

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

February 26, 2015 – 1:30 p.m.

On February 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
Bill Philibert
Jim Jeffers

Absent: David Landis

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 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 Masthay, Director of Real Estate
Karen Jackson, Executive Assistant
Marcia Beard, RVK
Amy McDuffee, Aon Hewitt Investment Consultants

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
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
Carol Leung, Investment Analyst
Mel Thomas, Editor
Pete Krnavek, Information Systems Manager
David Crow, Arlington Professional Fire Fighters
Bob Scott, Government Finance Officers Association of Texas
Keith Dagan, Government Finance Officers Association of Texas
George Kauffman, City of Garland
Julian Bostic, Neuberger Berman
Mike Stapell, City of Highland Park

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 Real Estate audit and there were no unexpected findings. Several recommendations were suggested by the auditors.

New members of the Investment team were introduced: Marc Leavitt, Director of Absolute Return, Chris Schelling, Director of Private Equity and Tom Masthay, Director of Real Estate and Real Return. Recruiting is currently underway for two investment analyst positions and another analyst position will be posted later in the year.

The Mid-Cap Transition Management was completed for the fourth quarter. Citigroup managed the transition. The cost was a higher than expected, but within the range of expectations.

Mr. Carlson discussed the Internal Procedures Manual for the Investment Policy Statement (IPS) and the Guide to the Procedures Manual. The Guide provides information regarding all the movement from the IPS to the Procedures Manual.

Mr. Carlson updated the Board on the status of PIMCO. Due to continued struggles with turnover and the departure of our portfolio manager, PIMCO will remain on the watch list pending a comprehensive review.

2. Consider and Act on Reallocation of Bank Loan/Collateralized Loan Obligations/Residential Mortgage Backed Securities and Commercial Mortgage Backed Securities Funds

Mr. Carlson discussed the status of Credit Suisse as a selected manager for the Collateralized Loan Obligation (CLO)/Bank Loan portfolio. Due to circumstances surrounding Credit Suisse's parent company, Credit Suisse Group AG, Staff is requesting permission to reallocate the amount that would have gone to Credit Suisse to the other two approved managers (Highland Capital Management L.P. and Guggenheim Partners Investment Management L.P.). Mr. Carlson stated that Staff is requesting flexibility on reallocating funds so that they can negotiate fees with the managers.

The Board had several questions on the reallocation: how will the allocation between the two managers be decided, what unique investment characteristics are being lost by not being able to allocate funds to Credit Suisse, and what happens to the risk/return profile when we drop from three managers to two managers? Mr. Shishkoff discussed how the risk calculations were conducted. He stated that this would not impact market risk, but would increase market concentration.

Ms. Oakley stated the Board has not voted on the allocation of a large dollar amount without knowing the exact allocation for each manager and she felt that more information is required to understand the process.

Mr. Parrish made a motion that the Board authorize: (a) reallocating some or all of the remaining \$250 Million allocation to the CLO/Bank Loan program to either one or both of the other two approved managers. In the event that less than all of such \$250 Million allocation has been reallocated to such approved manager(s) within one year from the date this recommendation is approved, such remaining un-reallocated amount shall then be deemed to be unallocated; (b) reallocating some or all of the remaining \$250 Million allocation to the RMBS/CMBS program to either one or both of the other two approved managers (Ellington Management Group, L.L.C. and Voya Investment Management Co. LLC). In the event that less than all of such \$250 Million allocation has been reallocated to such approved manager(s) within one year from the date this recommendation is approved, such remaining un-reallocated amount shall then be deemed to be unallocated; and (c) 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. Jeffers seconded the motion, Mr. Philibert voted affirmatively. Ms. Oakley and Mr. Rodriguez opposed the motion. Mr. Landis was absent. The motion failed 3-2 due to lack of the required four affirmative votes.

3. RVK Quarterly Investment Report (Including final December performance numbers)

Ms. Beard presented the performance report for the period ending December 31, 2014. U.S. Equity markets indicated strength; there was strong gain in the job market and expectations of interest rate increases. There was good news in the U.S. markets, but not in the

international markets. Risk appetite has returned to the market and flattening of the yield curve did help U.S. Fixed Income across the board. Absolute Return had a positive but not strong year.

