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

June 18, 2010

On June 18, 2010, the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a Regular meeting at 8:00 a.m. at the TMRS Headquarters, located at 1200 North IH 35 in Austin, Texas, with the following members present:

Board of Trustees
Ben Gorzell, Jr., Chair
April Nixon, Vice Chair
Carolyn Linér
Roel (“Roy”) Rodriguez
Pat Hernandez
H. Frank Simpson

Advisory Committee on Retirement Matters
David Crow, Arlington Professional Fire Fighters
Randle Meadows, Arlington Police Association
Jim Moore, City of Mesquite Fire Fighters
Bob Scott, Director of Finance, City of Carrollton

Present also were: David Gavia, Executive Director
Ian Allan, Director of Internal Audit
Rhonda Covarrubias, Director of Finance
Eric Davis, Deputy Executive Director
Bernie Eldridge, Director of Human Resources
Nancy Goerdel, Acting CIO/Director of Public Investments and Asset Allocation
Leslee Hardy, Staff Actuary
Holly Macki, Director of Real Estate
Michelle Mellon-Werch, Associate General Counsel
Cindy Morse, Executive Assistant
Debbie Munoz, Director of Member Services
Eddie Solis, Director of Government Relations
Bill Wallace, Director of Communications
Scott Willrich, Director of Information Resources
Robert Klausner, Klausner & Kaufman
Marcia Beard, R. V. Kuhns & Associates, Inc.
Russ Kuhns, R. V. Kuhns & Associates, Inc.
Peter Madsen, R. V. Kuhns & Associates, Inc.
Joe Newton, Gabriel, Roeder, Smith and Company
Mark Randall, Gabriel, Roeder, Smith and Company
Guests:  
Craig Bardo, Broad River  
Debbie Farahmandi, Investment Operations Specialist  
Pete Krnavek, Manager of Information Systems  
James Moeller, City of Mesquite  
Candace Nolte, Controller  
Kristin Qualls, Assistant Investment Officer  
Kate Reed, Investment Analyst - Equities  
Katie Reissman, Investment Analyst – Fixed Income  
Kathy Shields, City of Farmers Branch  
Greg Vick, Texas City Managers Association  
Tino Robledo, KPMG  
Susan Warren, KPMG  

The meeting was called to order by Ms. Nixon at 8:04 a.m., and Ms. Nixon gave the invocation. Mr. Gorzell was absent at the beginning of the meeting.

1. **Consider and Act on Consent Agenda**  
Mr. Gavia presented this item and asked the Board to adopt the Consent Agenda, which included the Minutes to the May 7, 2010 Joint Meeting of the Board of Trustees and the Advisory Committee on Retirement Matters, quarterly reports on service retirements, disability retirements, death benefits and financial statements. There was no discussion on this item. Mr. Simpson moved that the Consent Agenda be adopted as presented. Mr. Rodriguez seconded the motion, which passed unanimously. Ms. Linér abstained from the vote.

2. **Consider and Act on 2009 External Audit Results and Auditors Report to the Board of Trustees**  
Mr. Gavia introduced Susan Warren of KPMG to present the audit results. She stated that TMRS has a clean, unqualified audit opinion, free of material weakness or significant deficiencies. She discussed management’s responsibilities relating to accounting policies, internal control, conformity with generally accepted accounting principles (GAAP), and complying with the requirements of laws and regulations affecting TMRS. She discussed KPMG’s responsibilities regarding the audit.

Ms. Warren then presented the results of the audit, reporting that it is an unqualified (clean) opinion. She indicated that there were no corrected or uncorrected adjustments identified. The significant accounting policies used by TMRS are described in Note 1, and there were no significant changes to accounting policies. KPMG evaluated the management’s judgments and accounting estimates and determined they were reasonable. She reported that there were no other matters of note with regard to the audit.

