

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

**March 20, 2014 – 1:00 p.m.**

**March 21, 2014 – 8:30 a.m.**

On March 20, 2014 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**

Roel "Roy" Rodriguez, Chair

Jule Oakley, Vice Chair

Bill Philibert

David Landis

Jim Jeffers

Absent: Jim Parrish

**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

Bonnie Mitra, Director of Fixed Income

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

Jennifer Nichols, R. V. Kuhns & Associates

Ed Schultz, ORG

Barbara McDowell, ORG

Nancy Williams, Hewitt EnnisKnupp

Mark Randall, Gabriel, Roeder, Smith & Company

Joe Newton, Gabriel, Roeder, Smith & Company

**Also in attendance:**

Sherry Chapman, Investment Accountant  
Debbie Farahmandi, Investment Operations Specialist  
Howell Hollis, Investment Analyst  
Peter Jeske, Project Specialist  
Carol Leung, Investment Analyst  
Michelle Mellon-Werch, Associate General Counsel  
Candace Nolte, Controller  
Nick O'Keefe, Senior Staff Attorney  
Cindy Morse, Investment Support Analyst  
Kate Reed, Investment Risk Analyst  
David Rodriguez, Regional Manager – City Services  
Eddie Schultz, Real Estate Analyst  
David Crow, Arlington Professional Fire Fighters  
Bob Scott, Government Finance Officers Association of Texas/City of Carrolton  
Chris Jones, Combined Law Enforcement Associations of Texas (CLEAT)  
George Kauffman, City of Garland  
Scott Kerr, Texas State Association of Firefighters (TSAFF)/City of Plano  
Kevin Lawrence, Texas Municipal Police Association  
Juan Garcia, Governor's Office  
Meredyth Fowler, Speaker's Office  
Keith Hopkins, Mesquite Fire Department  
Melinda Griffith, Combined Law Enforcement Associations of Texas (CLEAT)  
Greg Shipley, Combined Law Enforcement Associations of Texas (CLEAT)/City of  
Corpus Christi  
Mel Thomas, Editor

Mr. Rodriguez called the meeting to order at 1:00 p.m. and gave the invocation. Jim Parrish was absent from the Board meeting.

**1. Chief Investment Officer Management Update**

Mr. Carlson began by updating the Board regarding PIMCO. During the previous week, Mr. Carlson met with PIMCO's Chief Investment Officer, Bill Gross, and four of the six new Deputy Chief Investment Officers. He feels good about the information he received and everyone at PIMCO is excited about the changes and opportunities. Mr. Carlson informed PIMCO about the items TMRS would monitor. Mr. Gavia asked about their succession plans and Mr. Carlson discussed those plans. ORG was the next update and he reviewed the results of the on-site visit. ORG has added new staff along with a new General Counsel and Mr. Carlson was pleased with the results of the meetings.

Mr. Carlson discussed the two-page portfolio highlights sheet which can be used by the Board to answer questions. It summarizes current projects, fees and includes definitions. It will be updated quarterly and placed in Diligent.

## **2. Quarterly Investment Staff Report/Asset Class Updates**

Mr. Carlson gave a quick performance update. He discussed that year-to-date was down slightly, but we are positive on the five year performance and February was a good month. He next reviewed the portfolio's asset allocation discussing where funding would come from to find new initiatives. He noted that the 5% allocation to private equity will not begin in 2014 due to timing and education needs. He explained that it will take four to eight years to fully fund the private equity allocation.

Ms. Qualls began by discussing equities by stating economic growth is improving in the U.S. and Europe. She listed the various strategies and managers and then discussed the annual review of UBS Global Asset Management. Ms. Qualls highlighted some structure changes at UBS. The portfolio management team has been stable with the portfolio managers being with UBS for at least ten years. The recommendation is to retain UBS.

The next item reviewed was the Board action and implementation on the Core/Satellite structure. Ms. Qualls discussed that the next focus will be in the mid-cap area for U.S. Equities and will complement the value tilt of the current exposure. Manager recommendations will be brought to the Board in June. On the non-U.S. side, the focus will be on emerging markets and manager recommendations will be brought to the Board in September.

In regards to Fixed Income, Mr. Mitra discussed the 10 year Treasury has rallied due to economic news. Corporate spreads are very tight right now. The Global linkers portfolio has benefited from falling interest rates. The Core Fixed Income mandate has outperformed the benchmark, as has the Core Plus mandate. The Real Return mandate has underperformed the benchmark. Mr. Mitra discussed that Absolute Return and non-Core Fixed Income will be funded from the Core Fixed Income.