Ms. Beard reviewed the Total Fund Composite. Strong investment gains were noted for the year with gain of about \$1.3 billion and a return of 5.99% gross of fees and 5.85% net of fees. TMRS' allocation versus peers indicates the portfolio remains conservative compared to peers due to TMRS having more exposure to fixed income, but the portfolio continues to move towards a well-diversified structure as fixed income is reduced. She reviewed Total Fund Performance versus benchmarks. For the five year period, TMRS exceeded both the actuarial assumption and the actual allocation benchmark. The assumed long-term rate of return established by the actuary is 7%. The Total Fund outperformed the Actual Allocation Benchmark by 11 basis points over the trailing five-year period due to relative performance of the Total Fixed Income Composite.

Ms. Beard also discussed Total Fund Performance Versus Peers, Total Fund Risk/Return Profile Versus Peers and the Asset Class Composite Performance.

Ms. Beard mentioned that the capital market assumptions used for asset allocation have been revised downward. These assumptions will continue to be discussed with Staff and the Board as they work on the 2015 Asset Allocation Study.

4. Private Equity Educational Session

Mr. Schelling discussed the agenda for this presentation and began by defining Private Equity. Private Equity is nothing more than investments in privately held businesses which are not registered, listed or publicly traded on exchange. Investment vehicles include: direct investments, co-investments, fund or limited partnerships and fund of funds. Limited Partnerships and Fund of Funds are the most common entry points. Private Equity is really the basis of current economics. It is a large, institutional asset class that has been around for a long time. Some examples of Private Equity companies are: Dell, Schlotzsky's, Petsmart and Dunkin Donuts.

Mr. Schelling discussed the risk/return characteristics of different types of Private Equity investments. For example, Angel/Seed investing typically has the highest returns but also the greatest risk. The objective of the asset class is to generally exceed the S&P 500 plus 5% over a full market cycle. This target may be revised downward after further study. Manager selection is critical to performance. Private Equity drivers of return include: operating company improvements, alignment of interests, balance sheet management and investment structuring, asymmetric information and illiquidity premia. Mr. Schelling reviewed data from Thomson Reuters that suggests 2% to 4% excess returns for this asset class. Private Equity risks include illiquidity, lack of transparency, high fees, delegation of custody, dispersion of returns and concentration.

Mr. Schelling reviewed a Private Equity fund structure and a fund life cycle. An investment is made in the fund and the fund goes out and purchases companies. Mr. Philibert asked if there was a common benchmark. There is not a common benchmark, but multiple types of

benchmarks (vintage year, S&P 500 plus 5%, etc.) are used together to triangulate performance. The “J” curve effect was then discussed. The “J” curve is a rate of return that varies over time. A negative return may occur at the beginning, but over the life of the return, the outcome may be a positive internal rate of return. Vintage year diversification must also be considered due to the economic cycle. Private Equity is not a buy and hold strategy; it has to be continually allocated. At some point, you will use the assets returned as your allocation. He reviewed what a typical Private Equity diversification strategy mix would look like.

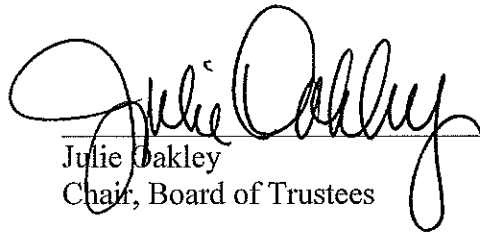
5. Executive Session (originally appeared as #6 on the Thursday, February 26, 2015 agenda)

At 3:50 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 5:10 p.m.

At 5:11 p.m. the meeting was recessed until 8:30 a.m. on Friday, February 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**

February 27, 2015 – 9:00 a.m.

On February 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
Jim Parrish, Vice Chair
Bill Philibert
Jim Jeffers

Absent: Roel “Roy” Rodriguez
David Landis

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
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, R. V. Kuhns & Associates
Amy McDuffee, Aon Hewitt Investment Consultants
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
Cindy Morse, Investment Support Analyst
Kate Reed, Investment Risk Analyst
David Rodriguez, Regional Manager – City Services
Eddie Schultz, Real Estate Analyst
Carol Leung, Investment Analyst
Bob Scott, Government Finance Officers Association of Texas
Chris Jones, Combined Law Enforcement Associations of Texas
George Kauffman, City of Garland
Keith Dagan, Government Finance Officers Association of Texas

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

6. Consider and Act on Adoption of Minutes from the February 26-27, 2015 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 February 26-27, 2015 Meeting of the Board of Trustees. Mr. Philibert seconded the motion, which passed 4-0.

