MINUTES OF THE
TEXAS MUNICIPAL RETIREMENT SYSTEM
Joint Meeting of the Board of Trustees and
Advisory Committee on Benefit Design

May 25, 2018 - 8:00 a.m.

On May 25, 2018, the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a meeting at 8:00 a.m. at TMRS Headquarters, located at 1200 North IH 35 in Austin, Texas, with the following members present:

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

Absent: Julie Oakley

Advisory Committee Members
Bonita Hall, Texas Municipal Human Resources Association (TMHRA)
Paulette Hartman, Texas City Management Association (TCMA)
George Kauffman, Retired member
Julie Masters, Mayor, City of Dickinson, Elected member
David Riggs, Texas State Association of Fire Fighters (TSAFF)
J.J. Rocha, Texas Municipal League (TML)
Mitch Slaymaker, Texas Municipal Police Association (TMPA, Alternate)
Greg Shipley, Combined Law Enforcement Associations of Texas (CLEAT)
Casey Srader, Government Finance Officers Association of Texas (GFOAT)

Present also were:

David Gavia, Executive Director
Eric Davis, Deputy Executive Director
TJ Carlson, Chief Investment Officer
Christine Sweeney, General Counsel
Dan Wattles, Director of Governmental Relations
Leslee Hardy, Director of Actuarial Services
Debbie Munoz, Director Member Services
Scott Willrich, Director of Information Resources
Rhonda Covarrubias, Director of Finance
Sandra Vice, Director of Internal Audit
Leslie Ritter, Director of Human Resources
Kristin Qualls, Director of Public Equity
Chris Schelling, Director of Private Equity
Dimitry Shishkoff, Director of Risk Management

Karen Jackson, Executive Assistant
Robert Klausner, Klausner, Kaufman, Jensen & Levinson
Marcia Beard, RVK
Amy McDuffee, Mosaic Governance Advisors
Mark Randall, Gabriel, Roeder, Smith & Company
Joe Newton, Gabriel, Roeder, Smith & Company
Keith Brainard, National Association of State Retirement Administrators
Dr. A. Gary Shilling, A. Gary Shilling & Co., Inc.

Also in attendance:

Eric Obermier, Assistant Director Information Resources
Michelle Mellon-Werch, Assistant General Counsel
Nick O'Keefe, Lead Investment Attorney
Madison Jechow, Assistant General Counsel
Michael Schaff, Assistant General Counsel
David Rodriquez, Senior Regional Manager– City Services
Anthony Mills, Senior Regional Manager– City Services
Sean Thompson, Regional Manager – City Services
Jennifer Andrews, Member Services Manager
Melanie Thomas, Process and Content Management Specialist
Cindy Morse, Investment Support Analyst
Debbie Farahmandi, Investment Operations Specialist
Geldon Vllahu, Operations Analyst
Susan Jaques, Performance Analyst
Carol Leung, Equities Investment Analyst II
Ryan Conner, Risk Management Analyst
Melissa Jerkins, Quantitative Analyst
Kurt Cressotti, Compliance Officer
German Gaymer, Fixed Income Analyst
Kevin Notaro, Absolute Return Analyst
Kenneth Oliver, Actuarial Analyst
Tish Root, Legal Assistant
Kenneth Herbold, Pension Review Board

Mr. Parrish called the meeting to order and the meeting was reconvened at 8:08 a.m.

1. **Consider and Act on Results of 2017 Actuarial Valuation and Approval of 2019 Retirement Contribution Rate and Supplemental Death Benefit Contribution Rates**
   Mr. Gavia introduced Mr. Newton and Mr. Randall from Gabriel, Roeder, Smith & Company (GRS) to present the results of the December 31, 2017 actuarial valuation. Mr. Gavia congratulated GRS and staff on another successful year. He stated that for the past ten years, TMRS' funded ratio has been gradually improving while some of TMRS' peers have been on an almost continual decline. There were many actuarial changes adopted by the Board that have been beneficial to TMRS.

Mr. Randall noted that this is GRS' tenth year working with TMRS and it has been a pleasure working with the System and it has been a very rewarding relationship. Mr. Newton stated that a strong funding policy has been beneficial, but as important if not more important is the governance structure and communication channels at TMRS that make things work.

