further moved that the Board approve that any differences in the final versus estimated fourth quarter private investment fund valuation adjustments, as well as any adjustments that may be necessary to finalize net investment income for the year, be reflected in the final Interest Reserve Account balance as of December 31, 2018 and considered in the 2019 BAF interest credit determination. Mr. Landis seconded the motion, which passed 5-0.

3. <u>TMRS Trustee Education: Actuarial Standards of Practice (ASOP) Update</u>

Mr. Newton and Ms. Janie Shaw made this presentation on Actuarial Standards of Practice (ASOP). Mr. Newton discussed the function of the ASOPs, how they are created and applied, and then interpreted by the actuarial community, GRS and GRS/TMRS.

Ms. Shaw began the discussion with the new Exposure Draft for ASOP 4 which deals with measuring pension obligations and determining pension contributions. The focus is a strong position against negative amortization. She explained the potential new disclosure of Investment Risk Defeasement Measure (IRDM), which is using a "risk free" rate to value liabilities based on the Unit Credit Funding method. Ms. Oakley asked why this is being done. Mr. Newton answered that since this value is being calculated by others, having your actuary calculate this will give you a point of comparison.

Ms. Shaw next moved to ASOP 27 which deals with the economic assumptions. The assumptions need to be realistic when taken together and have no significant bias. It takes into account historical and current economic data that is relevant as of the measurement date, including an expectation of the future. It reflects the actuary's professional judgment. Mr. Newton discussed how the reasonable range of an assumption is determined and he noted "a reasonable range for the assumed rate of return is between the median and mean return".

ASOP 35, regarding demographic assumptions, should reflect the effect of mortality improvement, both before and after the measurement date. Mr. Newton stated that he prefers small frequent changes to the tables. TMRS has plenty of mortality data to use in this regard, so there is no need to move to recently published national tables. Using our own data matches our experience and is updated every four years. He does not see a lot of changes in this area.

Ms. Shaw discussed smoothing the contribution rate (output) versus phasing in an assumption change (input) because the assumption used at each measurement date has to be reasonable.

Asset Valuation Methods, ASOP 44, was reviewed and it was noted that TMRS in compliance.

New ASOP 51 was discussed regarding assessing and disclosing pension risk. The actuary should identify risks that, in the actuary's professional judgment, may reasonably be anticipated to significantly affect the plan's future financial condition. Most of the methods discussed in this ASOP are already in use for TMRS so no major changes are expected; however, there will likely be more detailed disclosure of risks associated with the plan.

Mr. Newton discussed how these ASOPs will be used for TMRS going forward. Most assumptions have been trending close to actual experience. Mortality will need to be updated through 2018. Capital Market expectations remain low and peer systems continue to decrease investment return and payroll growth assumptions. The one area that will likely need to change is the funding policy as it relates to either amortization period or asset smoothing period; one of these may need to decrease by 5 years.

Mr. Newton concluded with the schedule for delivery regarding the valuation report in May, preliminary experience study results in June/August, Asset/Liability study in September, and final decisions on new assumptions and asset allocations in October. It is very unlikely that there is a need for large, immediate change. Focus should be on policies, strategies, and methods to continue to improve the sustainability of the System and remain in industry best practices.

4. **<u>Legislative Update and Overview of the 86th Legislative Session, Including Discussion on Status of TMRS Legislation (SB 1337 and HB 2821) and Other Filed and Proposed Legislation, Pension-Related Seminars TMRS Legislative Committee Briefings and Filed Federal Legislation</u>**

Mr. Wattles and Mr. Lewis presented an update of the 86th Legislative Session. Mr. Wattles indicated that there are only sixty days left in the session. The deadline for filing legislation, not including local and emergency bills, was March 8, 2019. The next legislative procedural deadline is May 6, 2019, which is the last day for House Committees to report out House bills. The session officially ends at midnight on Monday, May 27, 2019.