7. Investment Decision Governance Education Session (originally #5 on the Thursday, February 26, 2015 agenda)

Mr. Gavia introduced Amy McDuffee, Aon Hewitt Investment Consultants. This topic is an education piece in advance of the Board's Strategic Planning session. Ms. McDuffee stated it is best practice to periodically review its governance structure and look at what can be done differently or reaffirming current practices.

Ms. McDuffee began by defining governance as the structure, manner and process by which a board exercises authority or control. Governance includes two major domains: legal structure set by applicable governing law and the Board's decision-making framework. Governance is clearly defined roles and responsibilities, lines of authority and standards of accountability. Good governance policies and practices can help boards meet their fiduciary responsibilities, fosters stakeholder confidence and add value. Studies show that good governance is associated with increased returns.

Ms. McDuffee discussed the public retirement system landscape and highlighted the commonality of systems as well as several unique systems (i.e., single trustee systems). She noted some of the trends in fund governance and investment management. One trend is to

have more investment experts on boards. Another trend was toward more investment committee “as a whole” structure, whereby all board member sit on the investment committee but a different chair leads the meetings. In regards to investment decisions, the trend toward low cost passive management of public securities and increased allocation to more complex investments, for “mega” fund over \$50 billion, a more nimble/opportunistic approach and for those funds with alternative investments, a movement away from using fund of fund managers in favor of direct investing. There is also an increased attention to investment manager fees and terms in contracts especially with regard to alternative investments. Mr. Carlson and Ms. Beard shared their experiences with the types of investment committees. The last area of trends is delegation and staffing. Many of the trends relate to efficiency in the decision process, with reporting to the board after decisions are made. Mr. Carlson added that time constraints of the board have led to many changes. Mr. Klausner pointed out that the Board’s role is to set the policy decisions and then ensure the policy was followed. The paid professionals are then in charge of following and implementing the policy set. Ms. McDuffee stated the level of delegation boils down to the level of trust, but should be stayed on top of to make sure the policies are followed. Ms. Oakley added that due to our investment allocations, how we used to operate has changed radically and now that we are moving closer to our peers, we may need to review how we are operating.

Ms. McDuffee discussed investment governance model and the structure for sound delegation including different functions, their sources of assurance and sources of reassurance. She reviewed several different delegation models giving examples of several plans using different models. The traditional Investment Committee Model is similar to how TMRS currently operates. The Investment Advisory Committee Model uses a committee typically made up of non-board members to advise the board. In most instances, the committee members are fiduciaries, but not always. Some of the committees are compensated to assure focus on the system’s goals/needs. There are often conflicts of interest issues with this type of arrangement.

Ms. Oakley asked if there was a model that consolidates various aspects of all three models and if Ms. McDuffee could provide information of such a consolidated model. Ms. McDuffee touched on the typical responsibilities for an investment program. She noted responsibilities that usually are not delegated, sometimes delegated and frequently delegated. There is not a “right” model or method for all plans. The Board will determine what fits their needs best.

8. Consider and Act on the State Office of Administrative Hearing Administrative Law Judge’s Proposal for Decision in the Arvill Pierce, Deceased, Beneficiary Dispute (originally agenda item #9 on the Friday, February 27, 2015 agenda)

Ms. Sweeney discussed that most disputes are related to procedural items. In the instances of disputes relating to qualifications for benefits, she explained the process for dealing with a dispute both internally and then to the State Office Administrative Hearing, including how a decision can finally be contested.

Ms. Sweeney reviewed the specifics of the dispute being considered along with the timeline of events leading up to TMRS' decision on to whom TMRS should pay the final benefits. This decision was appealed and went to the State Office of Administrative Hearing which ultimately resulted in the proposed decision.