The results of the valuation show even stronger trends than just the funded ratio. Mr. Newton reviewed the System-wide results beginning with the actuarial funding ratio. The actuarial funded ratio improved to 87.4% (over 90% on a market basis) and the average funding period has dropped to 18.8 years. In addition, the payroll weighted average contribution rate has dropped to 13.09%. Mr. Newton discussed the aggregate Benefit Accumulation Fund (BAF) valuation and noted that salary increases have begun to "heat up" which means this is an area that we may need to watch in the next experience study. A summary of the Benefit Provision Changes were highlighted, noting the changes in the employee deposit rate, matching ratio, Updated Service Credit (USC) and Cost of Living Adjustment (COLA).

Yields based on Market Value of Assets based were reviewed and Mr. Newton discussed the smoothing methodology used and discussed Actuarial versus Market Values of the Assets. Assets versus Liabilities over the last ten years were highlighted. Going forward, the gap between assets and liabilities will begin to decline. The relative size of Unfunded Actuarial Accrued Liability (UAAL) to payroll was also reviewed. This ratio has been declining while the funded ratio has continued on a positive progression toward 100% or fully funded. TMRS' funded ratio compared to the average funded ratio from the 2016 NASRA survey of our peers is vastly different. TMRS is on a gradually improving slope while the peers are on a gradually declining slope. The projected funded ratio shows the potential volatility of funded ratio ranges. Mr. Newton stated that the funding policy helps protect against lower investment performance scenarios and keeps funded ratios up. He discussed the distribution of the funded ratio percentages as well as the distribution of single equivalent amortization periods.

The historical dollar weighted contribution rates and distribution of changes in contribution rates by city were reviewed. The contribution rates have been remarkably stable with 75% of TMRS cities within the expected range of ±- 0.50% contribution rate change. The impact on contribution rates of strong and adverse investment performance was reviewed. There are only seventeen cities left with a phase-in rate option.

Mr. Newton discussed the Sustainability Checklist. The checklist reviews a number of metrics, which taken as a whole, is indicative of the health of the retirement plan. It was noted that TMRS' strong funding policy adds protection. He discussed areas on the checklist for potential improvement which included amortization periods for benefit enhancements. Other items to pay attention to include the continued contraction of capital market expectations and the increase in the longer term liability (or asset) to payroll ratios which will increase contribution rate volatility.

Mr. Parrish noted that TMRS' normal course of action is to look at what incremental changes can be taken now to improve sustainability in the future.

In summary, system-wide health continues to improve. With no changes in assumptions, the expectation is for increasing funded ratios over the next valuations and continued stability in the contribution rates.

Mr. Carlson noted that the Asset Liability study will be moved up a year to 2019 because there has been a lot of changes in the capital market assumptions.

Mr. Jeffers moved that the Board accept the December 31, 2017 actuarial valuation prepared by its consulting actuary and certify retirement contribution rates and Supplemental Death Benefit contribution rates for municipalities for 2019. Mr. Landis seconded the motion, which passed 5-0.

2. **Consider and Act on Adoption of Minutes from the April 26, 2018 Meeting of the Advisory Committee on Benefit Design**

Mr. Parrish announced he was remiss by not acknowledging prior to the start of the meeting that this is a joint meeting with the Board of Trustees and the Advisory Committee on Benefit Design. Mr. Parrish noted a quorum of both bodies were present at the start of the meeting.

Mr. Gavia and Mr. Landis asked the Advisory Committee members to introduce themselves and what group they represent.

There was one suggested correction to the minutes and it was noted in a handout to the Advisory Committee members.

Mr. Landis moved that the Advisory Committee on Benefit Design adopt the minutes from the April 26, 2018 meeting. Ms. Masters seconded the motion, which passed unanimously.

3. **Board Committee Report: Advisory Committee on Benefit Design**

Mr. Landis discussed the changes made to the Advisory Committee on Benefit Design (Committee). The Committee was actively engaged during the April 26, 2018 meeting and there was a robust discussion among the Committee members. Mr. Landis stated, overall, it was a good meeting with good dialogue.

Mr. Garza noted he appreciated the engagement from the Committee and looks forward to working with the Committee.

