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

March 26, 2015 – 1:30 p.m.

On March 26, 2015 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**
Julie Oakley, Chair
Jim Parrish, Vice Chair
Roel “Roy” Rodriguez
David Landis
Jim Jeffers

Absent: Bill Philibert

**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
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 Fixed Income
Kristin Qualls, Director of Equities
Jesse Pittman, Project Manager
Robert Klausner, Klausner, Kaufman, Jensen & Levinson
Dimitry Shishkoff, Director of Risk Management
Marc Leavitt, Director of Absolute Return
Chris Schelling, Director of Private Equity
Tom Mashtay, Director of Real Estate
Karen Jackson, Executive Assistant
Amy Hsiang, RVK
Weston Kasper, RVK
Mark Randall, Gabriel, Roeder, Smith & Company
Amy McDuffee, Aon Hewitt Investment Consultants
Susan Warren, KPMG
Rebecca Goldstein, KPMG
Also in attendance:

Sherry Chapman, Investment Accountant
Debbie Farahmandi, Investment Operations Specialist
Melissa Jerkins, Quantitative Analyst
Peter Jeske, Project Specialist
Michelle Mellon-Werch, Associate General Counsel
Madison Jechow, Assistant General Counsel
Di Fu, Investment Data Analyst
Nick O'Keefe, Senior Staff Attorney
Cindy Morse, Investment Support Analyst
Kate Reed, Investment Risk Analyst
David Rodriguez, Regional Manager – City Services
Colin Davidson, Regional Representative – City Services
Anthony Mills, Regional Representative – City Services
Eddie Schultz, Real Estate Analyst
Carol Leung, Investment Analyst
Ariel Chou, Actuarial Analyst
Mel Thomas, Editor
Chris Jones, Combined Law Enforcement Associations of Texas
David Crow, Arlington Professional Fire Fighters
Alex Cramer, Arlington Professional Fire Fighters
Bob Scott, Government Finance Officers Association of Texas
George Kauffman, City of Garland

Ms. Oakley called the meeting to order at 1:32 p.m. and Mr. Rodriguez gave the invocation.

1. Chief Investment Officer Management Update, Including Governance, Personnel, Manager Updates and Other Investment Related News or Matters
Mr. Carlson discussed the updated pacing plan. The estimated amount of initial investment has been added to the plan as well as other procedural items. He reviewed both the updated Annual Manager Review Report Card with its five-step grading system and the Board’s Reference Sheet with its expanded format.

Mr. Carlson updated the Board on the watch list status of PIMCO. PIMCO remains on the watch list, but it is meeting expectations.

2. Consider and Act on Reallocation of Bank Loan/Collateralized Loan Obligations/Residential Mortgage Backed Securities and Commercial Mortgage Backed Securities Funds
Mr. Carlson reviewed the background regarding approved investments in the Bank Loan/Collateralized Loan Obligation strategy. He discussed the issues surrounding Credit Suisse and Staff’s recommendation to reallocate the funds previously approved for Credit Suisse to the other two previously approved managers, the Highland Fund and the Guggenheim Fund. Mr. Carlson highlighted key considerations and an analysis of combinations of the original three managers and concluded that the Guggenheim/Highland combination offered the best combination under various measures.
Mr. Carlson then reviewed the reallocation under the Residential Mortgage Backed Securities and Commercial Mortgage Backed Securities (RMBS/CMBS) strategy. In this instance, TMRS could not come to terms with one of the original three managers. He reviewed the original list of managers from which the three were originally selected and indicated that no other managers on the list would be appropriate. (Mr. Landis joined the meeting at this point.) Reallocating the funds to the two existing managers, gives Staff the opportunity to try to negotiate fees.

