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

August 16, 2012 – 3:30 p.m.
August 17, 2012 – 8:30 a.m.

On August 16, 2012, the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a meeting at 3:30 p.m. at TMRS Headquarters, located at 1200 North IH 35 in Austin, Texas, with the following members present:

Board of Trustees
Frank Simpson, Chair
April Nixon
Jim Parrish
Roel (“Roy”) Rodriguez

Absent: Ben Gorzell, Jr.
Julie Oakley

Present also were:
David Gavia, Executive Director
Eric Davis, Deputy Executive Director
Rhonda Covarrubias, Director of Finance
Bernie Eldridge, Director of Human Resources
Nancy Goerdel, Chief Investment Officer
Leslee Hardy, Director of Actuarial 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
Michelle Mellon-Werch, Associate General Counsel
Bonnie Mitra, Director of Fixed Income
Debbie Munoz, Director of Member Services
Candace Nolte, Controller
Cindy Morse, Investment Support Analyst
Nick O’Keefe, Senior Staff Attorney
Kristin Qualls, Director of Equities
Kate Reed, Investment Risk Analyst
Dimitry Shishkoff, Director of Risk Management
Stacy White, Executive Assistant
Robert Klausner, Klausner Kaufman Jensen & Levinson
Marcia Beard, R. V. Kuhns & Associates
Nancy Williams, Hewitt EnnisKnupp
Bob Scott, Government Finance Officers Association of Texas (GFOAT)

Mr. Simpson called the meeting to order at 4:37 p.m.
1. **Educational Presentation on Investment Decision-Making Process**

Ms. Goerdel introduced this agenda item and explained that because of the number and complexity of investment-related agenda items that are scheduled to come before the Board, Nancy Williams has been asked to begin a dialogue with the Board regarding the most efficient use of the their time on these items going forward, as well as the possibility that it may be beneficial to the Board to delegate some actions to staff. Ms. Williams agreed that this is an opportune time to begin this type of discussion with the Board.

Ms. Goerdel stated that two areas of possible delegation include revisions to the Investment Policy Statement (IPS) (i.e., substantive vs. non-substantive revisions) and potential manager presentations. After a brief discussion concerning revisions to the IPS, the Board members agreed that they would like to continue seeing all revisions to the IPS.

Ms. Goerdel stated that manager presentations will become more time consuming for the Board as further diversification is sought. Mr. Gavia suggested that future Board meetings may need to start earlier on Thursday afternoons in order to cover the entire agenda and still be able to adjourn at a reasonable time on Fridays.

Mr. Simpson suggested that the Governor’s Office be alerted to the increased time requirement of our Board members in order to inform potential applicants. A Board member job description has been previously created by the Board and forwarded to the Governor’s Office for their use. Ms. Nixon requested that staff put together a hierarchy of decisions for the Board which outlines the types of decisions that should and should not be delegated.

Mr. Gavia indicated that the Board could consider eliminating manager presentations from prospective managers. Mr. Simpson asked if manager presentations are the “highest/best” use of the Board’s time. Ms. Williams suggested that since the staff and consultants are properly doing their review, evaluations and other due diligence on the prospective managers, the Board does not necessarily need to hear a presentation from the managers. If a new asset class is initiated, the Board will prefer some educational sessions on the asset class until they are comfortable with the new class and the risks and returns associated with it. Mr. Klausner added that it is not uncommon in a public plan of this size for the Chief Investment Officer to approve managers, subject to the Board’s comfort level that appropriate due diligence has been conducted. Ms. Williams added that the advanced education is where the Board’s time is best spent, especially in reviewing the risks and returns of an asset class. She said there is no specific model to follow; it is about the Board’s comfort level. Ms. Williams noted that if the Board does delegate some of these decisions to the Chief Investment Officer or Executive Director, the Board can always alter their preferences at a later date. Ms. Goerdel added that the IPS states that prospective managers “may” present to the Board, but it is not required.

After further discussion on whether potential managers should make a presentation to the Board, the Board decided to table the issue until the next day when the two absent Board members are present and able to contribute to the discussion.
2. **Executive Session**

At 4:59 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 6:12 p.m. All members of the Board who had been present when the Board went into Executive Session were again present. No public action was taken.

At 6:12 p.m., the meeting recessed until 8:30 a.m. on Friday, August 17, 2012.

