

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

February 20, 2014 – 2:00 p.m.

February 21, 2014 – 8:30 a.m.

On February 20, 2014, the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a meeting at 2:00 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
Jim Parrish, Vice Chair
Bill Philibert
David Landis
Julie Oakley
James "Jim" Jeffers

Present also were:

David Gavia, Executive Director
Eric Davis, Deputy Executive Director
Ian Allan, Director of Internal Audit
Rhonda Covarrubias, Director of Finance
Kristi 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
Rhonda Covarrubias, Director of Finance
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
Todd Shupp, R.V. Kuhns & Associates
Johnathan Kowolik, R.V. Kuhns & Associates

Also in attendance:

Sherry Chapman, Investment Accountant
Debbie Farahmandi, Investment Operations Specialist
Howell Hollis, Investment Analyst
Peter Jeske, Support Services Analyst
George Kauffman, City of Garland
Scott Kerr, Texas State Association of Firefighters (TSAFF)/City of Plano
David Crow, Arlington Professional Fire Fighters
Bob Scott, Government Finance Officers Association of Texas/City of Carrollton
Greg Shipley, Combined Law Enforcement Associations of Texas (CLEAT)/City of
Corpus Christi
Melanie Griffith, Combined Law Enforcement Associations of Texas (CLEAT)
Keith Hopkins, Mesquite Fire Department
Candace Nolte, Controller
Cindy Morse, Investment Support Analyst
Kate Reed, Investment Risk Analyst
David Rodriguez, Regional Manager – City Services
Eddie Schultz, Real Estate Analyst
Mel Thomas, Editor
Meredyth Fowler, Speakers Office
Juan Garcia, Governor's Office
Mel Thomas, Editor

Mr. Rodriguez called the meeting to order at 2:00 p.m. and Mr. Landis gave the invocation. Mr. Rodriguez welcomed Jim Jeffers to his inaugural Board meeting.

1. Chief Investment Officer Management Update

Mr. Carlson began this discussion to update the Board on items of interest. He discussed the management and leadership changes at PIMCO caused by the departure of their Chief Executive Officer and co-CIO, Mr. Mohamed El-Erian. Mr. El-Erian's CIO responsibilities will be assumed by the firm's founder and co-CIO, Bill Gross with six senior investment staff members being promoted to Deputy CIO to assist Mr. Gross in leading the firm's investment team. Two individuals have been named to take over Mr. El-Erian's CEO duties. The TMRS account service team will not be changing. Additional due diligence will be performed on-site to ensure TMRS' comfort with the firm and its direction.

Mr. Carlson updated the Board on Staff accomplishments. He noted Real Estate Analyst, Mr. Schultz's, passage of the CFA Level 1 examination. Mr. Hollis, Investment Analyst, and Mr. Schultz will take the CFA Level II examination. Ms. Morse, Investment Support Analyst and Ms. Macki, Director of Real Estate, passed the Six Sigma Green Belt Certification and Ms. Morse also received her Certificate of Achievement in Public Plan Policy (CAPPP).

2. R. V. Kuhns Quarterly Investment Report

Todd Shupp from R.V. Kuhns began the quarterly investment report with the Executive Summary. 2013 was an impressive year in the U.S. Equity market, but there was still some uncertainty in the markets. Non-U.S. Equities were solid, but not as strong as U.S. Equities. Fixed income experienced its first negative year of performance in over fourteen years as interest rate increases made an impact in 2014. The Quantitative Easing program by the Federal Reserve is beginning to wind down. Final Gross Domestic Product (GDP) figures for the third quarter were revised upward based on stronger consumer spending and private inventory growth. Inflation remains muted.

Shifting to the TMRS portfolio, Mr. Shupp showed several peer comparisons noting that TMRS still has a larger exposure to fixed income than its peers. He reviewed total fund performance versus benchmarks. Over the rolling five-year average, we have outperformed all three benchmarks. Performance versus peers, indicated that TMRS is lagging its peers, but noted that the target portfolio is still not completely reached. The Risk/Return profile was reviewed next. In the five-year period, TMRS had slightly lower returns than its peers, but with significantly less risk. Asset Class Composite was the next item reviewed with performance indicating the return gross of fees was 9.75%.