Mr. Carlson reviewed the following recommendation:

- Reallocate the remaining $250 Million allocation to the CLO/Bank Loan program to the other two approved managers, the Highland Fund and the Guggenheim Fund, in the amount of $125 Million to each manager.
- Reallocate the remaining $250 Million allocation to the RMBS/CMBS program to the other two approved managers, Ellington Management Group, L.L.C. and Voya Investment Management Co. LLC., in the amount of $125 Million to each manager.
- Authorize the Executive Director to negotiate and execute any and all contract amendments or modifications that he deems necessary, appropriate or desirable from time to time to accomplish such reallocations.

Mr. Parrish made a motion to approve the recommendation as presented. Mr. Jeffers seconded the motion, which passed 5-0.

3. **Consider and Act on Real Estate Consultant Recommendation**

Mr. Carlson began with a brief overview of the relationship with the current consultant, ORG. Mr. Masthay reviewed the Real Estate Consultant Request for Proposal (RFP) process and timeline. The process began with eight candidates and four semi-finalists were selected. An essay was issued and after the responses were received, two finalists were selected. After an on-site due diligence visit and finalist rank order established, a finalist was selected.

Mr. Schultz discussed the RFP design and issuance and a copy of the RFP is included in the Board materials. Mr. Masthay reviewed the ranking methodology and discussed how the methodology shifted between rounds. He next discussed the due diligence objectives in rounds two through five of the process. The essay round was designed to determine the manager’s thought process and philosophy in the current economy. The process resulted in Courtland Partners as the recommended consultant.

The benefits of retaining Courtland include: 1) resource expansion in the U.S. and Europe; 2) knowledge of the TMRS portfolio and like-minded philosophy; 3) good business and client service risk profile; and 4) pricing advantages. Mr. Masthay discussed the potential disadvantages that have largely been mitigated. He outlined the risks to retaining Courtland Partners: 1) onboarding of a new consultant in the “middle innings” of portfolio implementation brings potential portfolio composition and philosophical risks; 2) operational drag has the potential to delay further implementation; and 3) unknown elements in the dynamics of the consulting relationship and business. The final pricing bids for both
Courtland and ORG were reviewed. Courtland is a considerably larger firm compared to ORG.

Mr. Parrish made a motion to the Board to select Courtland Partners, Ltd. as the Real Estate specialty consultant for a term of up to 5 years, contingent on successful negotiation of the consulting services contract and at consultant fees no higher than proposed in the Board materials, and that the Executive Director be authorized to negotiate, execute, and deliver the consulting services contract and any other agreements or documents the Executive Director deems necessary or appropriate to accomplish such transaction. Mr. Landis seconded the motion, which passed 5-0.

4. **Fixed Income Overview**
Ms. Macki began the overview of the Fixed Income strategy with a review of the current and target allocations. Mr. Carlson gave the Board an outline of the next steps and deliverables in the current asset allocation process. The current target allocations to Fixed Income is 30% Core Fixed Income and 10% Non-Core Fixed Income.

Ms. Hsiang discussed the Fixed Income Peer Comparison. TMRS has a higher allocation than peers to Fixed Income overall, and a lower allocation than peers to International and Global Fixed Income. In a Fixed Income Peer Comparison of five year annual returns, TMRS ranked in the 93rd percentile with a return of 5.26%. Ms. Macki reviewed Capital Market Assumptions from multiple providers, which anticipate lower return expectations for fixed income, particularly over the next five to ten years. This analysis suggests that changes to the current asset allocation may need to be considered in order to enhance returns and aid in achieving the 7% actuarial investment return assumption. This would not require a major reshuffling of the portfolio.

Ms. Macki highlighted the return potential and risk factors of liquid, less liquid and illiquid fixed income strategies. She reviewed the risk/return characteristics of the various strategies and concluded by discussing how to approach asset allocation in a low return environment.

5. **Consider and Act on 2014 Interest Credit Allocation to the Benefit Accumulation Fund and Interest Reserve Account**
Mr. Gavia gave an overview of SB350 and the goal to build significant reserves prior to its passage. However, after SB350, the asset smoothing method replaced the need for accumulating significant reserves. The asset smoothing methodology is able to adequately manage contribution rate stability as it relates to investment returns. Therefore, building a significant interest reserve is no longer necessary as a hedge against future adverse returns.