Ms. Macki discussed the Real Estate allocation and noted performance has been good. She reviewed the market environment for various types of property. She discussed the Real Estate Investment Trust (REIT) returns versus Equity markets and the shift in correlation to being closer to Fixed Income rather than the usual correlation to Equities. Current findings suggest that performance is still being affected by the "J" curve effect. Ms. Macki discussed diversification by property type, manager and geographic location. She reviewed committed versus allocated funds. The volatility of property types were discussed from short and long term perspectives.

Mr. Shishkoff discussed what this all means from a risk and compliance perspective. There were no instances of non-compliance. He discussed total fund risk, tracking error risk and the contribution of each manager and asset class to tracking error.

## **3. Consider and Act on Clarification of Investment Policy Statement Regarding the Use of Futures**

Mr. Mitra discussed the use of futures to manage duration within the portfolio. The implementation of the IPS Treasury Futures guidelines as written proved to be cumbersome. The changes are recommended to make the policy more user friendly with the same amount

of collateral being held. The change is to where the collateral will be held. The other change is to not limit ourselves to just five and ten year futures.

Ms. Oakley made a motion to adopt the revisions to the Investment Policy Statement as proposed. Mr. Philibert seconded the motion, which passed 5-0.

**4. Consider and Act on Real Estate Manager Recommendations**

Ms. Macki, Ed Schwartz and Barbara McDowell began this presentation. Ms. Macki reviewed the Real estate investment search including the timeline and search process. She reviewed the manager selection criteria, due diligence ranking factors and final candidates and their rankings.

The evaluation team recommended the Walton Street Real Estate Debt Fund. Mr. Schwartz stated that Walton Street's debt strategy would complement the existing Real Estate portfolio and will help achieve the Board's goal of maximizing risk-adjusted returns for the real estate asset class. Two other managers were recommended for follow-on investments: Invesco U.S. Income Fund and Rubenstein Properties II.

Walton Street Real Estate Debt fund has a net return target of 9-11%. TMRS will be a founding investor which will provide for fee breaks. Follow-on investments with two existing managers provided for better opportunities than other current market offerings.

Ms. McDowell reviewed the Invesco U.S. Income Fund and Rubenstein Properties Fund II. Invesco's U.S. Income Fund investment strategy focuses on stable income return opportunities. The Rubenstein Properties Fund II focuses on acquiring and developing office properties that require repositioning, lease-up, and/or other value creation activities.

Ms. Macki reviewed the conclusions and recommendations as presented. ORG and Staff recommend the following managers and allocations: 1) Invesco U.S. Income Fund for an additional \$50 million allocation, 2) Walton Street Debt Fund for a \$100 million allocation and 3) Rubenstein Properties II for an additional \$25 million allocation for a total allocation of \$175 million.

Ms. Oakley made a motion to authorize the allocation as recommended with the amendment that authorization is contingent upon a favorable background check, where necessary, and successful negotiation of the contract. Mr. Landis seconded the motion, which passed 5-0.

**5. Consider and Act on Non-U.S. Equity Manager Recommendations**

Ms. Qualls and Jennifer Nichols of R.V. Kuhns provided a review of the timeline for the current search process, which also included the equity structure background and education of the "initial phase" into active satellite strategies. Ms. Qualls also reviewed the objectives of the search, which were to further diversify the portfolio within the equity asset class and generate increased returns through active management. Ms. Nichols discussed the manager search process, timeline and minimum qualifications. There were 15 candidates offering 17 different products who responded to the Request for Information questionnaire. Ms. Nichols reviewed how the initial scoring was categorized and that six candidates were selected for

interviews. The candidates were re-scored and the top four candidates were chosen for on-site visits. Scoring was provided by both TMRS and R.V. Kuhns to determine strength in the following categories for the finalist candidates. The characteristics utilized for selection were team, philosophy and process, risk management, performance history and portfolio fit.

Based on the finalist scoring criteria, two managers were recommended for Board consideration: Lazard Asset Management and Wellington Management. Ms. Qualls and Ms. Nichols detailed firm characteristics of both Lazard and Wellington.

Ms. Qualls reviewed the Risk Budget Impact-Excess Return. This allocation should increase expected return while staying within the risk budget.

Ms. Oakley made a motion that the Board approve the selection by TMRS Staff and the TMRS Investment Consultant, R.V. Kuhns, of the following managers or their affiliates for investment specified equity strategies. TMRS Staff and TMRS Investment Consultant, R.V. Kuhns, also recommend the authorization of the Executive Director to negotiate the contracts and settle on the appropriate fund structure:

- Lazard Asset Management - International Equity Plus strategy for a \$200 million mandate
- Wellington Management - International Horizons strategy for a \$200 million mandate

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

#### **6. Consider and Act on Amortization Policy Changes**

Mr. Randall and Mr. Newton discussed the national trend toward shorter amortization periods. It is more conservative actuarially and saves the cities money over the long run. Maintaining sustainable benefits for all members and retirees is the top priority of staff and the actuary. Changes have occurred to ensure the System is well-funded and that member benefits stay secure. The Actuarial Accrued Liability represents a "target" level of assets calculated as if everything always had been and always will be "perfect". In reality, the actual asset level will be higher or lower than this perfect target. Amortization policies determine how this difference is managed from a funding perspective. Mr. Randall reviewed the current amortization policy and discussed how gains were used to offset against the current largest loss base. He discussed the 25 year open amortization period for "overfunded" cities, the closed 15 year period used for amortizing ad hoc benefit enhancements as well as the "small city" policy.