Ms. Oakley asked about the overweighting in Equities. Mr. Carlson noted that this is the place holder for the private equity allocation and therefore will remain overweight until private equity is funded.

3. Consider and Act on Absolute Return Strategy Fund of Fund Manager Recommendations.

Mr. Carlson began by stating in the long term the expectation is to have about one-third of this allocation in Hedge Fund of Funds (HFoF) and two-thirds in direct hedge fund investments. Mr. Shupp started the education overview for the new Board members. He reviewed the risk and return expectations of the Absolute Return Strategies (ARS). The goal is to 1) increase portfolio returns, 2) attempt to decrease portfolio risk and 3) provide performance with low correlation to traditional asset classes, even with a relatively small allocation. Compared to traditional asset classes, ARS are less transparent, less liquid and more expensive. Our structure will be a fund-of-one approach which will give TMRS much better transparency. ARS is an important thematic piece (alpha) of the total fund allocation.

Mr. Shupp reviewed several different types of hedge fund strategies; for example, Directional (HFN Long/Short Equity Index), Non-Directional (HFN Relative Value Aggregate) and Event Driven (HFN Event Driven Index). Mr. Shupp discussed the TMRS policy benchmark for the ARS target allocation. The goal is to have a multi-strategy absolute return fund of funds. There are a variety of risks, both investment and operational, but through due diligence, these risks can be mitigated. While there are unique risks, ARS can have a positive impact on the expected risk/return profile of a portfolio. Based on R.V. Kuhn's recommendation, TMRS will be investing in a Fund-of-One Fund of Hedge Funds initially. Mr. Shupp reviewed the advantages of such an investment structure and disadvantages of such an investment structure. One disadvantage is the extra layer of fees charged by the Fund of Fund Manager.

In summary, a Fund of One of Hedge Fund (FoHF) is the recommended initial structure. Fees can be higher in this asset class, but TMRS has negotiated an advantageous fee structure for TMRS. Discussion centered on liquidity, limitations/management, and are we getting paid for illiquidity.

Mr. Mitra and Mr. Shishkoff next discussed the Fund of One Manager recommendation. Mr. Mitra reviewed the timeline and steps leading up to this recommendation. He discussed TRMS' objectives: portfolio diversification, stable return stream and controlled volatility, and a positively skewed risk/return profile.

Mr. Mitra reviewed the manager search process beginning with 17 initial manager candidates, narrowing this down to four managers. The manger screening criteria was reviewed, highlighting that a manger must have at least \$7.5 billion in discretionary assets under management, a 10-year track record and experience managing a custom portfolio and have five customized Fund of One accounts. The scoring results were reviewed and four finalists were named.

From the four finalists, Blackstone Alternative Asset Management (BAAM) was selected as the recommended manager. Mr. Mitra discussed the characteristics that brought BAAM to be the top candidate and highlighted their investment management strengths. Mr. Shishkoff reviewed their strengths in risk management. BAAM has a technology platform that permits monitoring at all levels of their operations and they make it available to clients. Strong marks were given for compliance, ethics and service. Mr. Shishkoff discussed the risk budgeting impact graphically showing the expected improvement in return and reduction in tracking error.

Mr. Landis asked about fee structure. Mr. Mitra stated that the negotiated management fee is very low, 35 basis points, with performance fees based on the level of return. Performance pay only happens subject to high-water mark (exceeding the portfolio's highest historic NAV on an annualized basis). As a Fund of One, Blackstone is the general partner and TMRS would be the only limited partner. TMRS owns the fund and can change general partners if need be.

Mr. Parrish made a motion to recommend the Board approve Blackstone Alternative Asset Management (BAAM) to be TMRS' customized fund of one adviser in accordance with the fee structure presented; and authorize the Executive Director and Staff to proceed with the creation of a general partner/limited partner (GP/LP) type partnership with BAAM as the GP and TMRS as the LP, to invest in a portfolio of hedge funds through a customized fund of one vehicle. Ms. Oakley seconded the motion, which passed 6-0.