A total of 7,494 bills and resolutions were filed as of the 60-day deadline, which is considerably higher than the 6,804 bills filed during the 85th Regular Session. This includes 4,923 House bills and 2,571 Senate bills. Of the total number of bills, we are tracking 321 bills and resolutions. For reference, this is 57 fewer bills than we tracked last session at this time in the session.

The TMRS Bill (SB 1337 and HB 2821) is moving through the process. Staff provided input for a committee substitute due to the need for a number of technical corrections to the bill text prepared by the Legislative Council office. The Senate version of the bill, SB 1337 has passed out of the Senate State Affairs Committee. Mr. Lewis stated that this progress is indicative of how adequate preparation and having a good reputation help move the bill along. Another factor is having stellar bill sponsors, which we have this session. The Senate Committee also recommended the bill be placed on the local and uncontested calendar, which will further help expedite passage of the bill.

There are other bills that were filed that could affect passage of our bill. HB 2396 (Representative Lozano) is a return-to-work bill. HB 4587 (Representative Smithee) would create a fixed-rate, non-retroactive cost-of-living adjustment (COLA) bill. HB 1170 (Representative Anchia) would prohibit the four statewide systems from investing in firearms and ammunition. SB 680 (Senator Fallon) would cap prospectively the maximum amount of a retirement benefit. SB 322 (Senator Huffman) would impose requirements on investment reporting. HB 1887 (Representative Murphy) is similar. SB 2224 (Senator Huffman) would require public pensions to have a written funding policy, which TMRS already has.

The House Pensions, Investments & Financial Services Committee (PIFS) has thus far held five hearings since the organizational hearing on February 13, 2019. The PIFS Committee holds regular meetings every Thursday. The PIFS Committee has indicated that HB 2821, the TMRS bill, is likely to be heard at a hearing on April 4, 2019.

5. Receive an Internal Audit Committee Update

Ms. Vice and Ms. Focht-Williams presented the highlights from the March 28, 2019 Internal Audit Committee meeting. Ms. Focht-Williams discussed the results of the Investment Operations Audit. There were two objectives: 1) follow-up on the implementation of 12 investment operating model recommendations provided by a previous consultant, Beacon Consulting, and 2) assess the internal control structure of the current Investment Operations function. Eleven of the twelve recommendations were implemented or addressed, and one was partially implemented. The partially implemented recommendation was in regards to data management across departments, and Internal Audit will continue to follow-up with the Legal Department on its implementation. Additionally, testing of the Investment Operations Department resulted in no exceptions, and Internal Audit concluded that the Investment Operations department developed procedures and implemented controls that were working effectively.

Ms. Vice notified the Board that Securance Consulting had completed its confidential annual IT security assessment in December 2018. Ms. Vice stated that the Internal Audit Charter has been reviewed and she proposed changes to the charter for the Audit Committee's consideration. These changes, which will be brought to the Board for their consideration, are intended to align the Charter with revised internal auditing standards. Also Ms. Vice presented the Internal Audit customer service results from the 2018 Engagement Survey.

6. Receive Risk Assessment and Consider and Act on TMRS Audit Plan

Ms. Vice presented the results of the *2019 Risk Assessment* and proposed *Audit Plan for 2019 to 2020.* Ms. Vice presented the risk assessment and the audit plan to the Internal Audit Committee on March 28, 2019. Mr. Jeffers, Committee Chair, and Mr. Landis, Committee

Vice-chair, reviewed the proposed audit plan and suggested no changes. The connection from the Strategic Plan to the Risk Assessment to the Audit Plan was also discussed.

Mr. Landis moved that the Board approve the proposed *Audit Plan for 2019 to 2020.* Ms. Oakley and Mr. Garza seconded the motion, which passed 5-0.

7. **Consider and Act on Private Equity Manager Search Recommendation(s)**
Mr. Carlson stated this is a re-up with an existing manager. Mr. Schelling and Mr. Teneriello presented the Private Equity manager recommendation. Mr. Teneriello reviewed the due diligence process and stated that with this $50 million recommendation, Private Equity will have utilized approximately 60% of the 2019 pacing plan on a committed basis.