Mr. Randall highlighted the 7% investment return assumption. He discussed that this assumption will be reviewed later this year in the actuarial experience investigation study and a recommendation could be made to lower the assumption, but this is yet to be determined.

GRS recommends crediting the BAF with the market return of 5.68% which will maintain the $100 million Interest Reserve Account. Mr. Randall reviewed the Ten Year Smoothing Asset Valuation Method with a 15% "soft" corridor. Actuarial Value of Assets must be no
greater than 115% of Market Value and no less than 85% of Market Value. The method will credit 7% with 10% recognition of any remaining gains or losses while maintaining 90% of the deferred gains or losses. The smoothing calculation produces an actuarial rate of return of approximately 7.45% for 2014 on the Benefit Accumulation Fund and should allow contribution rates to remain stable for 2016 from investment performance. Mr. Randall reviewed the last three years of Market Value Assets/Actuarial Value of Assets (MVA/AVA) and deferred gains. He presented yields based on MVA as well as how closely AVA has trended to MVA. Mr. Randall also discussed contribution versus benefits and refunds (net external cash flow). GRS recommends crediting the BAF with an estimated 5.68% which represents the net investment income remaining after the statutory requirements and operating expense transfers have been fulfilled, includes the estimated fourth quarter real estate valuation adjustments, and maintains a $100 Million Interest Reserve Account balance.

GRS also advises that the 5.68% BAF interest credit will result in an estimated 7.45% smoothed or actuarial return for 2014 which will produce a small actuarial gain and allow contribution rates to remain relatively stable in 2016 from investment performance, while decreasing the System’s net deferred gain position.

Mr. Rodriguez moved that the Board credit the BAF with 5.68% 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. He further moved that 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, 2014 and considered in the 2015 BAF interest credit determination. Mr. Jeffers seconded the motion, which passed 5-0.

6. Consider and Act on Actuarial Audit Firm Recommendation
Ms. Hardy began by introducing Ariel Chou, the newly hired TMRS Actuarial Analyst. At the time this strategic objective was originally developed, the actuarial audit was scheduled for 2014, ten years after the last actuarial audit in 2004. At the October 2014 meeting, the Board approved amending the objective timeline by delaying the actuarial audit firm search until 2015 so that the auditing actuary could provide an independent review of both the December 31, 2014 actuarial valuation results as well as the 2015 actuarial experience investigation study. The purpose of an actuarial audit was reviewed. It is principally a prudent risk management exercise and it is intended to add value to the system.

Ms. Hardy reviewed the timeline of events from the issuance of the Request for Proposal (RFP) through this recommendation. She discussed the search process indicating five national actuarial consulting firms and one local regional actuarial firm were sent the RFP. Five firms responded: four national and one regional. Ms. Hardy highlighted the components included in the RFP and reviewed the preliminary reference calls, ranking process, re-ranking and the resulting recommendation. She discussed the due diligence ranking factors and the relevant points under each factor. Ms. Hardy reviewed the preliminary rankings and the final ranking after phone interviews were conducted.
Cavanaugh Macdonald Consulting was selected as the finalist and Ms. Hardy discussed the firm’s qualifications as well as the qualifications of the lead consultants.

Mr. Landis moved that the Board select Cavanaugh Macdonald Consulting as the actuarial consulting firm to provide the actuarial auditing services outlined in the Request for Proposal of Actuarial Auditing Services at the fee set out in their proposal, and that the Executive Director be authorized to negotiate, execute, and deliver the Actuarial Consulting Services Agreement with Cavanaugh Macdonald Consulting, along with any other agreements or documents the Executive Director deems necessary or appropriate for the transaction. Mr. Parrish seconded the motion, which passed 5-0.

7. Executive Session
At 3:46 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 5:46 p.m.

At 5:46 p.m. the meeting was recessed until 9:00 a.m. on Friday, March 27, 2015.

