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

September 23, 2015 – 8:30 a.m.

On September 23, 2015 the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a meeting at 8:30 a.m. at the Marriott Rivercenter, located at 101 Bowie Street, San Antonio, Texas, with the following members present:

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

Present also were:
David Gavia, Executive Director
Rhonda Covarrubias, Director of Finance
Eric Davis, Deputy Executive Director
Kristie O'Hara, Director of Human Resources
TJ Carlson, Chief Investment Officer
Leslee Hardy, Director of Actuarial Services
Christine Sweeney, General Counsel
Dan Wattles, Director of Governmental Relations
Kristin Qualls, Director of Equities
Chris Schelling, Director of Private Equity
Karen Jackson, Executive Assistant
Marcia Beard, RVK
Joe Ledgerwood, RVK
Joe Newton, Gabriel, Roeder, Smith and Company
Brad Stewart, Gabriel, Roeder, Smith and Company
Amy McDuffee, Aon Hewitt Investments
Mike Elio, StepStone

Also in attendance:
David Rodriquez, Regional Manager – City Services
Carol Leung, Investment Analyst
Greg Shipley, Combined Law Enforcement Associations of Texas
Alex Cramer, Arlington Professional Fire Fighters
Cody Hill, Arlington Professional Fire Fighters
George Kauffman, City of Garland
Keith Dagen, Government Finance Officers Association of Texas
Jerry Gonzales, Service Employees International Union
Bob Scott, City of Carrollton

Ms. Oakley called the meeting to order at 8:30 a.m. and Ms. Oakley gave the invocation.

1. **Chief Investment Officer Management Update, Including Governance, Personnel, Manager Updates and Other Investment Related News or Matters**
   Mr. Carlson updated the Board on the RFP for a general investment consultant. It went out to seven firms and it is posted on the TMRS web site. A decision is expected in December. Mr. Carlson noted the second quarter staff report is in the Board's resource materials in Diligent Board Books.

2. **Consider and Act on Non U.S. Equity Small Cap Manager Recommendation(s)**
   Ms. Qualls reviewed the search process and manager recommendations for non-U.S. Small Cap Equity. She also discussed the timeline and the objectives, which included portfolio diversification, excess return potential, and controlled volatility.

   Mr. Ledgerwood reviewed the timeline and minimum qualifications for the search as well as the details of the manager search process noting that funding implementation is expected during the fourth quarter. Ms. Qualls reviewed the scoring process and the finalist scoring results. Portfolio fit comprised the biggest point award which included both a qualitative and quantitative aspect to determine "best fit." Wasatch Advisors, Inc. and Wellington Management Company, LLP were the two managers selected for Board recommendation.

   Ms. Qualls provided a detailed review of Wasatch Advisors, Inc. and discussed the firm's structure and how the team would work with TMRS. It is 100% employee-owned and is a growth-oriented strategy. Eighty percent of the portfolio will be developed using a bottom-up fundamental research approach and 20% of the portfolio from top-down/macroeconomic views. The portfolio management team is made up of 13 members with one lead portfolio manager and 2 additional portfolio managers. The team is also supported by 4 junior research analysts. Extensive due diligence is performed and a separate risk review is performed. The strategy is almost at capacity, which is $3 billion and has between 70 and 100 holdings. Excess return is expected to be 2% over benchmark per year over a full market cycle of 5-7 years with a tracking error between 4-6%.

   Mr. Ledgerwood reviewed the firm and team makeup of Wellington Management Company, LLP. It is a 100% employee-owned partnership with a bottom-up opportunistic investment approach. The team is made up of five members and two of those members are considered portfolio managers. Risk management is integrated into the portfolio construction process with oversight from a separate risk management group. Excess return objective is 1.75% to 2.25% per year over a full market cycle of 3 – 5 years with expected tracking error between 3% and 8%. Ms. Qualls discussed the risk budget impact noting that this will increase the total expected return without changing the expected risk.

   Ms. Qualls reviewed the recommendation that the Board approve both Wasatch and Wellington to each manage 1% of the total fund (approximately $230 million each). The portfolios will be structured as separately-managed accounts and TMRS staff will determine if a transition manager will be used.

Discussion centered on the advantages and disadvantages of hiring an "employee owned" firm. The Board asked for information on the review teams scoring and rescoring process of potential managers. Ms. Qualls explained the iterative process of scoring and moving portfolio fit up in the scoring process.