The manager selection portfolio considerations were discussed and Mr. Teneriello noted the deeper "J" curve when it comes to growth/venture funds. Private equity manager diversification by commitment was reviewed, as well as the measured approach to global geographic diversification.

Searchlight III is a $50 million commitment to a value-added buy-out oriented strategy. The firm targets complex transactions in middle market companies that can be acquired at below-market purchase prices outside of auction channels or competitive processes. Mr. Schelling discussed the items to consider, including past performance as well as fund size and issues to watch. Searchlight III has a very experienced and cohesive team and has a unique and flexible investment strategy within their sectors of focus.

Mr. Parrish moved that the Board approve the following allocation(s):

(i) Authorize the following allocation(s), each as proposed and in accordance with the TMRS Investment Policy Statement, with an initial investment allocation up to the amount set out below and at fees no greater than presented in the Summary of Recommendations chart in the TMRS Staff memo, each individually contingent on favorable background checks, if required below, and successful negotiation of the investment agreements:

Name of Investment Manager, Investment Fund, or Fund Strategy	Asset Class Strategy	Initial Investment Allocation	Background Check Required (Yes or No)
Searchlight Capital III, L.P.	Buy-Out	$50 million	Yes

(ii) Approve and incorporate by reference for all purposes the Board Standard Investment Authorizations for each such investment allocation.

Mr. Landis seconded the motion; which passed 5-0.

8. **Review and Discussion of External Audit Plan for the Year Ended 2018 (SAS-114) and Service Organizational Control**
Mr. Ostroski (Engagement Principal with CLA) presented the review and discussion of the 2018 External Audit Plan for External Financial Statements and System and Organizational Controls (SOC) Audits.

The Engagement Team was highlighted, noting the key team members for the Financial Audit and the SOC-1 Audit. Mr. Ostroski discussed the scope of the engagement which includes: 1) audit of the financial statements as of December 31, 2018, 2) audit of the Schedule of Changes in Fiduciary Net Position by Participating Municipality (GASB 68), 3) audit and report of TMRS' pension management system controls (SOC-1 Type 2), and 4) any written communications with the Board.

Mr. Ostroski next reviewed the required governance communications and the Auditor's responsibility to perform the audit in accordance with generally accepted auditing standards. Management's responsibilities to prepare and fairly present the financial statements were also discussed.

The activities regarding the SOC Audit were reviewed. Mr. Ostroski highlighted the audit timeline, reviewed planning and control objectives, and the opinion of the operating effectiveness of these controls.

The work plan for the financial statement audit was discussed. Mr. Ostroski noted that the audit will be conducted in accordance with standards generally accepted in the U.S. (U.S. GAAS), using a phased approach. The planning phase was discussed and it includes preliminary analytical procedures, establishing materiality, fraud procedures, and risk assessment procedures. The objective is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and relevant assertion levels. Risk assessment drives audit procedures. He reviewed significant processes and audit areas: investment and investment income, as well as contributions/member testing and benefit payments.

Information technology general controls were reviewed and Mr. Ostroski noted that the procedures performed during the SOC testing can also be utilized in the financial statement audit. He discussed CLA's use of data analytics in the contributions and distributions areas and how it will be reviewed with management.

The key milestones of the financial statement audit timeline were reviewed. Mr. Ostroski concluded by asking the Board if there were any issues to be discussed and the Board indicated that there were no issues to discuss at this time.

9. **Update on Pension Administration System Assessment**
Mr. Pittman, Ms. Muñoz and Mr. Willrich presented an update for the Pension Administration System Assessment (PASA). Ms. Muñoz reviewed the milestones to date, from the Request for Proposal (RFP) through the kickoff meeting. Ms. Muñoz reviewed the deliverables which were included in the contract for this assessment.

The budget for this project was discussed and it was noted the cost estimates are conservative based on a similar effort completed by other public pension systems. The selected vendor's (LRWL) best and final offer does exceed the budgeted amount, but staff believes that this shortfall can be addressed via budget adjustments from other on-going projects.