4. Securities Lending Program Annual Review

Mr. Kowolik from R.V. Kuhns and Mr. Hollis began a review of the Securities Lending program. TMRS transitioned to Deutsche Bank as the agent lender in 2013. The program is working as expected and no changes are recommended. Although the program operates in a more risk-averse manner than some peers, it is designed to emphasize the lending of securities with "intrinsic value" to the marketplace and to minimize future cash collateral

reinvestment risks. Mr. Hollis reviewed the credit metrics of Deutsche Bank and Mr. Kowolik reviewed the lending and reinvestment programs, highlighting the 2013 earnings for TMRS (approximately \$2 million). Cash collateral holdings were reviewed as of December 31, 2013 and there were no concerns that warranted a recommended change to the program.

Three items were discussed for information purposes. A review of the investment policy guidelines for the Security Lending program indicated no recommended changes. TMRS will continue to solicit updated estimates on a periodic basis from Deutsche Bank to determine if a greater degree of economic value might accrue to TMRS from lending equity securities. Finally, TMRS will continue to review a path forward on the Legacy Duration portfolio.

5. Review Resources Support for New and Existing Investment Programs including Absolute Return Strategy, Private Equity and Others

Mr. Carlson reviewed resource support for new and existing investment programs. His first action is to realign the Compliance Analyst to report directly to the Chief Investment Officer. Second, the Real Return Asset Class will be realigned under Real Estate under the same Director. This would allow the Fixed Income Director to focus solely on Core and Non-Core Fixed Income. Third, upgrade the Absolute Return Strategies Analyst position to Director level enabling this asset class to be properly developed. The last item for consideration is the hiring of a Private Equity Director to help build this program in advance of making a Private Equity Allocation. Mr. Carlson laid out the potential education and implementation schedule for Private Equity.

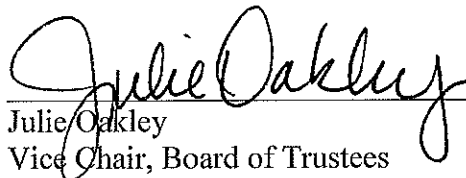
6. Executive Session

At 4:52 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 6:00 p.m. All members of the Board who had been present when the Board went into Executive Session were again present.

At 6:00 p.m., the meeting was recessed until 8:30 a.m. on Friday, February 21, 2014.



David Gavia
Executive Director



Julie Oakley
Vice Chair, Board of Trustees

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Julie Oakley
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Present also were:

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Ian Allan, Director of Internal Audit
Rhonda Covarrubias, Director of Finance
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Also in attendance:

Scott Kerr, Texas State Association of Firefighters (TSAFF)/City of Plano
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Bob Scott, Government Finance Officers Association of Texas/City of Carrollton
Melanie Griffith, Combined Law Enforcement Associations of Texas (CLEAT)
Keith Hopkins, Mesquite Fire Department
David Rodriquez, Regional Manager – City Services
Mel Thomas, Editor

Mr. Rodriguez called the meeting to order at 8:32 a.m. and gave the invocation.

7. Consider and Act on Minutes from the December 5-6, 2013 Regular Meeting of the Board of Trustees.

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

Mr. Parrish made a motion that the Board adopt the minutes from the December 5-6, 2013 Meeting of the Board of Trustees. Mr. Philibert seconded the motion and Ms. Oakley abstained, which passed 5-0.

8. Consider and Act on the Creation of Board of Trustees Internal Audit Committee

Mr. Gavia presented the background of the Creation of the Audit Committee which had previously been suspended. If the Board chooses to re-create the Committee, it is suggested that it be staffed by two Board members and the committee be tasked with developing a Committee charter, developing a 2014 audit plan recommendation, reviewing pending audit reports, defining a role for the Committee for the currently planned external audit and reporting back to the full Board on progress made at the March 2014 meeting. Mr. Rodriguez supported the development of this Committee. Mr. Parrish and Mr. Jeffers volunteered to serve on the Committee with Mr. Parrish serving as Chair.