Mr. Newton discussed how new liabilities are created: prior service credit, benefit changes and adverse actuarial experience. Current funding policy is to "ladder" each year's liability using the City's maximum period, either 25 or 30 years. GRS is recommending a transition back to amortizing new losses over a closed 25 year period for all cities. National trend is towards shorter amortization periods and, for cities with a 30 year maximum amortization period, this will shorten the length of time until a positive unfunded accrued liability (UAAL) amortization is achieved. Mr. Newton used an example of the difference between the 30 and 25 year periods. Gains would continue to be treated the same as would ad hoc benefit enhancements.

GRS recommends a 25 year amortization period for all new losses, beginning with the December 31, 2014 valuation including those created by: 1) All non-ad hoc benefit enhancements, 2) changes to assumptions or funding policies, and 3) experience differing from expectation (assumptions). The "small City" formula will also reflect a 25 year maximum amortization period.

Mr. Rodriguez recommended time should be spent educating the Cities and that this topic be brought back at a later meeting.

Ms. Philibert made a motion to table the item until a later Board meeting. Ms. Oakley seconded the motion, which passed 5-0.

**7. Consider and Act on 2013 Interest Credit Allocation to the Benefit Accumulation Fund and Interest Reserve Account**

Mr. Randall recommended crediting the Benefit Accumulation Fund (BAF) an approximate 2013 market value rate of return of 9.70%. This allocation will maintain the \$100 million Interest Reserve Account. Mr. Randall explained the Ten (10) Year Smoothing with a 15% "soft" corridor. The "smoothed" 2013 rate of return will be 7.66% for 2013 on the BAF and leaves about \$1,175 million in deferred gains as of December 31, 2013. This is approximately 5% of the total system assets.

Mr. Randall reviewed yields based on market value of assets as well as a comparison of market and actuarial value of assets. He showed contribution versus benefits and refunds.

Mr. Philibert made a motion that the Board credit the BAF with 9.70% interest which represents the estimated net investment income remaining after adjustments for the statutory interest credit requirements and budget transfers, includes the estimated fourth quarter real estate valuation adjustments and maintains a \$100 Million Interest Reserve Account balance. Any differences in the final versus estimated fourth quarter real estate 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, 2013 and considered in the 2014 BAF interest credit determination. Ms. Oakley seconded the motion, which passed 5-0.

**8. Consider and Act on Appointment(s) to the Advisory Committee on Retirement Matters**

Mr. Gavia reviewed the group and individual classes of the Advisory Committee on Retirement Matters. Julie Oakley and Jim Parrish helped Staff review the applications received.

Ms. Oakley moved that Bryan Langley, Assistant City Manager and Chief Financial Officer with the City of Denton, be appointed to a three-year term to expire on December 31, 2016 in the Individual Class of the TMRS Advisory Committee on Retirement Matters. Mr. Philibert seconded the motion, which passed 5-0.

9. **Executive Session**

At 4:26 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 the meeting was opened to the public again at 6:45 p.m. All members of the Board who had been present when the Board went into Executive Session were again present.

At 6:45 p.m. the meeting was recessed until 8:30 a.m. on Friday, March 21, 2014.



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David Gavia  
Executive Director



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Roel "Roy" Rodriguez  
Chair, Board of Trustees

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

**March 20, 2014 – 1:00 p.m.**

**March 21, 2014 – 8:30 a.m.**

On March 21, 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**

Julie Oakley, Vice Chair

Bill Philibert

David Landis

Jim Jeffers

Absent: Jim Parrish

Roy Rodriguez

**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

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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

Susan Warren, KPMG LLP

John Fisher, KPMG LLP

Chris Stone, KPMG LLP

**Also in attendance:**

Sherry Chapman, Investment Accountant



Peter Jeske, Project Specialist  
Michelle Mellon-Werch, Associate General Counsel  
Candace Nolte, Controller  
Nick O'Keefe, Senior Staff Attorney  
David Rodriquez, Regional Manager – City Services  
David Crow, Arlington Professional Fire Fighters  
Bob Scott, Government Finance Officers Association of Texas/City of Carrollton  
Chris Jones, Combined Law Enforcement Associations of Texas (CLEAT)  
George Kauffman, City of Garland  
Scott Kerr, Texas State Association of Firefighters (TSAFF)/City of Plano  
Kevin Lawrence, Texas Municipal Police Association  
Juan Garcia, Governor's Office  
Meredyth Fowler, Speaker's Office  
Keith Hopkins, Mesquite Fire Department  
Melinda Griffith, Combined Law Enforcement Associations of Texas (CLEAT)  
Greg Shipley, Combined Law Enforcement Associations of Texas (CLEAT)/City of  
Corpus Christi  
Mel Thomas, Editor

Mr. Rodriguez called the meeting to order at 8:30 a.m. and Mr. Jeffers gave the invocation.