Mr. Parrish thanked staff and he thought staff did an excellent job in sourcing this project. He asked for information regarding LRWL's activities with other clients. The budget adjustments used to cover the PASA shortfall were also discussed. No projects will be foregone to meet this shortfall.

10. **Executive Director Update: Overview of Investment Expense Disclosures in the TMRS Comprehensive Annual Financial Report *(formerly #15 on Friday, March 29, 2019 agenda)***

Ms. Covarrubias and Ms. Nolte presented an overview of the Investment expense disclosures in the TMRS Comprehensive Annual Financial Report (CAFR). During the February, 2019 Board meeting, Mr. Parrish noted that, per the Comptroller's website, TMRS was reflecting much higher investment fees than the other statewide systems.

Ms. Covarrubias discussed additional details regarding the TMRS expense information shown on the Comptroller's website. The Comptroller's website information, as presented, was obtained directly from the financial statements that are contained in TMRS' 2017 Comprehensive Annual Financial Report (CAFR). However, that website information does not include the additional investment expense details from the Investment section of the CAFR. TMRS follows the Governmental Auditing, Accounting, and Financial Reporting (GAAFR), also known as the "blue book", with regard to reporting which requires total investment expenses (line item in the income statement) to include: 1) investment management fees, 2) custodial fees, and 3) other significant investment related costs. All investment fees are in the CAFR, however the financial statement reporting may be different for various Systems, regarding treatment for 1) fees paid from trust and 2) fees netted from returns.

Current issues in this area include: 1) no consistency in interpretation on how to report "fees netted from returns", 2) inability to compare operating efficiency from system to system, and 3) inconsistent investment manager reporting. Ms. Covarrubias provided examples of how these fees are reported. She also provided an example of how TMRS' investment expenses would be lower had TMRS reported investment expenses similar (methodology) to other statewide systems. It was noted that the Comptroller's website does not include the relevant information from the investment section of the CAFR, to draw a complete picture of investment-related expenses.

For 2018, TMRS is no longer reporting fees netted from returns as a separate investment expense, but the data will continue to be disclosed in the investment section of the CAFR. TMRS will continue to analyze and monitor Texas statewide retirement systems' CAFRs to understand their reporting, and discuss the issue with our auditors and other public pension plans.

11. **Executive Session** ***(formerly #10 on the Thursday, March 28, 2019 agenda)***
At 4:36 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. The meeting was opened to the public again at 5:56 p.m. and all members of the Board that were present before the Executive Session were still present.

At 5:57 p.m. the meeting was recessed until 8:30 a.m. on Friday, March 29, 2019.

David Gavia
Executive Director

Bill Philibert
Chair, Board of Trustees

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

March 29, 2019 - 8:30 a.m.

On March 29, 2019, the Board of Trustees of the Texas Municipal Retirement System (TMRS) reconvened 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
Bill Philibert, Chair
David Landis, Vice Chair
Jim Parrish
Julie Oakley
Jesus Garza

Absent: Jim Jeffers

Present also were:

David Gavia, Executive Director
Eric Davis, Deputy Executive Director
TJ Carlson, Chief Investment Officer
Christine Sweeney, General Counsel
Bill Wallace, Director of Communications
Dan Wattles, Director of Governmental Relations
Debbie Munoz, Director of Member Services
Scott Willrich, Director of Information Resources
Rhonda Covarrubias, Director of Finance
Jesse Pittman, Senior Project Manager
Leslie Ritter, Director of Human Resources
Kristin Qualls, Director of Public Equity
Dimitry Shishkoff, Director of Risk Management
Karen Jackson, Executive Assistant
Stacy White, Executive Assistant
Robert Klausner, Klausner, Kaufman, Jensen & Levinson
Marcia Beard, RVK
Amy McDuffee, Mosaic Governance Advisors

Also in attendance:

Eric Obermier, Assistant Director of Information Resources
Michelle Mellon-Werch, Assistant General Counsel
Nick O'Keefe, Lead Investment Attorney
Andi Focht-Williams, Senior Internal Auditor
Peter Jeske, Business Process Analyst
Cindy Morse, Investment Support Analyst

