

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

June 19, 2014 – 1:30 p.m.

June 20, 2014 – 8:30 a.m.

On June 19, 2014 the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a meeting at 1:30 p.m. at TMRS Headquarters, located at 1200 North IH 35 in Austin, Texas, with the following members present:

Board of Trustees

Roel "Roy" Rodriguez, Chair

Julie Oakley, Vice Chair

Jim Parrish

Bill Philibert

David Landis

Jim Jeffers

Present also were:

David Gavia, Executive Director

Ian Allan, Director of Internal Audit

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

Debbie Munoz, Director of Member Services

Christine Sweeney, General Counsel

Bill Wallace, Director of Communications

Dan Wattles, Director of Governmental Relations

Scott Willrich, Director of Information Resources

Holly Macki, Director of Real Estate

Kristin Qualls, Director of Equities

Dimitry Shishkoff, Director of Risk Management

Jesse Pittman, Project Manager

Karen Jackson, Executive Assistant

Robert Klausner, Klausner, Kaufman, Jensen & Levinson

Marcia Beard, RVK

Joe Ledgerwood, RVK

Kasey Kuenzli, RVK

Barbara McDowell, ORG

Nancy Williams, Hewitt EnnisKnupp

Amy McDuffee, Hewitt EnnisKnupp

Also in attendance:

Sherry Chapman, Investment Accountant

Debbie Farahmandi, Investment Operations Specialist
Howell Hollis, Investment Analyst
Peter Jeske, Project Specialist
Michelle Mellon-Werch, Associate General Counsel
Candace Nolte, Controller
Nick O'Keefe, Senior Staff Attorney
Cindy Morse, Investment Support Analyst
Carol Leung, Investment Analyst
Kate Reed, Investment Risk Analyst
Melissa Jerkins, Quantitative Analyst
Di Fu, Investment Data Analyst
David Rodriguez, Regional Manager – City Services
Eddie Schultz, Real Estate Analyst
Mel Thomas, Editor
David Crow, Arlington Professional Fire Fighters
Greg Shipley, Combined Law Enforcement Association of Texas
Scott Kerr, Texas State Association of Fire Fighters
Keith Dagan, Government Finance Officers Association
George Kauffman, City of Garland
Melinda Griffith, Combined Law Enforcement Association of Texas
David Russell, Texas Municipal Police Association
Meredyth Fowler, Speaker's Office

Mr. Rodriguez called the meeting to order at 1:30 p.m. and Mr. Rodriguez gave the invocation.

1. Chief Investment Officer Management Update including Governance, Personnel, Manager Updates and Other Related Items

Mr. Carlson introduced the new Data Analyst, Di Fu. He updated the Board on the status of the search for Directors of Fixed Income and Absolute Return. He gave the Board an update on the personnel changes at PIMCO which are very positive. In August, the annual affirmation of the asset allocation and risk review will be presented. In October, a major review of the Investment Policy Statement will be presented to the Board for review.

2. Consider and Act on Proposed Amendments to the Investment Policy Statement Concerning the Residential Mortgage Backed Securities and Commercial Mortgage Back Securities (RMBS/CMBS) Strategy and Sector Allocation Limit

During the May 2014 Board meeting, the Board approved the selection of three managers for a RMBS/CMBS mandate and approved Staff's and RVK's recommendation to increase the sector allocation limit from 25% to 40% of the Non-Core Fixed Income asset class. The Board is being asked to ratify its previous action to increase the sector allocation limit for the RMBS/CMBS allocation from 25% to 40% by specifically amending the IPS.

Ms. Oakley made a motion that the Board amend the IPS to include the proposed RMBS/CMBS Guidelines and also amend the IPS to include the RMBS/CMBS sector allocation limit change from 25% to 40% as approved by the Board at its May 2014 meeting. Mr. Philibert seconded the motion, which passed 6-0.

3. Quarterly Investment Staff Report/Asset Class Updates

Mr. Carlson reported total performance through April was at 2.74% and that we are outperforming our benchmark. We have also outperformed our benchmark for the five years ending on April 30, 2014.

Ms. Qualls discussed the equity allocation. The core portfolio percentage will be decreased due to continued funding of the Satellite Strategy. North Trust Asset Management has been taken off the watch list.