David Gavia
Executive Director

Julie Oakley
Chair, Board of Trustees
MINUTES OF THE
TEXAS MUNICIPAL RETIREMENT SYSTEM
Meeting of the Board of Trustees

March 27, 2015 – 9:00 a.m.

On March 27, 2015, the Board of Trustees of the Texas Municipal Retirement System (TMRS) reconvened for a meeting at 9:00 a.m. at TMRS Headquarters, located at 1200 North IH 35 in Austin, Texas, with the following members present:

**Board of Trustees**
- Julie Oakley, Chair
- Roel “Roy” Rodriguez
- David Landis
- Jim Jeffers

Absent: Jim Parrish
- Bill Philibert

**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
- Debbie Munoz, Director of Member Services
- Christine Sweeney, General Counsel
- Bill Wallace, Director of Communications
- Dan Wattles, Director of Governmental Relations
- Kristin Qualls, Director of Equities
- Scott Willrich, Director of Information Resources
- Holly Macki, Director of Real Estate
- Jesse Pittman, Project Manager
- Dimitry Shishkoff, Director of Risk Management
- Marc Leavitt, Director of Absolute Return
- Chris Schelling, Director of Private Equity
- Tom Masthay, Director of Real Estate
- Robert Klausner, Klausner, Kaufman, Jensen & Levinson
- Karen Jackson, Executive Assistant
- Marcia Beard, RVK
- Amy Hsiang, RVK
- Weston Kasper, RVK
- Amy McDuffee, Aon Hewitt Investment Consultants
- Susan Warren, KPMG
- Rebecca Goldstein, KPMG
- Ron Lewis, Ron Lewis & Associates
Also in attendance:

Sherry Chapman, Investment Accountant
Debbie Farahmandi, Investment Operations Specialist
Melissa Jerkins, Quantitative Analyst
Di Fu, Investment Data Analyst
Peter Jeske, Project Specialist
Michelle Mellon-Werch, Associate General Counsel
Madison Jechow, Assistant General Counsel
Nick O’Keefe, Senior Staff Attorney
Kate Reed, Investment Risk Analyst
Candace Nolte, Assistant Finance Director
David Rodriguez, Regional Manager – City Services
Eddie Schultz, Real Estate Analyst
Carol Leung, Investment Analyst
Ariel Chou, Actuarial Analyst
Bob Scott, Government Finance Officers Association of Texas
Chris Jones, Combined Law Enforcement Associations of Texas
George Kauffman, City of Garland
David Crow, Arlington Professional Fire Fighters
Alex Cramer, Arlington Professional Fire Fighters

Ms. Oakley called the meeting to order at 9:10 a.m. and gave the invocation.

8. **Consider and Act on Consent Agenda**
   Mr. Gavia stated that Staff had nothing to add to the minutes as presented. There were no changes suggested by the Board.

   Mr. Jeffers made a motion that the Board adopt the minutes from the February 26-27, 2015 Meeting of the Board of Trustees. Mr. Rodriguez seconded the motion, which passed 4-0.

9. **Review and Discussion of 2014 External Audit (SAS-114) and Service Organization Control Audit**
   Ms. Warren indicated this is the SAS 114 planning session and the audit team remains the same as last year. The objective of the audit is to provide reasonable assurance that the financial statements are free from material misstatements and conform to generally accepted accounting principles (GAAP). Management’s responsibilities were reviewed regarding preparation of the financial statements as well as the Board’s responsibilities for setting the proper tone and creating and maintaining a culture of honesty and high ethical standards. Ms. Warren discussed KPMG’s responsibilities for creating and implementing the audit plan. She reviewed KPMG’s audit approach and methodology.