Signed by David Gavia  
David Gavia  
Executive Director

Signed by Frank Simpson  
Frank Simpson  
Chair, Board of Trustees
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**Board of Trustees**
Frank Simpson, Chair
Julie Oakley, Vice Chair
Ben Gorzell, Jr.
April Nixon
Jim Parrish
Roel (“Roy”) Rodriguez

Present also were:
David Gavia, Executive Director
Rhonda Covarrubias, Director of Finance
Eric Davis, Deputy Executive Director
Bernie Eldridge, Director of Human Resources
Nancy Goerdel, Chief Investment Officer
Leslee Hardy, Director of Actuarial Services
Bonnie Mitra, Director of Fixed Income
Christine Sweeney, General Counsel
Holly Macki, Director of Real Estate
Michelle Mellon-Werch, Associate General Counsel
Debbie Munoz, Director of Member Services
Joe Newton, Gabriel Roeder Smith & Company
Kristin Qualls, Director of Equities
Dimitry Shishkoff, Director of Risk Management
Bill Wallace, Director of Communications
Dan Wattles, Director of Governmental Relations
Stacy White, Executive Assistant
Scott Willrich, Director of Information Resources
Robert Klausner, Klausner Kaufman Jensen & Levinson
Marcia Beard, R. V. Kuhns & Associates
Jonathan Kowolik, R. V. Kuhns & Associates
Jeremy Miller, R.V. Kuhns & Associates
Nancy Williams, Aon Hewitt
Ed Schwartz, ORG Portfolio Management
Lynn Kehoe, ORG Portfolio Management

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Also in attendance:

Sherry Chapman, Investment Accountant
David Crow, Arlington Fire Fighters
Chris Jones, Combined Law Enforcement Associations of Texas (CLEAT)
   Juan Garcia, Governor’s Office
   George Kauffman, City of Garland
   Robert Hammond, City of San Antonio
   Keith Hopkins, Mesquite Firefighters Association
   Glenn Johnson, Garland Fire Fighters Association
   Ron Lewis, Lewis & Associates
Scott Kerr, Texas State Association of Fire Fighters
Randall Meadows, Arlington Police Association
Anthony Mills, Regional Manager – City Services
Lorraine Moreno, Regional Manager – City Services
Cindy Morse, Investment Support Analyst
   Candace Nolte, Controller
   Nick O’Keefe, Senior Staff Attorney
   Kate Reed, Investment Risk Analyst
David Rodriguez, Regional Manager – City Services
   Melanie Thomas, Editor
Sean Thompson, Regional Representative - City Services
Bob Scott, Government Finance Officers Association of Texas (GFOAT)
   Tim Smollen, Deutsche Bank
   Anthony Toscano, Deutsche Bank
   Mark Doherty, State Street
   Bob Taylor, State Street
   Meredyth Fowler, Speaker’s Office
   Merita Zoga, Representative Truitt’s Office

Mr. Simpson called the meeting to order at 8:35 a.m. and Jim Parrish gave the invocation.

3. Consider and Act on Adoption of Minutes from the June 21-22, 2012 Meeting of the Board of Trustees
   Mr. Simpson presented this item and asked if there were any changes or questions. There being none, Mr. Parrish moved that the minutes from the June 21-22, 2012 Meeting of the Board be adopted as presented. Ms. Nixon seconded the motion, which passed unanimously 6-0.

4. 2013 Legislative Session Update
   Mr. Wattles provided a legislative update on the results of the state primary and runoff elections. Mr. Wattles then gave an overview of the make-up of both the House and Senate and discussed the turnover of elected officials, including committee chairs. The majority of the House will be Freshmen or Sophomores. The Senate could see a change in the powers
granted to the Lt. Governor, who presides over the Senate. Mr. Lewis pointed out the high degree of uncertainty in the Texas Legislature. Speaker Straus will likely return as House Speaker, which could add some stability. The Pensions, Investments and Financial Services (PIFS) Committee lost Representative Truitt as Chair, as well as three other members of the Committee as a result of the elections. The retirement of Senator Steve Ogden as Finance Committee Chair will likely impact the Senate State Affairs Committee.

Mr. Wattles mentioned the interim PIFS Committee charges, which will all be taken up over two days in September. He also mentioned the TRS and ERS Interim Benefits Studies which are due to the Legislature on September 1, 2012.