Mr. Parrish made a motion the Board adopt the Final Order which incorporates Proposal for Decision's findings of fact and conclusions of law, and authorized the Board Chair and the Executive Director to sign the Final Order. Mr. Philibert seconded the motion, which passed 4-0.

9. **Consider and Act on Ratification of Ordinances Adopting Updated Service Credit and/or Annuity Increases Effective January 1, 2015 (Received after the December 5, 2014 Board Meeting) (originally agenda item #10 on the Friday, February 27, 2015 agenda)**

Mr. Gavia previously presented this item for Board approval at the December 4-5, 2014 Board meeting. Ordinances received before the December meeting were approved. Ms. Oakley explained that the list presented at this time includes ordinances received after the December Board meeting. The ordinances were received by December 31, 2014, and have been implemented as part of each cities' plan design, meet the requirements of the TMRS Act and should be ratified by the Board.

Mr. Philibert made a motion that the Board ratify those ordinances adopting Updated Service Credit and/or Annuity Increases that were not included on the listing presented at the December 5, 2014, Board meeting. Mr. Parrish seconded the motion, which passed 4-0.

10. **Consider and Act on New Appointments and/or Reappointments to the Advisory Committee on Retirement Matters (originally appeared as #11 on the Friday, February 27, 2015 agenda)**

Mr. Wattles discussed the nominations and alternates for the three of the four Group Class organizations with vacancies on the Committee. TMRS has not yet received a nomination from the Texas State Association of Firefighters. In the individual class, there are currently three vacancies. One Individual Class "retiree" position became open with the passing of Ron Crabtree. The other Individual Class "elected" position became open when Neil Resnik was not re-elected to the Addison Town Council. The third became open on December 31, 2014 when Allen Bogard, City Manager with the City of Sugar Land, completed his second three year appointment and termed out, pursuant to the terms of the charter. Staff has received applications for the two vacant Individual Class positions, but is not recommending action be taken at this time.

Ms. Oakley expressed how much she appreciates the knowledge and expertise provided by the Advisory Committee members and she hopes the Committee will continue to serve and give their time to TMRS. Ms. Oakley would like to review the Advisory Committee Charter in the Strategic Planning session this July.

Mr. Parrish made a motion that the Board:

- Appoint Alex Cramer to a six-year term to expire on December 31, 2020 to represent the Arlington Professional Fire Fighters on the TMRS Advisory Committee on Retirement Matters in the Group Class.
- Appoint Keith Dagan to a six-year term to expire on December 31, 2020 to represent the Government Finance Officers Association of Texas on the TMRS Advisory Committee on Retirement Matters in the Group Class.
- Appoint J.J. Rocha to a six-year term to expire on December 31, 2020 to represent the Texas Municipal League on the TMRS Advisory Committee on Retirement Matters in the Group Class.
- Appoint David Crow as an alternate representative for the Arlington Professional Fire Fighters on the TMRS Advisory Committee on Retirement Matters in the Group Class.
- Appoint Bob Scott as an alternate representative for the Government Finance Officers on the TMRS Advisory Committee on Retirement Matters in the Group Class.
- Appoint Monty Wynn as an alternate representative for the Texas Municipal League on the TMRS Advisory Committee on Retirement Matters in the Group Class.

Mr. Philibert seconded the motion, which was approved 4-0.

11. 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. Mr. Lewis stated that the Board member nominations required by the Governor's Appointments Office should be taken care of in the next couple of weeks. This includes confirmation of Board appointments by the Senate Nominations Committee.

Mr. Lewis discussed the landscape of the Legislature. The Senate has more new members and the group, as a whole, has become more conservative. On the House side, we have a new Pensions Committee Chair and several new members and this means education will be necessary.

Some of the legislative priorities include: education, transportation, border security and tax relief. The Legislature should complete their work by June 1st and Mr. Lewis predicts there should not be a special session. Also, since March 13th is the last day to file bills, there will be a lot of activity in the next two weeks. With the exception of the Employees Retirement System of Texas, Mr. Wattles noted that pension issues are not as prominent.

Mr. Parrish left during this portion of the meeting at 10:30 a.m.

Since there was no longer a quorum, the meeting was officially adjourned at 10:30 a.m.



David Gavia
Executive Director



Julie Oakley
Chair, Board of Trustees