Mr. Carlson discussed Cored-Fixed Income. Even though it is a low interest environment, nominal returns are good and Blackrock is outperforming the benchmark along with PIMCO. In the Non-Core space, we are finalizing contracts with six managers.

Ms. Macki reported on the Real Return allocation and that Colchester is out performing the appropriate benchmark.

The contract for Absolute Return is reaching finalization and there is no update on private equity. Staff will ask the Board for a Director of Private Equity in the next nine months and the target date for initial funding remains December 2015.

Mr. Carlson introduced Kate Reed, Compliance Analyst and she discussed the Compliance Report and the guidelines. There are 125 testable compliance points in total and of the points tested, all points are in compliance. Mr. Philibert asked what an out of compliance result would mean. Mr. Carlson explained a couple of examples of where a manager might be out of compliance.

Mr. Shishkoff reviewed risk management activities. There are two basic risk areas, strategic risk and implementation risk. He reviewed the total portfolio's risk status based on actual holdings. Our total portfolio is well below the long-term risk benchmark. He noted that tracking error is measured at both the asset class and manager level.

4. Consider and Act on U.S. Mid-Cap Manager Recommendations

Ms. Qualls discussed the U.S. Mid-Cap Manager recommendations and reviewed the search timeline. This is Phase II of the Core/Satellite Structure that recommends an allocation of \$200 million to each manager for a total allocation of \$400 million. The purpose of this project is to continue to diversify within the equity portfolio while complementing current equity strategies and other asset classes through low correlations. The expected excess return is consistent with TMRS's overall objective to identify value opportunities to realize value-added returns through additional active management strategies. It is also determined that the level of risk from these recommendations is within TMRS's risk tolerance levels.

Mr. Ledgerwood from RVK reviewed the manager search process and how it is similar to other manager searches. He reviewed the minimum qualifications and Ms. Qualls reviewed the scoring structure. Five managers were selected for the semi-finalist telephone interviews.

Following the telephone interviews, two managers were eliminated from further consideration, while the remaining three managers were selected for onsite due diligence visits. After the onsite visits, the managers were scored again with portfolio fit comprising the biggest point reward which included both a qualitative and quantitative aspect to determine the "best fit" for TMRS. TMRS wants to ensure a manager fits well given the total equity portfolio. The two managers selected for Board Recommendation: The Boston Company Asset Management and Champlain Investment Partners.

The Boston Company Asset Management has AUM of approximately \$49 billion and the investment team consists currently of eleven members that are led by David Daglio. The Boston Company strategy has a mid-capitalization opportunistic orientation with a thorough risk and return analysis at the stock level to determine that the reward/risk ratio is appropriate. The team utilizes a bottom up, fundamental research approach that looks for companies that trade at a discount to their intrinsic value. Active pre- and post-trade compliance monitoring is done by a separate compliance team. Champlain Investment Partners is an employee-owned partnership with eight employee partners and AUM of approximately \$6.1 billion. The investment team is led by Scott Brayman and includes three additional portfolio managers as well as analysts. The strategy is a mid-capitalization core strategy that uses a bottom-up, fundamental stock selection approach that focuses on investing in good businesses at a good price. Investment goals are to make money, manage risk and be consistent. These allocations are expected to increase returns by 0.05% with no increase in total tracking error. The portfolios will be structured as separately managed accounts and will be funded from the Northern Trust Asset Management Russell 3000 core/passive fund.

Mr. Landis made a motion that the Board approve the selection of the following managers or their affiliates for investment in the specified equity strategies at fees not to exceed those proposed:

1. The Boston Company Asset Management - Mid-Cap Opportunistic Value strategy for a \$200 million mandate as a separately managed account;
2. Champlain Investment Partners - Mid-Cap Core strategy for a \$200 million mandate as a separately managed account;

And that the Executive Director is authorized to negotiate contracts satisfactory to the System.

Mr. Parrish seconded the motion, which passed 6-0.

5. Absolute Return Education Session

Marsha Beard from RVK gave a review of the Absolute Return Strategy (ARS). A properly structured ARS portfolio increases return, decreases portfolio risk and has low correlation to traditional asset classes. Strategies are very diverse, and made up of private partnerships that seek positive returns. With the passing of new financial regulatory reform in 2010, managers are required to register with the SEC. Broad categories are directional, non-directional and event driven. ARS produces attractive correlations and risk-adjusted returns over the long term. Ms. Beard compared the Fund of One returns versus the S&P Index and

Barclays U.S. Aggregate Bond Index. ARS tends to provide down side protection when the equity markets are in negative territory. Ms. Beard reviewed the risks and risk mitigation for operational, investment and other risks. In regards to implementation options, TMRS will use the Fund-of-One Fund approach and will likely move to the direct investment approach over time.