5. **Advisory Committee 2013 Legislative Recommendation Update**
   Ms. Williams joined Mr. Wattles to present this item. Mr. Gavia began by stating that over the course of the five meetings of the Advisory Committee on Retirement Matters, the Committee was provided an abundant amount of information including information on national trends which haven’t always been favorable to public benefits. He noted that in general, the TMRS plan is in a stronger financial position than most other retirement systems. Ms. Williams highlighted the Advisory Committee’s prior activities and reported that the Board of Trustee’s Chair Frank Simpson and Vice-Chair Julie Oakley and TMRS staff convened five Advisory Committee on Retirement Matters meetings from December 2011 through August 2012. The purpose of the meetings was to review, discuss and determine the level of support for potential benefit plan changes by the Committee. Ms. Williams stated that the TMRS staff surveyed the Committee members on the benefit options that were reviewed and appeared to have the most interest, so as to ascertain the level of support. The straw-poll indicated interest in the six final proposals presented to the Committee, but there was no consensus on these proposals. The last meeting, held August 16th began with a discussion of the legislative environment. Mr. Gavia mentioned that our past legislative sponsors in the House, Representatives Truitt and Kuempel, will not be available to carry a TMRS bill, while our Senate sponsor, Senator Williams may not be able to carry a TMRS bill due to new and increased responsibilities. In the discussion, Ms. Williams stated that the consensus of the Advisory Committee was that now is not the time for TMRS to seek legislation, and that pro-active defense of the System’s structure should be the priority. There was acknowledgement that some cities or groups may file bills affecting TMRS for their own needs that will have to be addressed as they are introduced.

Ms. Oakley thanked the Advisory Committee members and staff for their hard work during this process. Ms. Nixon echoed Ms. Oakley’s sentiments.

6. **Consider and Act on 2013 Legislative Agenda**
   Mr. Gavia stated that, based on the results of the Advisory Committee meeting, the Committee indicated that this is not the right time for TMRS to seek legislation, given the number of new legislators and the need to educate them about TMRS. Instead of making a recommendation to the TMRS Board for the System to seek legislative changes in the 2013 legislative session, the Committee supported a pro-active defense of TMRS current structure. Mr. Parrish and Mr. Rodriguez both asked that this be added to the September Board agenda so that they have time to study the results of the Committee’s discussions. Mr.
Gorzell asked that all materials provided to the Committee be provided to the Board members for their review. The item should be flexible enough to allow Board to act if necessary.

7. **Consider and Act on Custody and Securities Lending Search Recommendation**

Ms. Goerdel reported that TMRS is currently utilizing State Street for custodial and securities lending services. As part of the Board’s 2012 Strategic Plan initiative, the TMRS Investment and Finance Departments were asked to conduct a search for custodial and securities lending services by the end of 2012. In the annual securities lending review by the System’s Investment Consultant, R.V. Kuhns, the recommendation was to consider unbundling the custody and securities lending components and so the approach taken for this search was to issue Request for Information (RFIs) for custody and securities lending separately. Unbundling the services would provide increased transparency and allow for additional controls to better manage securities lending risk.

**Global Custody Search Process and Due Diligence**

Ms. Covarrubias reviewed the process timeline and provided further detail of the actual RFI process. The screening process produced four custodial candidates and TMRS received responses from three of them. Ms. Covarrubias outlined the screening criteria and discussed the minimum requirements, which were in line with R.V. Kuhns’s recommendations. Mr. Kowolik of R.V. Kuhns then reviewed the screening results and evaluation and provided a matrix of ranking factors. He stated that independent evaluations were conducted by R.V. Kuhns and TMRS. Mr. Kowolik then reviewed the characteristics of finalist State Street Bank. Ms. Covarrubias highlighted the key considerations in choosing a custodian and stated that State Street is the leader in providing custodial services to the public pension sector and have continued to provide TMRS with excellent service over the past ten-year period. She added that remaining with State Street, as incumbent, provides a cost-benefit (no transitional costs or risks) and allows TMRS the flexibility to unbundle securities lending from its proposal and pursue a third party lending alternative. Based on the ranking, TMRS and R.V. Kuhns conducted a due diligence site visit with State Street Bank. Both R.V. Kuhns and staff jointly recommend that the Board approve the retention of State Street Bank as TMRS’ custodial services provider.