   Ms. Warren discussed their audit risk assessment and due to the removal of actuarial data there were no longer any significant estimates in the financial statements. She noted some additional and significant changes to the TMRS CAFR because of GASB 67, including new required schedule of supplemental information, proposed new/revised schedules for the
actuarial section and noted that the SOC1 report will be issued for the 15 months ended March 31, 2015. Ms. Warren reviewed the audit plan/scope pointing out that we will be following GAAP and American Institute of Certified Public Accountants (AICPA) standards. Ms. Warren discussed the idea of materiality. Professional standards require that the auditor exercise professional judgment when they consider materiality and its relationship with audit risk when determining the nature, timing and extent of audit procedures and when evaluating the effect of misstatements. She next reviewed the deliverables and the timeline. Other matters for discussion include the Board’s views on: 1) who should be contacted between Board meetings, 2) significant issues or changes, 3) any changes to the TMRS’ objectives and strategies and related business risks that would affect the audit, 4) any additional areas that warrant particular attention during the audit, and 5) any issues regarding violations of laws or regulations. Mrs. Warren discussed the involvement of others, including SOC1 audits of TMRS’ service providers.

10. Legislative Update and Overview of the 84th Legislative Session, Including Discussion on Filed Legislation (originally appeared as #8 on the Friday, February 27, 2015 agenda)
Mr. Wattles and Mr. Lewis began this update on the current legislative session. Since there are numerous legislators new to TMRS committees, Mr. Lewis indicated a lot of time has been spent on education. There are only 28 working days left in the session and the House has been working on the budget and financial issues.

TMRS is tracking approximately 300 bills and Mr. Wattles reviewed the bills filed that affect TMRS and other pension plans. He highlighted the key procedural dates remaining for the session. Legislators have been working primarily on addressing the Employees Retirement System’s funding issues. The House Pensions Committee has only passed a couple of pension-related bills thus far. One bill affecting the Texas County District Retirement System has passed both the House Pensions Committee and Senate State Affairs Committee.

Mr. Wattles discussed HB 2188 and HB 3100 by Representative Lozano which are both Return to Work bills. He first reviewed the current TMRS Return to Work requirements. HB 3100 would require interest recalculation of the annuity and for those who have returned after an eight year gap, would receive the lump sum after they re-retire. This would require that “accumulated interest” be paid on the amount of the suspended payments. Mr. Rodriguez stated that would like to see the Advisory Committee study this topic during the next interim and Ms. Oakley concurred. The other two bills are Cost of Living Adjustment (COLA) bills that allow optional fixed rate COLAs without the current catchup requirement. These bills are identical to HB 718 filed by Representative Smithee in the 83rd regular Legislative Session.

11. Quarterly Investment Staff Report/Asset Class Updates
Mr. Carlson began this discussion by reviewing the Year to Date (YTD) return and five year performance. This year has been highly volatile with the YTD performance changing between 30 and 50 basis points daily. He highlighted progress in shifting the current portfolio toward the target allocation.
Ms. Qualls discussed the Public Equity performance. She provided updated performance numbers and stated that international equities are currently outperforming domestic equities. Ms. Qualls reviewed the Core/Satellite Structure Allocation, the various strategies and their respective managers. She also gave an update on the pacing plan for this asset class.

Ms. Mackie reviewed the Fixed Income portfolio. She reviewed BlackRock and PIMCO’s returns for the year. She reviewed the Fixed Income Allocation structure and also reviewed the different strategies and managers.

Mr. Masthay discussed the Real Estate performance for the third quarter of 2015 which has been positive. The portfolio is roughly at 5% of the total assets and even after full funding, will constantly have capital reallocations. TMRS is currently well diversified in both sectors and managers. Mr. Masthay reviewed portfolio diversification and the pacing plan for this asset class. He also discussed the Real Return portfolio and its manager, Colchester. He reviewed the pacing plan and future potential actions in this area.

Mr. Carlson discussed Private Equity and indicated that this class has yet to be funded. Ms. Reed reviewed compliance testing and noted that 188 separate compliance tests were run as of December 31, 2014. All funds were in compliance with TMRS guidelines. Mr. Shishkoff reviewed the current priorities in Risk Management. He briefly reviewed the Total Fund Tracking error.