Ms. Beard reviewed the manager search process which resulted in the selection of Blackstone Alternative Asset Management. She discussed how to build a hedge fund portfolio including developing infrastructure and hiring appropriate staff, determining liquidity requirements and other considerations.

6. Real Return Education Session

Mr. Carlson began by reviewing TMRS' Real Return history. To move forward, we need to begin diversifying the current 5% allocation away from our sole investment manager and strategy. Real Return has been placed together with the Real Estate allocation for staffing purposes due to their similarities. Real Estate is often considered a sub-set of Real Return. Pension funds typically invest in Real Return related investments for the expected inflation protection these investments offer (high correlation to inflation). A properly developed Real Return portfolio can offer additional benefits including: yield generation, return enhancement and additional diversification impact. Different inflation scenarios were reviewed and the impact inflation has on different portfolio sectors.

Mr. Carlson discussed the two general methods regarding how to access Real Returns: 1) using a strategy in which inflation sensitivity is a primary drive of the investment process or 2) investing in assets which are expected to react in a similar direction to inflation. He reviewed asset characteristics for both liquid and illiquid assets. As we are look to build out this portfolio, we want to evaluate the current opportunity set, select assets/strategies that have a reasonably high correlation with inflation, determine acceptable liquidity limits, diversify across inflation types and maintain a reasonable return profile expectation. Mr. Carlson concluded by discussing future plans in the Real Return Asset Class.

7. Consider and Act on Absolute Return and Real Return Consultant Search Approval

Mr. Carlson discussed the Absolute Return history and Real Return history and the desire to conduct the Absolute Return and Real Return consultant searches concurrently because consultants will be able to apply for one or the other or both strategies. RVK will not be assisting in this search because they could be seen as a competitor. As there is no current allowance for this expense in the 2014 budget, no expenses are to be incurred in 2014 unless it can be reallocated from a different budget line item. The range of fees is likely to be from \$240,000 up to \$500,000 per year per asset class.

Mr. Parrish made a motion that the Board authorize Staff to conduct a concurrent search for both Absolute and Real Return investment consultant, with no costs incurred in 2014 unless it can be reallocated from a different budget line item. Mr. Philibert seconded the motion, which passed 6-0.

8. Legislative Update (originally appeared as #15 on the Friday, June 20, 2014 agenda)

Mr. Wattles introduced Mr. Ron Lewis to present an update to the current legislative environment. Mr. Lewis began by discussing the Texas primary and run off results pertaining to the six major statewide offices. Last interim was historic from a legislative turnover perspective, but the expected turnover for this interim is even more pronounced. He reviewed the pre-election changes in both the House and the Senate and the Texas primary and runoff results. There are at least 20 new members in the House with almost two thirds of the members having two sessions or less experience. There will be a new House Pension Committee chair for the third straight session. On the Senate side, there will be either eight or nine new members with one-half of the Senate having less than two sessions.

Mr. Lewis stated that there has not been a turnover like this in the legislature since the "Sharpstown" situation in the early 1970s. Mr. Wattles discussed the House Pension Committee's interim charges and the presentation TMRS has been asked to make for the hearings. He also discussed the Trustee/Administrator training that will be required by the Pension Review Board and the proposed rules should be published by late June 2014.

9. Update on 2014 Meetings of the Advisory Committee on Retirement Matters (originally appeared as #16 on the Friday, June 20, 2014 agenda)

Mr. Wattles updated the Board on the meetings of the Advisory Committee (AC). The AC has had three meetings reviewing four topics as presented by the Board. These topics include: 1) fixed-rate COLAs, 2) "catch-up" provision that is part of our CPI-based COLA, 3) eligibility threshold and 4) two-tiered plans. After a thorough review, a majority of the Advisory Committee advised against recommending any plan design changes to the Board.