**State Street’s Global Custody Presentation**

Bob Taylor and Mark Doherty presented on behalf of State Street Bank (SSB). They discussed that SSB is a leader in this space. They noted that SSB is extremely well capitalized and rates very high in the 2012 Federal Reserve Comprehensive Capital Analysis and Review (CCAR) Stress Test. Mr. Taylor discussed the relationship management and solution framework for TMRS. Mr. Taylor discussed the benefits of their proposal for TMRS including alignment in the market place, SSB as a single provider for all asset classes, and SSB’s capability to provide services around the complete investment spectrum. He then discussed the distinctive characteristics of SSB including their expertise in public funds, pure institutional focus, singular technology strategy, thought leadership, and an un-conflicted business model.
Global Custody Recommendation
April Nixon moved that the Board select State Street Bank and Trust to continue as TMRS’ Custodial Services Provider, and authorize the Executive Director to negotiate a contract satisfactory to the System for fees substantially as proposed in the Board Communication for a term of three years (with two one-year extensions), beginning January 1, 2013. Ben Gorzell seconded the motion; which carried unanimously, 6-0.

Securities Lending Process and Due Diligence
Mr. Mitra and Mr. Kowolik provided an overview of the securities lending search process. Mr. Kowolik presented the timeline, process and screening criteria for this search which was similar to the custody search process. The screening criteria results produced ten potential candidates of which six responded. The evaluation process ranked Deutsche Bank (DB) as the number one candidate. Mr. Mitra then reviewed the due diligence ranking factors and the finalist characteristics. He then reviewed Deutsche Bank’s specific characteristics, noting that Deutsche Bank provided the most compelling assurance of a focus on intrinsic value lending. DB also has a stronger financial position to support indemnification against counterparty risk and their re-investment strategy has less exposure to interest rate mismatch and credit risk. R. V. Kuhns and TMRS’ review teams recommended that Deutsche Bank be selected as the System’s third-party lending agent.

Deutsche Bank’s Securities Lending Presentation
Mr. Smollen and Mr. Toscano presented Deutsche Bank’s Agency Securities Lending program. Mr. Smollen highlighted the transformation of Deutsche Bank in the Americas and provided an overview of the Agency Securities Lending structure and support units. He reviewed Deutsche Bank’s Agency Securities Lending’s mission, objective, tenets, and target market, on a third-party lending model. He summarized Deutsche Bank’s strengths including long-tenured management team, historical track record and focus on risk management. Mr. Toscano discussed the “intrinsic value” approach, dual indemnification, full transparency and control. Mr. Smollen summarized their presentation focusing on DB’s “intrinsic value” securities lending strategy, their emphasis on indemnification activity, and the de-risking features (separate accounts, customization, real-time transparency and access to management team).

In response to a question from Ms. Oakley, Mr. Kowolik described how the initial candidate pool was developed and he confirmed that litigation history was a part of the review process.

Securities Lending Recommendation
Roy Rodriguez moved that the Board select Deutsche Bank as TMRS’ Securities Lending agent, and authorize the Executive Director to negotiate a contract satisfactory to the System, for the fee splits substantially as proposed in the Board Communication, for a term of three years (with two one-year extensions), beginning January 1, 2013. If, in the sole opinion of TMRS, an acceptable contract with Deutsche Bank cannot be reached, TMRS reserves the right to disqualify Deutsche Bank and to negotiate with the alternate finalist in this search process. Julie Oakley seconded the motion; which carried unanimously 6-0.
8. Consider and Act on Asset Allocation Study and Recommendation

Ms. Goerdel reviewed the process the Board follows in setting the strategic asset allocation. As required in the Investment Policy Statement, a formal asset allocation study is to be conducted at least every three years to verify or amend the targets. Ms. Beard and Mr. Miller reviewed the asset allocation philosophy and stated that the current policy assists to ensure that the risk tolerance remains appropriate. They also reviewed the asset management decision flow process as well as TMRS’ historical asset allocation and the timeline of diversification implementation. Ms. Beard provided an overview of the analysis and review process.

Ms. Beard discussed the basic considerations of the Asset Allocation study. She reminded the Board that the Asset Allocation decision is one of the most important investment decisions they will make and is a major determinant of long-term return and volatility. Analyses should include risk, return and correlation. Issues that were considered in this study were related to: equities; real return; real estate; and fixed income. Mr. Miller then discussed how the objectives are determined; risk tolerance and opportunity set and the reasons for optimizing all three. He discussed optimization and the process for identifying and evaluating the most desirable allocations. He then discussed the thematic categories: capital appreciation, capital preservation, inflation and alpha. Mr. Miller reviewed the 2012 Capital Market Assumptions. He reviewed the outcome of the efficient frontier model which he reported can provide a modest improvement in return and a modest reduction in risk, compared to the current target.