Mr. Rodriguez made a motion that the Board of Trustees approve the selection of Wasatch Advisors, Inc. and Wellington Management Company LLP, or their affiliates, to manage non-U.S. small cap equities portfolios within separately managed account structures as proposed and in accordance with the TMRS Investment Policy Statement, each with an initial investment allocation up to 1% of TMRS's total portfolio (approximately $230 million each), and at fees no greater than presented, each individually contingent on successful negotiation of the investment agreements. The motion also recommended authorizing the Executive Director to negotiate, execute, acknowledge and deliver all contracts, agreements, and any other documents necessary or appropriate to give effect to such investments, in each case on such terms and conditions as are satisfactory to the System for such investments. Mr. Parrish seconded the motion, which passed 6-0.

3. **Review and Discussion of Proposed Amendments to Investment Policy Statement Regarding Private Equity**

Mr. Schelling and Mr. Mike Elios of StepStone Group reviewed the proposed amendments to the Investment Policy Statement regarding Private Equity. The first proposed amendment is to change the long term policy objective for Private Equity for periods of five years or greater from the S&P 500 + 5.00% to the Russell 3000 + 3.00%.

Mr. Schelling discussed strategy guidelines and reviewed the broad ranges within the different sub-strategies. He noted that 80% of the geographic diversification will be domestic. Manager concentration and other limits are consistent with existing policy limits.

4. **Fixed Income/Non-Core Fixed Income/Security Lending Annual Asset Class Review**

Mr. Carlson began with an overview of the fixed income performance. Due to a stronger economy and a recovery in the labor market, yields have risen during 2015. The fixed income portfolio is meant to diversify the portfolio as well as enhance total return and provide stability. Mr. Carlson reviewed year-to-date returns and the fixed income diversification timeline. He discussed the core fixed income allocation and the split between BlackRock and PIMCO. Due to the change in the allocation, down to 10% of the portfolio, the split between BlackRock and PIMCO may need to be reviewed.

The non-core pacing plan was discussed along with the current non-core fixed income allocation. It was noted that the new target allocation is 20% of the total portfolio. Mr. Carlson reviewed the list of managers and their strategies.

Mr. Carlson discussed the individual managers for core fixed income. He noted part of the need to review the split between BlackRock and PIMCO is the fact that Blackrock does not have an alpha target. PIMCO has shown you can have an alpha target and safely add value. Each manager's report card was reviewed and Mr. Carlson noted that PIMCO is still on the "watch list," but they are performing well. Since their personnel change, PIMCO's performance has improved as of the date of the report.

Regarding Non-Core Fixed Income, the objective is to enhance total return through capital appreciation in addition to generating income. Mr. Carlson reviewed the manager report cards and noted that Ellington and Guggenheim Partners have fair ratings that staff is working to improve.

The securities lending program through Deutsche Bank was discussed. It is a fully indemnified program with an approved listed of borrowers. There is a limit to the maximum percentage a borrower can have. This program has added income in a very safe manner with low risk. A rating of "fair" was noted on Deutsche Bank's report card.

Mr. Carlson concluded that no manager changes are currently recommended and staff will continue to work with managers on the highlighted issues. Expansion of the non-core fixed allocation will continue in addition to reducing the core fixed income portfolio in accordance with the recent asset allocation study.

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

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

Mr. Parrish made a motion that the Board adopt the consent agenda as presented. Mr. Philibert seconded the motion, which passed 5-0. (Mr. Rodriguez stepped away earlier and was not present during the motion.)

6. **Review and Discussion of Preliminary Experience Study Recommendation(s)**

Mr. Gavia reviewed the background information for the experience study. He introduced Mr. Newton and Mr. Stewart to present the preliminary experience study recommendations. The full draft report is available in the Diligent Resource section of the Board books. Actuarial assumptions are not static and should be reviewed periodically. This is a review of all the assumptions used. They should occasionally change to reflect new information, changing knowledge, mortality improvement and changing patterns of retirements. The true cost of plan benefits will be borne out in actual plan experience. Actuarial assumptions help manage the plan costs and are important for decision making in that they dictate the timing of contributions and develop expectation for future contributions, investment returns and benefit payments.

Mr. Newton reviewed the Actuarial Standards of Practice (ASOP) as they relate to setting assumptions. He focused primarily on ASOP #27, Selection of Economic Assumptions. Mr. Newton summarized the recommendation and mentioned the changes already made by the Board: 6.75% investment return, new mortality assumptions with generational methodologies, and entry age normal cost method. Material new recommendations include decrease the inflation assumption from 3.00% to 2.50% per annum, decrease cost-of-living assumption consistent with the new inflation assumption, decrease termination probabilities, decrease percentage of vested members assumed to choose a refund in lieu of a deferred benefit and introduce an assumption for future active population declines as appropriate in determining the payroll growth assumption. All of these taken together add cost in general to city plans.