Mr. Landis made a motion that the Board establish an Audit Committee consisting of two Board members for the limited purpose of providing Internal Audit oversight, task the Committee with developing an Audit Committee charter, develop recommendations for the 2014 Audit plan, review pending audit reports, identify and assign a short-duration audit to the Internal Auditor, if necessary, define a role for the Committee for the currently planned external audit, and report back on its progress at the March 2014 Board meeting. Mr. Philibert seconded the motion, which passed 6-0.

9. Consider and Act on Ratification of Ordinances Adopting Updated Service Credit and/or Annuity Increases Effective January 1, 2014 (Received after the December 6, 2013 Board meeting)

Mr. Gavia previously presented this item for Board approval at the December meeting and a list of ordinances had been approved. The list presented at this time includes ordinances received after the December 6, 2013 meeting. The ordinances were received by December 31, 2013 and have been implemented as part of each cities plan design and should be ratified by the Board.

Ms. Oakley made a motion that the Board ratify those ordinances adopting Updated Service Credit/or Annuity Increases that were not included on the listing presented at the December 6, 2013 Board meeting. Mr. Parrish seconded the motion, which passed 6-0.

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

Mr. Gavia reviewed the vacancies on the Advisory Committee. Staff has discussed and vetted the nomination of Ron Crabtree to fill a retiree slot in the individual class. Tadd Phillips has been nominated by the Texas Municipal Human Resources Association and there is a lengthy list of alternate candidates to represent the group class members.

Mr. Parrish made a motion to recommend that the Board approve the nominations as presented, including Mr. Crabtree, Mr. Phillips and the alternates nominated by the groups. Mr. Philibert seconded the motion, which passed 6-0.

11. Consider and Act on Advisory Committee on Retirement Matters Future Meetings and Topics During the Legislative Interim

Mr. Gavia discussed how the Board had previously enlisted the Advisory Committee to discuss and develop recommendations concerning potential changes to the TMRS Act in past legislative interims. Staff feels there is benefit to having the Advisory Committee meet during the interim in preparation for the 84th Legislative Session. A preliminary survey was conducted to solicit topics of interest for investigation and to help the Board determine if certain topics, such as those previously filed as legislation, should be studied during the interim.

Mr. Rodriguez added his support for the Committee with a special first meeting in April and a second meeting in May. He asked Ms. Oakley to Chair this Committee and Mr. Landis to serve as Vice Chair. Mr. Rodriguez suggested that focus be paid to the suggestions of the Advisory Committee based on their past work on the issues.

Mr. Parrish made a motion that the Board Chair designate a chair and vice-chair of the Advisory Committee on Retirement Matters and that the Board allow the Chair and vice-chair of the Committee to determine the topics to be studied and number of meetings necessary to prepare for the 84th Legislative Session, and to convene these meetings during the interim, at the Chair and Vice-Chair's discretion. Mr. Philibert seconded the motion; which passed 6-0.

12. Strategic Plan Update

Mr. Gavia reviewed that the current Strategic Plan was developed in 2007 and 2008 with additional objectives added in 2011. He next discussed the progress made toward these objectives as of February 2014 including:

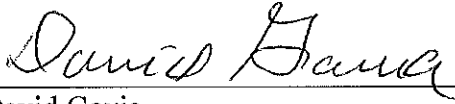
- Actuarial changes including adoption of new Annuity Purchase Rates and methodology for implementation as well as adopting the Entry Age Normal actuarial funding method.
- Investment portfolio changes including further diversification
- Progress made in regards to customer service by developing "Straight Through Processing".

Mr. Gavia suggested a Board retreat should be considered to develop and review the Strategic Plan during 2014.

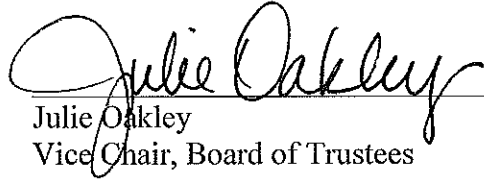
13. Call for Future Agenda Items

No items were discussed.

The meeting was adjourned at 9:05 a.m.



David Gavia
Executive Director



Julie Oakley
Vice Chair, Board of Trustees