Ms. Beard reported that after much discussion with TMRS staff, the following changes to the Asset Allocation are recommended, and would be implemented through a gradual process, as has been the process: (a) U.S. Equity and International Equity allocations would not be reduced at this time. The “overweight” resulting from the reduction in those targets would be used as a placeholder for the private equity allocation, which is not expected to be funded for another year or two. At such time, the private equity allocation would be funded from the public equity allocations; (b) Non-core fixed income benchmark and implementation strategy will be developed and proposed at a future Board meeting; and (c) the Real Return benchmark and implementation strategy will be developed and proposed at a future Board meeting to better reflect the objective and to support diversification of that asset class.

Julie Oakley moved that the Board adopt the following revisions to the TMRS Strategic Target Allocation:

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Proposed</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Equity</td>
<td>17.5%</td>
<td>-2.5%</td>
</tr>
<tr>
<td>International Equity</td>
<td>17.5%</td>
<td>-2.5%</td>
</tr>
<tr>
<td>Core Fixed Income</td>
<td>30.0%</td>
<td>-5.0%</td>
</tr>
<tr>
<td>Non-Core Fixed Income</td>
<td>10.0%</td>
<td>+10.0%</td>
</tr>
<tr>
<td>Real Estate</td>
<td>10.0%</td>
<td>none</td>
</tr>
<tr>
<td>Real Return</td>
<td>5.0%</td>
<td>none</td>
</tr>
<tr>
<td>Absolute Return</td>
<td>5.0%</td>
<td>none</td>
</tr>
</tbody>
</table>
Private Equity 5.0%  
Cash Equivalents 0.0%

Jim Parrish seconded the motion; which carried unanimously by the members present, 5-0. *(Roy Rodriguez was not present for the vote)*

9. **Discussion on Co-Investment Option for Real Estate Allocation**  
*At this point, Mr. Parrish left the meeting.*

Mr. Schwartz, Ms. Kehoe and Ms. Macki presented this item. Ms. Kehoe began with a definition of "co-investment" stating that co-investment occurs when two or more pension funds or groups of funds share ownership of a real estate investment. This investment structure is allowable per TMRS’ Investment Policy Statement.

Ms. Kehoe highlighted the attributes of the co-investment environment and structure, along with possible benefits and risks of such an investment type. As a General Partner, co-investment benefits include the opportunity for the Fund to acquire an investment in a property that may otherwise be too large or create portfolio concentrations; the ability to spread the risk to co-investors so the underlying Fund is less concentrated and more diversified; the ability to earn fees from additional capital raised from Limited Partners. As a Limited Partner, co-investment benefits include the ability to gain additional exposure to an attractive property; the ability to increase exposure in a controlled and discretionary manner; improved diversification exposure at the portfolio level; typically lower fees and no J-curve impact on performance.

As a General Partner, possible risks include the same risk as the underlying investment, along with increased scrutiny and reporting requirements. As a Limited Partner, possible risks include compound risk of underlying investment through concentration to a particular asset or pool of assets; no more control over the asset than fund investors; and possibly a short decision time frame to invest. Mr. Gavia added that if TMRS agrees to go this route, some delegation to staff would likely be required due to the tight time frames involved. Two examples of co-investments were presented.

Mr. Schwartz presented a brief background on ORG’s experience with co-investments. Ms. Kehoe highlighted the implementation requirements and noted that implementation should include a certain level of staff discretion to execute opportunities within stated parameters and limitations.

The Board expressed their interest in staff bringing this back to the Board for action at a future meeting.

10. **Investment Report: Performance Update**  
Ms. Beard presented the capital markets review and the comparative performance report as of June 30, 2012. She reported that the System did well during the months of June and July due to having less equity in the portfolio than our peers. The year-to-date return as of June 30, 2012 is 4.24%, while the 1 year return is 2.90%.
11. Call for Future Agenda Items
Mr. Simpson asked the Board if there were any future agenda items to be discussed. The Board requested staff incorporate more information regarding potential investment managers’ strategies in staff materials, but they are comfortable with not having the managers present. There being no further business, the meeting adjourned at 12:45 p.m.

David Gavia
Executive Director

Frank Simpson
Chair, Board of Trustees