Debbie Farahmandi, Investment Operations Specialist
Kurt Cressotti, Compliance Officer
Melissa Jerkins, Quantitative Analyst II
Ryan Conner, Risk Management Analyst
Kevin Notaro, Absolute Return Analyst
Jacob Bowland, Fixed Income Analyst
Bob Scott, City of Carrollton
Casey Srader, Government Finance Officers Association of Texas
Greg Shipley, Combined Law Enforcement Associations of Texas
David Riggs, Texas State Association of Fire Fighters
Devon Waters, City of Arlington

Mr. Philibert called the meeting to order and the meeting was reconvened at 8:30 a.m.

12. **TMRS Trustee Training: Board Governance Discussion, including Discussion of Investment Beliefs, Future Governance Agendas and Meeting Dates *(formerly #11 on the Friday, March 29, 2019 Agenda)***

Ms. McDuffee and Ms. Beard presented this topic. Ms. McDuffee began by discussing the timeline and suggested agenda topics for a proposed July 2019 Governance Workshop (Workshop). Ms. McDuffee indicated that the Workshop is an opportunity to provide direction on what individual topics ought to be prepared and brought to the Board so that they can get informed/educated and make decisions. There will be several hours of training prior of the Workshop in July which may include developing or gathering documents in advance of the meeting. Ms. McDuffee discussed a suggested approach to the Board and indicated it could include an external speaker to discuss how governance works in larger plans, and/or a panel of investment consultants. As the Board and its needs change over time, this process will be on going. Continued engagement and commitment by the Board is critical to stay on track.

Mr. Garza stated he felt the Board needs to spend more time as a group to enhance cohesion prior to the July Workshop. Mr. Landis agreed and indicated he would like an informal meeting which would include the Board, the Executive Director and the Governance Consultant. Mr. Garza explained he would also prefer the meeting to be less formal and to also have less structure. He felt having less structure would enable the ability to learn more about each Board member. The concept of team building and self-evaluation can be difficult for a public body like the Board. However, Ms. McDuffee indicated she would work with the Executive Director and General Counsel to assist with scheduling a meeting prior to the May Board meeting. The Board was supportive of this concept.

Today's discussion will include both topics on governance and the development of investment beliefs. Ms. McDuffee worked through the goals for the meetings leading up to the July Workshop. The anticipated outcomes were discussed relating to 1) governance structure and responsibilities review, 2) Investment Beliefs, and 3) governance documents review. Mr. Garza asked if there was a way to tie this into the Strategic Plan in a formal, visible manner. He requested discussion of professional development and direction on how the Board could/should represent TMRS at events. Mr. Garza also inquired about the possibility of having a staff member dedicated to serve as a Board liaison. There was discussion regarding succession planning in the organization and potential Board member development.

Ms. Beard began the discussion on Investment Beliefs. Investment Beliefs articulate fundamental views on institutional investing and provide a foundation to the Board to guide investment-related decisions. The Board's Investment Beliefs should be collective, not individual. A review of the history of TMRS' investment policy was discussed and how it has evolved over time. Ms. Beard and staff will provide guidance and analysis to the Board. The Board will be tasked with implementing these beliefs. Ms. Oakley and Mr. Garza stated that currently there is not a comfort level between the Board and the consultants. There needs to be a development of the relationships between the Board and consultants.

Investment Beliefs help define how TMRS will create investment value in an environment of uncertainty, risk and opportunity. The Investment Beliefs should include three essential elements: 1) clear view of capital markets, 2) a competent organization, and 3) a view on societal issues that affect investments. The Board, Executive Director and Investment Staff are key to translating investment beliefs into investment practice. It is critical that these stakeholders are closely involved in the process of developing these beliefs. By agreeing upon and codifying Investment Beliefs, TMRS will be able to set a foundation for its decision making as well as encourage cultural alignment.

The history of TMRS' investment philosophy was reviewed. Ms. Beard presented several sample beliefs from other organizations and how they relate to capital markets, organization structure, views on ESG, and other topics.