Mr. Wattles discussed the development of a "Statement of Philosophy" for consideration by the Board for the legislative session. AC member comments included: 1) convey that current options are currently more than adequate for controlling costs, 2) the AC is not in favor of pursuing changes, 3) play defense and that changes are not needed, and 4) a general statement of support for TMRS and its many participants and retirees. Staff will work on a draft resolution to be brought to the Board for consideration at a future Board meeting for discussion and action.

10. Executive Session

At 4:40 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.

Julie Oakley left the meeting prior to Executive Session and Roy Rodriguez, Board Chair, left the meeting during Executive Session. The remaining members of the Board returned from Executive Session at 5:47 p.m. No action was taken in the Executive Session.

Mr. Jeffers made a motion to adjust the General Counsel's salary by 3.5% and adjust the Director of Internal Audit's salary by 3% effective the last pay period in June. Mr. Philibert seconded the motion, which passed, 4-0.

At 5:37 p.m. the meeting was recessed until 8:30 a.m. on Friday, June 19, 2014.

David Gavia

David Gavia
Executive Director

R. Rodriguez

Roel "Roy" Rodriguez
Chair, Board of Trustees

**MINUTES OF THE
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Meeting of the Board of Trustees**

June 19, 2014 – 1:30 p.m.

June 20, 2014 – 8:30 a.m.

On June 20, 2014, 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

Roel "Roy" Rodriguez, Chair

Julie Oakley, Vice Chair

Jim Parrish

Bill Philibert

David Landis

Jim Jeffers

Present also were:

David Gavia, Executive Director
Ian Allan, Director of Internal Audit
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
Debbie Munoz, Director of Member Services
Christine Sweeney, General Counsel
Bill Wallace, Director of Communications
Dan Wattles, Director of Governmental Relations
Scott Willrich, Director of Information Resources
Kristin Qualls, Director of Equities
Dimitry Shishkoff, Director of Risk Management
Jesse Pittman, Project Manager
Karen Jackson, Executive Assistant
Robert Klausner, Klausner, Kaufman, Jensen & Levinson
Marcia Beard, R. V. Kuhns & Associates
Barbara McDowell, ORG

Also in attendance:

Sherry Chapman, Investment Accountant
Debbie Farahmandi, Investment Operations Specialist
Michelle Mellon-Werch, Associate General Counsel
Cindy Morse, Investment Support Analyst
Carol Leung, Investment Analyst

Kate Reed, Investment Risk Analyst
Melissa Jerkins, Quantitative Analyst
Di Fu, Investment Data Analyst
David Rodriguez, Regional Manager – City Services
Eddie Schultz, Real Estate Analyst
Mel Thomas, Editor
David Crow, Arlington Professional Fire Fighters
Greg Shipley, Combined Law Enforcement Association of Texas
Scott Kerr, Texas State Association of Fire Fighters
George Kauffman, City of Garland
Melinda Griffith, Combined Law Enforcement Association of Texas
Meredyth Fowler, Speaker's Office

Mr. Rodriguez called the meeting to order at 8:31 a.m. and Mr. Philibert made opening remarks regarding the passing of Advisory Committee member, Ron Crabtree.

11. Annual Real Estate Asset Class Review (originally appeared as #5 on the Thursday, June 19, 2014 agenda)

Ms. Mackie and Barbara McDowell from ORG began this review of the Real Estate portfolio. Ms. Mackie first reviewed the returns of the portfolio indicating that overall we are outperforming the benchmark. The target allocation is about \$2.2 billion with almost \$800 million invested. She next reviewed diversification by strategy, manager, property type and geographic location. Ms. Mackie gave a broad market overview discussing characteristics of various market types (office, retail, industrial and apartments). Detailed investment performance was reviewed. She highlighted the outliers on both high and low return explaining the reason for the performance.

Ms. McDowell began by comparing property type diversification to different indexes and she also compared TMRS' diversification geographically to other indexes. She reviewed policy target compliance for diversification, property type, geographic location and manager as of December 31, 2013. Vintage year diversification was reviewed based on allocated and committed and unallocated. The level of approved allocations was within policy guidelines.

12. Consider and Act on Consent Agenda.

Mr. Gavia presented the items contained in the consent agenda. He asked if there were any questions or revisions to the minutes and there were none.

Ms. Oakley moved that the Board adopt the Consent Agenda as presented. Mr. Parrish seconded the motion, which passed 6-0.