12. Absolute Return Asset Class Annual Review
Mr. Leavitt began the review of the Absolute Return asset class by providing a summary of the historical timeline of educational sessions, Board action and implementation items. Blackstone is the one existing manager for this portfolio. Absolute Return objectives include: 1) decreasing portfolio risk, 2) potentially increasing returns (Fixed Income substitute), 3) providing performance with low correlation to traditional asset classes, 4) capturing attractive long-term risk-adjusted returns, 5) seeking to generate positive returns, and 6) seeking to capture Alpha. Mr. Leavitt reviewed historic returns of Absolute Return over the past 25 years and various strategies and sub-strategies were discussed.

Mr. Leavitt gave an overview of Blackstone and discussed the strategies and objectives. There are currently 29 managers in this customized fund of one portfolio and he reviewed the different strategy exposures, portfolio concentrations, turnover, rebalancing and pacing plan. Blackstone historically has had low beta to traditional asset classes resulting in low volatility. Mr. Leavitt discussed the Absolute Return Strategy Execution Plan. The ideal allocation pathway consists of groups of approximately five managers at a time for Phase II and Phase III of the pacing plan. This plan will 1) provide immediate diversification, 2) minimize dispersion and tracking error, and 3) ensure that the allocation is weighted according to risk/reward profile. He briefly outlined some of the risks of a “one manager at a time” approach including that it 1) increases volatility and dispersion, 2) increases the probability of underperformance, 3) extends the implementation horizon and 4) may increase contract uncertainty. Various risk/return profiles were discussed and how our current approach could stand step into more diverse strategies.
13. **Overview of Pension Review Board Administrator and Trustee Training Requirements**

Mr. Wattles presented the new training requirements by the Pension review Board (PRB) regarding Trustee and Administrator education. The training requirements apply to existing and new trustees of state and local retirement systems and system administrators. System administrators are effectively defined as the system’s executive directors. Portions of TMRS Board meetings will help meet these requirements. Mr. Wattles reviewed the timeline for implementing the program. There are two facets to the training: core and non-core and training must be tracked in the PRB system. Core training must be completed for current Trustees and Administrators by December 31, 2016. There are seven different core competencies.

TMRS has inventoried the training provided to the TMRS Board at their meetings. Mr. Wattles discussed this training and the fact that TMRS will apply to become an “Accredited Sponsor” for future training provided to Board members by TMRS. Mr. Gavia noted that if Board members want to seek additional training, budgeted funds are available.

14. **Strategic Plan Update**

Mr. Gavia reviewed the current Strategic Plan including the Mission, Vision and Values statements. The Strategic plan was created in 2007 and it was updated in 2011. Many of these objectives have been completed or are currently underway. The Board has scheduled a meeting in late July to review the current plan. Ms. Oakley mentioned there have been several items discussed by the Board and should be included in this upcoming plan (i.e., the Advisory Committee Charter and Asset Allocation).

Mr. Gavia gave an overview of the separate goals of the existing plan. Regarding Goal 1, he discussed the change to Entry Age Normal, the SOC1 audit, replacement of mortality tables, creation of new annuity purchase rates and conducting an actuarial audit. The Board is updated regularly on the Investment objectives in Goal 2. Goal 3, Customer Service and Communications, Mr. Gavia highlighted the on-going “Straight through Processing” activities. Goal 4 is still pending and a succession plan for key positions is currently being developed. Regarding Goal 5, Mr. Gavia discussed the Board’s governance policies and the completion of an independent review of the Internal Audit function.

15. **Executive Director Reports, Including Reports from Administration, Actuarial Services, Communications, Finance, Governmental Relations, Human Resources, Information Resources, Legal, Member Services and Project Management**

Mr. Gavia presented the reports for discussion. He acknowledged several items including the Finance Department’s receipt of the Government Finance Officers’ Association award for the CAFR and PAFR. Mr. Gavia, along with Mr. Davis, also discussed the progress of the building remodel/build-out.
16. **Call for Future Agenda Item**
No items were mentioned.

The meeting was adjourned at 11:35 a.m.

David Gavia  
Executive Director

Julie Oakley  
Chair, Board of Trustees