Ms. Beard suggested surveying the Board, Executive Director and key investment staff. The responses to the survey will be summarized to help identify where there is consensus and where there is not, and the results discussed at a subsequent Board meeting. Differences in beliefs provide a great opportunity to discuss and to ultimately agree to a set of eight to twelve beliefs. Once the Investment Beliefs are developed, the Board can determine where TMRS stands in relation to these beliefs. Ms. Beard would like to start the process after the March Board meeting

Ms. McDuffee noted that TMRS' vision is to be the model for pension plans. This can be accomplished with discussing our Governance policies and developing our Investment Beliefs.

13. <u>Employee Engagement Plan Update</u> <u>*(formerly #12 on the Friday, March 29, 2019 Agenda)*</u>

Ms. Ritter and Ms. Judy England-Joseph from CPS HR Consulting presented the results from the latest Engagement Survey. Ms. Ritter highlighted the background on the engagement and internal customer service survey. She discussed the actions taken throughout the fifteen months and listed the items approved by the Executive Director and the Board of Trustees. The process used for the second engagement and internal customer survey was reviewed.

Goal 4 of TMRS' current Strategic Plan calls for TMRS to transform the culture to one of innovation, collaboration, and open communication, and specifically in Objective 3 of Goal 4 to elevate employee engagement levels.

In October, 2018, CPS HR Consulting conducted our second engagement and internal customer service survey. Ms. England-Joseph explained that since there are only have two sets of data, there is no real trend data and some items went up and some went down. The engagement survey covered eight sections: Mission, Team, Work, Resources, Supervisor, Training, Leadership, and Pay and Benefits. Ms. England-Joseph discussed the six engagement statements and the scale respondents used to respond. She explained the responses were calculated using a mean engagement score for each employee. It was noted that the percentage of fully-engaged employees is down six percentage points from 2017. She reviewed the drivers of engagement and focused on the areas to improve. The three key areas of improvement were: 1) leadership and managing change, 2) pay and benefits, and 3) culture. She noted activities within these three areas where the organization is doing well and should work to maintain.

Ms. England-Joseph reviewed the highest scoring questions and she noted that some of TMRS' responses are "off-the-chart" high and should be celebrated. The lowest scoring questions were also discussed and these are the areas where efforts should be taken to help improve engagement. These are the areas where staff is saying to the organization that it should pay attention. The most improved questions suggest that the actions taken after the last survey have made a difference. The most decreased questions were reviewed and again these are areas where respondents are requesting that there needs to be improvement.

There was no real change in the intent to leave or stay. There are things people are unhappy with, but they are still committed to their job.

Since there are only two data points, this is not trend data. Ms. England-Joseph indicated that this is a long term journey that should result in long term improvement.

Mr. Garza asked about millennial engagement and the drop in engagement with employees in the eleven to fifteen year employment period. Ms. England-Joseph discussed those results and she noted that changes in the on-boarding process could help improve this area. Departments should take the survey data and discuss what can be done at that level to help improve engagement. The focus group or Engagement Taskforce can be beneficial to address the latest survey results and formalize any action-items and recommendations deemed necessary. Any new recommendations for consideration should be shared with the entire organization.

14. <u>Public Equity Annual Asset Class Review</u> <u>*(formerly #13 on the Friday, March 29, 2019 Agenda)*</u>

Ms. Qualls presented the annual asset class review for Public Equity. She noted she is currently conducting interviews to fill the vacant analyst position.

There are nine managers managing fourteen strategies. Managers are reviewed on both quantitative and qualitative factors. Ten strategies are rated excellent, two strategies are rated in good standing and two strategies are rated fair. Ms. Qualls reviewed the on-going monitoring, due-diligence, research and oversight activities for all of the managers. The Public Equity portfolio continues to fund other asset classes and to evolve the passive/active structure. The funds that were deployed and used in funding other asset classes were also discussed.