**10. 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.

Mr. Philibert moved that the Board adopt the Consent Agenda as presented. Mr. Landis seconded the motion, which passed 4-0.

**11. Review and Discussion of 2013 External Audit (SAS-114) and Service Organization Control Audit**

Susan Warren, Audit Partner, John Fisher, Audit Manager, and Chris Stone, IT Director, from KPMG were present to discuss the 2013 Audit Plan. Ms. Warren outlined the agenda for this required communication with the Board. She reviewed the members of the client service team assigned to the TMRS audit, highlighting the partners and specialty participants. Ms. Warren next outlined the objective of an audit. The objective of an audit of financial statements is to enable the auditor to express an opinion about whether financial statements that have been prepared by management with the oversight of the Board of Trustees are presented fairly, in all material respects, in conformity with generally accepted accounting principles (GAAP). The audit is planned and performed to obtain reasonable assurance that the financial statements as a whole are free from material misstatement. It includes performing tests of the accounting records and evaluating policies and estimates. Both management's and the Board's responsibilities regarding an audit were discussed. KMPG's responsibilities were discussed next.

Ms. Warren reviewed the responsibilities for information in documents contained in the audited financial statements. She discussed risk assessment and various areas of potential risk and where we are currently in this process. Ms. Warren discussed the audit scope and the standard that will be used and adhered to in performing the audit. She reviewed the concept of materiality and the various levels and types of materiality. The audit plan deliverables and the time line were discussed.

A list of required questions to the Board to obtain their views and responses was discussed and no significant items were revealed.

Ms. Covarrubias then discussed TMRS' SOC audit planning and the GAP analysis that was performed. She explained why TMRS has added the step of having a SOC audit performed.

Mr. Stone explained that a SOC audit is a report by auditors to the management and auditors of the service providers' customers. It is used to make the city auditor aware of the System's internal controls. A SOC1 Type II audit not only lists the internal controls, but also tests that the controls are working as designed. He reviewed the difference between a SOC audit and financial statement audit and the benefits to the Service Organization (TMRS) of having a SOC audit. Mr. Stone discussed the sections of a SOC audit document and who has responsibility for those sections. The report covers: 1) description of controls, 2) adequacy of controls and 3) operating effectiveness of controls. He reviewed examples of both Process Level Control Objectives and Information Technology Control Objectives. Mr. Stone reviewed what control reporting would look like.

Mrs. Warren and Mr. Gavia discussed the advantages to TMRS of the SOC audit process. Ms. Covarrubias added that TMRS will have to maintain this document on an on-going basis. As our internal processes change or functions are added, TMRS will have to continually update the document which will flow through to SOC testing. She reviewed the User Control Activities letter that was recently mailed to the cities. This letter outlines the city's responsibilities in order to rely on the TMRS SOC audit.

#### **12. Consider and Act on Internal Audit Committee Charter**

Mr. Gavia reviewed the reestablishment of the Internal Audit Committee and the Committee's review of the Internal Audit Committee Charter. An amendment was proposed to the Charter clarifying that the Internal Audit Committee is an advisory committee and the Board did not delegate any of its authority to this Committee.

Ms. Landis made a motion that the Board adopts the proposed Internal Audit Committee Charter as presented. Mr. Jeffers seconded the motion, which passed 4-0.

#### **13. Consider and Act on Adoption of the 2014 Risk-Based Audit Plan**

Mr. Gavia discussed that the Committee review the risk-based audit plan. The Committee asked for additional information to be developed before the audit plan can be approved.

Mr. Philibert made a motion to table the item until the next meeting so additional information can be developed. Mr. Jeffers seconded the motion, which passed 4-0.

**14. Executive Director and Staff Reports, including Reports from Administration, Communications, Staff Actuary, Finance, Governmental Relations, Human Resources, Information Resources, Internal Audit, Legal and Member Services**

Mr. Gavia presented these reports, highlighting Staff achievements in obtaining certifications and education achievements.

**15. Call for Future Agenda Items**

Discussion on amortization policy should be included for the May 20-21, 2014 Board meeting.

The meeting was adjourned at 9:20 a.m.



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David Gavia  
Executive Director



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Julie Oakley  
Vice Chair, Board of Trustees