Mr. Newton reviewed the direction of change (increase or decrease costs) of these assumption changes. Change in salary scale and COLAs decrease costs, but investment return, termination rates, city termination load and percentage-taking refund all add costs. There were numerous "minor/immaterial" new recommendations and they included: annual real wage growth, restructuring individual salary increase, pre and post retirement disabled mortality, lowering disability assumption, reduce amortization period for new gains or losses to 25 years, set maximum amortization period for ad hoc adoptions to 15 years or life expectancy of the group if less than 15 years and add a provision to the asset valuation smoothing technique to ensure gains or losses are fully recognized within 10 years.

Mr. Newton discussed the individual assumptions. The inflation assumption is consistent with RVK's assumption and the investment return of 6.75% is well supported. The wage assumptions above inflation have come down. This will predict a lower ultimate benefit (i.e., funding target). The termination assumption is coming down which will result in more people being expected to retire. Mr. Newton demonstrated the result of these recommended changes on contribution rates. Systemwide impact on average rate showed a slight increase. Cities without a repeating COLA saw, on average, a larger increase. Cities with repeating COLAs saw a smaller impact. Fifty percent of cities had a rate increase less than 0.5% and 87% of cities had a rate increase less than 1%.

The Board discussed timing of these changes and how it will impact contribution rate stabilization.

7. Review and Discussion of Proposed Amendments to the Strategic Plan

Ms. McDuffee reviewed the timeline and the strategic plan process. The focus is to get the Board's recommendations on the draft plan regarding the goals and objectives.
Ms. McDuffee highlighted objectives for each of the five goals. The five goals are as follows:

Goal 1: Ensure the financial stability and long-term viability of the plan.
Goal 2: Continue to provide excellent customer service and communications to members, annuitants, employers and other constituencies.
Goal 3: Identify the best governance structure and establish a prudent policy framework for TMRS.
Goal 4: Foster a culture within TMRS of open communication, where collaboration is encouraged and innovation is rewarded.
Goal 5: Pursue a legislative agenda that supports the TMRS mission and vision.

Mr. Rodriguez stated he did recall the discussion about Goal 5, Objective 1 and he asked for clarification. Ms. McDuffee reminded the Board of the discussion and possible other topics. Mr. Parrish noted the request that the Board provide more direction to the Advisory

Committee (Goal 5, Objective 3). There appeared to be no additional topics that were not addressed.

Ms. McDuffee discussed next steps and what will be brought back to the December Board meeting.

8. Consider and Act on Selection of Firm to Conduct Internal Audit(s) and Risk Assessment

Mr. Gavia discussed the co-source pilot audit completed by Weaver (formerly Weaver Tidwell). On balance, the pilot was considered a success and funds were included in the 2015 budget to possibly engage outside firms to conduct one to two audits. The Internal Audit Committee met and agreed to have Weaver perform two audits and a risk analysis.

The first audit will be an overview of the implementation of the Annuity Purchase Rate (APR) factors. The second audit will be on the Investment Accounting Division of the Finance Department. Where there have been several audits of the Investment Department to date, there has not been a specific review of investment accounting which resides in the Finance Department. The responsibilities of investment accounting have steadily increased over time with the addition of several new asset classes, and it is appropriate to evaluate their processes and guidelines at this time.

Mr. Gavia discussed the risk assessment to be performed by Weaver. Given the current vacancy in the Director position, the Internal Audit Committee recommends Weaver to conduct a risk assessment and assist the Internal Audit Committee in developing an audit plan to be executed while our search for an Internal Audit Director continues.

Mr. Landis made a motion to retain the Weaver firm to conduct a review of the TMRS implementation of the new APRs, the Investment Accounting Division of the Finance Department and to develop a risk assessment for fees not to exceed the maximum ranges set out in these materials and that the Executive Director be authorized to negotiate and execute agreements satisfactory to the System and IAC. Mr. Rodriguez suggested the motion be amended to postpone the risk assessment audit until the Internal Auditor is hired.

Mr. Landis amended the motion to include postponing the risk assessment until the Internal Auditor is hired. Mr. Rodriguez seconded the motion, which passed 6-0.

9. Consider and Act on Meeting Dates and Locations for 2016 Board of Trustees Meetings

Mr. Gavia presented the first choice of dates for the 2016 Board meetings as well as proposed agenda items. If the Board needs more time to review their schedules, this item could be postponed to the October 22-23, 2015 Board meeting.

Mr. Philibert made a motion to table this discussion until the October Board meeting. Mr. Parrish seconded the motion, which passed 6-0.

10. **Executive Director and Staff Reports**
Mr. Gavia presented the reports for discussion. He acknowledged the release of the new on-line address update feature for TMRS Direct.

11. **Executive Session**
At 12:23 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 12:57 p.m.

12. **Call for Future Agenda Items**
No items were mentioned.

At 12:59 p.m. the meeting was adjourned.

David Gavia
Executive Director

Julie Oakley
Chair, Board of Trustees