The global equity mandate and objectives per the Investment Policy Statement (IPS) were highlighted. The changes to the passive/active allocations were reviewed and Ms. Qualls showed the breakdowns compared to the total portfolio, the total equity portfolio as well as the allocations by manager. She also reviewed geographic and market capitalization diversification. Performance monitoring objectives were discussed and Ms. Qualls noted that no managers are in need of being "watch-listed" at this time.

Ms. Qualls updated the Board on the public equity performance. The market decline in 2018 and reversal in 2019 was reviewed. She discussed the market performance in 2018 and how that impacted the TMRS public equity portfolios. Risks present going forward included US-China trade war and its impact on markets, market volatility, aggressive tightening by the Federal Reserve, populism and a material growth slowdown around the world. Market performance from various viewpoints such as growth vs. value and sector and regional performance was explained.

Performance for Q4 2018 was extremely volatile. It has rebounded in 2019, but continues to demonstrate the volatility in the market. The portfolio transaction cost analysis was discussed and Ms. Qualls also reviewed the implementation risk ranges implied by the IPS.

Transition management was reviewed, noting two new transition managers were added to the current bench of already approved transition managers at the September 2018 meeting. Ms. Qualls highlighted the transition management activity that occurred in December 2018. This transition management activity occurred during a period of continued underperformance in the strategies that were redeemed, which added to the overall underperformance of the transition event. Explicit costs were in line with estimates, while implicit costs were outside expectations. On a qualitative basis, Citi provided excellent project management, project and trading communication, and exceeded expectations in these areas. Third party analysis found no material issues with the transition event.

Ms. Qualls reported that 2019 initiatives include: 1) incorporating the new global mandate and its impact on the current equity portfolio, 2) continuing to evaluate the passive/active structure, 3) utilizing rebalancing policy for adjustments between managers, 4) expanding the search process to better evaluate new investment opportunities, 5) continuing to develop new monitoring analysis of equity managers, and 6) considering merging all passively managed portfolios with one investment manager for possible fee reductions.

In conclusion, TMRS and RVK concur that all current public equity portfolios are performing in accordance within expectations and no changes are immediately needed.

15. **Chief Investment Officer Management Update, Including Governance, Personnel, Manager Updates and Other Investment Related News or Matters *(formerly #14 on the Friday, March 29, 2019 Agenda)***

Mr. Carlson noted that the Public Equity analyst position is currently being recruited for but it has not been filled. Both the Private Equity analyst position and the Operations Analyst position have been filled. The current Private Equity Analyst has been promoted from an Analyst I to an Analyst II.

Since the beginning of the year, unaudited performance for the portfolio has been strong.

16. **Review and Discussion of the Board Consultant Review Process and Future Scheduling**

Mr. Gavia reviewed the list of TMRS consultants to be evaluated by the Board. The proposed plan is to develop a timeline for the review and to also develop criteria. The criteria will be based on a review of each of consultant as well as review of the relationship between the Board and the consultant.

It was suggested to delay the review of the investment consultants until the contracts are renewed.

The Board discussed questions regarding the Request for Proposal (RFP)/ selection/ contracting processes of the Board and of the System. There was also discussion about what value the consultants add to the Board. As a starting point, Ms. McDuffee suggested developing criteria for the Board to consider in this evaluation process, non-investment consultants first and then the investment consultants.

17. **Executive Director and Staff Reports**

Mr. Gavia provided an update on several pending items. He discussed the two CEM benchmarking projects: Administration and Investments.

An update was provided for the search for the new Deputy Executive Director position.

Mr. Gavia noted the five-year budget comparison was uploaded to Diligent.

Possible dates for the July Board Governance Workshop were discussed. The Board agreed that April 17th was an acceptable date for the April Governance Workshop meeting.

Mr. Gavia noted the retirement of Debbie Davila earlier this week and thanked her for her service.

18. **Call for Future Agenda Items**

None were noted.

There being no further business, Mr. Landis moved to adjourn the meeting. Mr. Garza seconded the motion. The meeting was adjourned at 11:47 a.m.

David Gavia
Executive Director

Bill Philibert
Chair, Board of Trustees