13. Consider and Act on the 2013 External Audit (SAS-114) and Auditor Report to the Board of Trustees

Susan Warren and John Fisher from KPMG were introduced to discuss the 2013 Audit. Ms. Warren reviewed the agenda and management's responsibilities regarding the audit as well as KPMG's and the Board's responsibilities. TMRS has an unmodified (clean) opinion. There were no material weaknesses or significant deficiencies identified during the 2013 audit.

There were no significant corrected or uncorrected adjustments identified during the 2013 audit. There were no significant changes to TMRS' accounting policies during fiscal year 2013. The actuarial assumptions were found to be reasonable in relation to the financial statements taken as a whole.

Mr. Philibert moved that the Board accept the audit results for the year ended December 31, 2013 and adopt the *Report to the Board of Trustees*. Mr. Jeffers seconded the motion, which passed 6-0.

14. Consider and Act on the 2013 Comprehensive Annual Financial Report (CAFR)

Ms. Covarrubias began the review of the CAFR section by section. This is prepared in accordance with generally accepted accounting principles, the GFOA Certificate of Achievement program guidelines and all applicable GASB requirements. She discussed the items included in the introductory section, highlighting activity in 2013, a brief investment overview and funding and actuarial overview. The Independent Auditor's Report in the Financial Section was reviewed next. Management's Discussion and Analysis was also reviewed. Statements of Plan Net Position, Notes to Financial Statements, Required Supplementary Information and Supplemental Schedules were reviewed.

Ms. Covarrubias then reviewed the Investment Section. This section includes a report on Investment Activity provided from RVK. This section includes an overview of the investment policies and investment results. The Actuarial Section has a separate section for the Pension Trust and the Supplemental Death Benefits Trust. The Actuarial Certification letters and actuarial valuation results are both included in this section. The statistical section provides additional historical perspective. Ms. Covarrubias stated that the CAFR will be added to the TMRS website and an email blast will be sent notifying the cities that it is available. The CAFR will be transmitted to GFOA for a certificate of achievement. The Summary Annual Financial Report (PAFR) will also be submitted to GFOA.

Mr. Parrish moved that the Board approve the 2013 Comprehensive Annual Report. Ms. Oakley seconded the motion, which passed 6-0.

15. Consider and Act on Adoption of the 2014-2015 Risk Based Audit Plan

Mr. Allen presented his proposed biennial audit plan. This plan is prepared based on a risk assessment for each department and potential engagements are ranked based on professional judgment. Mr. Allen is working with the Board's Internal Audit Committee and the Internal Audit Committee then determines from this list what the priorities should be. Co-sourcing of the work with an outside firm could improve speed and volume of work that can be done. A pilot engagement to test co-sourcing will be brought to the Board for approval. Ultimately a list of firms can be created that can be used as the co-source auditing partner. With co-sourcing, two to three audits should be completed yearly.

Mr. Jeffers made a motion for the Board to adopt the *2014-2015 Risk-Based Audit Plan* as it has been amended by the Internal Audit Committee and presented in today's Board materials. Mr. Landis seconded the motion, which passed 6-0.

16. Consider and Act on Agreement for Governmental Relations Consulting Services

Mr. Gavia presented this item. Staff recommends that the Board renew the agreement with Ron Lewis of Ron Lewis and Associates for a two-year period in the amount of \$82,500 per year. Mr. Philibert asked about other clients Mr. Lewis may have and would it be a potential conflict of interest.

Ms. Oakley made a motion for the Board to renew the agreement with Ron Lewis of Ron Lewis and Associates for governmental relations consulting services in the amount of \$82,500 per year for a term to expire on May 31, 2016. An amendment should be added to include contract language to address potential conflicts of interest. Mr. Parrish seconded the motion, which passed 6-0.

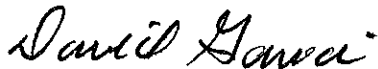
17. Executive Director and Staff Reports, including Reports from Administration, Communications, Actuarial Services, Finance, Governmental Relations, Human Resources, Information Resources, Internal Audit, Legal, Member Services and Project Management

There was nothing to add to the reports presented.

18. Call for Future Agenda Items

Mr. Gavia mentioned he would discuss potential dates for a Strategic Planning Session with the Chair and Vice Chair.

The meeting was adjourned at 10:23 a.m.



David Gavia
Executive Director



Roel "Roy" Rodriguez
Chair, Board of Trustees