Mr. Wattles thanked the Committee for their participation and the feedback provided to TMRS. The discussions helped TMRS learn more about what is going on in our communities. We did learn about areas where TMRS can enhance communication with our constituents.

Mr. Riggs requested to address the Board and the Committee in regard to item #10 in the April 26, 2018 Committee minutes. He asked for the Committee to study removing the catch-up provision on the COLA be considered in potential legislation.

At this point, Mr. Garza left the meeting at 9:40 a.m.

4. **Annual Economic Outlook Presentation *(formerly #5 on the Friday, May 25, 2018, agenda)***

Mr. Gavia introduced Dr. Shilling to present the annual economic outlook. Dr. Shilling discussed the very long run-up in stocks despite the slowest recovery in history. This has still occurred even though the Federal Reserve lowered interest rates and began quantitative easing. The increase in volatility changed abruptly in February 2018. Stock market capitalization is at an all-time high, but investors are chasing risk to reach for returns. The Federal Reserve had brought rates down to basically zero, but they are now gradually raising rates as well as slowly selling out its portfolio. This could take approximately six years to accomplish this. Every time the Federal Reserve raised interest rates in a bull market, a recession has followed. There was only one exception. The most reasonable forecast is slow growth for the next few years.

The reason the Federal Reserve would like to raise interest rates is they feel 3% is a neutral rate and they would like to eventually get to that level. Currently, there is little to no cushion if another recession would occur. Raising it to the 3% level would allow something to cut when a recession does occur.

There is a new outlook at the Federal Reserve. The new Chairman of the Federal Reserve, Jerome Powell, is different than his predecessors. He does not see the need to bail out the stock market unless it is a threat to the economy. The Federal Reserve has twin goals: full employment (which they feel we are at currently) and price stability (do not want to see deflation). Globalization has basically prevented wage growth. Job growth has peaked and unionization has seen a steady decline. Self-employment has increased, but there are reasons why we have not seen wage growth.

There is an important link in longer term interest rates and inflation. The Federal Reserve would like to raise longer term interest rates, but they are not getting inflation so long rates are not going up. Tax cuts and spending on infrastructures will result in additional issues. The increase in defense spending means more debt issuance. However, Dr. Shilling does not see a drastic increase in rates on the long end.

The trade deficit has been consistent and stable. Trump's idea of fair trade has been a shock to those that are interested in "free trade". If China decided to dump their U.S. treasury bonds, this would cause a bond market collapse and lead to a worldwide recession. This scenario is unlikely.

The dollar is strong and U.S. markets remain attractive. A strong dollar increases prices on exports and make imports cheaper.
In conclusion, Dr. Shilling does not see a looming recession and market stability should continue with no big changes on the horizon.

5. **<u>Public Pension Trends Presentation</u>** ***<u>(formerly #4 on the Friday, May 25, 2018, agenda)</u>***
Mr. Gavia introduced Mr. Brainard, Research Director of the National Association of State Retirement Administrators and provided a highlight of his career and his credentials.

Mr. Brainard began with a comparison of retirement benefits in the U.S. in the private and public sectors. Only about 15% of the private sector is providing traditional pension plans (defined benefit) versus 87% of the public sector participating in a pension plan. He reviewed statistics regarding public pensions in the U.S. and noted approximately $4.33 trillion in assets. The change in aggregate actuarial funding level and actuarial values of assets were discussed. Mr. Brainard discussed the median change from prior year in actuarial value of assets and liabilities. For improvement to occur, assets must grow faster than liabilities. He reviewed the distribution of public pension funding levels and highlighted TMRS' position above the median.

One of the trends that has occurred in recent years is the shifting of risks. This has led to an increase in the creation of hybrid plans. There has been significant growth in hybrid plans over the past twenty years. The number of mandatory and optional defined contribution plans as workers' primary retirement benefit has grown. Oklahoma is the only state that has shifted new employees to a defined contribution plan. Alaska has a defined contribution plan as the primary retirement benefit, combined with non-Social Security participation.

Mr. Landis left during this portion of the meeting at 10:52 a.m. Since there was no longer a quorum, the meeting was officially adjourned at 10:52 a.m.

David Gavia
Executive Director

Jim Parrish
Chair, Board of Trustees