Ms. Linér moved that the Auditor’s Report be accepted by the Board. Mr. Simpson seconded the motion, which passed unanimously.
Ms. Covarrubias began her presentation of the draft Comprehensive Annual Financial Report (CAFR) by thanking all of the staff members involved in producing the CAFR.

Ms. Covarrubias stated that the CAFR contains the same five (5) sections as proceeding years. In the Introductory Section, she highlighted the Plan Sponsor award that TMRS received, the changes brought about by House Bill 360, the selection of a new Executive Director, investment performance, funding and actuarial overviews for the year, as well as awards and acknowledgements received.

Ms. Covarrubias then moved to the Financial Section, where she discussed the Auditor’s Report, Management’s Discussion and Analysis. She then reviewed the highlights of the financial statements and footnotes. She highlighted key points in the Required Supplementary Information and the Schedule of Investment Expenses, and the yearly roll forward of both the Employee Savings Fund (ESF) and the Municipality Accumulation Fund (MAF).

Ms. Covarrubias then presented a high level review of the Investments Section. In the Actuarial Section, she noted that the information in this section is broken down based on the Retirement and Supplemental Death Benefit trusts. She also summarized the individual valuation results. She briefly explained that the Statistical Section provides information in response to GASB 44, and shows trend data. Ms. Covarrubias then went on to discuss the Popular Annual Financial Report (PAFR), stating that this report is also submitted to Government Finance Officers Association (GFOA) for review and recognition.

Mr. Rodriguez moved that the Board approve the CAFR and its distribution. Ms. Linér seconded the motion, which passed unanimously.

4. Consider and Act on Contract for Governmental Relations Consulting Services
Mr. Gavia presented the proposed contract extension for governmental relations consulting services. Mr. Simpson moved that the contract be extended for a term to expire on May 31, 2012. Mr. Rodriguez seconded the motion, which passed unanimously.

5. Discussion on Fund Restructuring
Mr. Randall began his presentation by stating that the focus of the presentation is going to be the impact on rates as well as funding levels. He mentioned the presentation will have more detail than past presentations. He said that the information being discussed are estimates because several key variables are still unknown (assets and reserves). Mr. Randall stated that if the restructuring is approved, restructuring will go forward as of December 31, 2010. He indicated that the biggest portion of the restructuring is the elimination of the CSARF. He presented an example showing that the impact of restructuring is due to the CSARF reallocation, as opposed to the plan benefits (i.e., USC and COLA). He showed a distribution of potential rate reductions, followed by actuarial results, in the aggregate, for Group 1 (1 to 1 matching, no repeating COLAs), Group 3 (2 to 1 matching, no repeating COLAs) and Group 6 (2 to 1 matching, repeating COLAs) cities.
Mr. Newton discussed the findings from the aggregated review, and then went to the individual city results for Group 1, 3 and 6 cities. Mr. Newton showed the 30 largest cities in TMRS (by assets). He reiterated that these results were estimates, so actual results will vary based on the actual value of the fund at December 31, 2010.

Mr. Randall reviewed the small city considerations, including the definition of “small” city, and possible retention of the CSARF at some level with a more conservative funding policy so the small cities can more rapidly fund benefits and stabilize contribution rates.

Mr. Randall then discussed timing of the restructuring. He said that if restructuring is passed during the 2011 legislative session, the Fund will likely be reallocated as December 31, 2010. The typical valuation cycle has actuarial results presented at an early May Board meeting. If restructuring is passed, Mr. Randall proposes the cycle be extended by approximately one month. The December 31, 2010 valuation results would be pushed out by one month to account for these changes. He also recommended that the actuarial experience investigation study be conducted at this time instead of the following year, so that if any assumption changes need to be made, they can be made coincident with the fund restructuring.

Mr. Simpson asked about changing mortality tables and the annuity purchase rate and inquired when this issue might be addressed. Discussion centered on the benefits of restructuring which removes the need, at least in the short and intermediate term, to change the mortality assumptions related to benefit calculations.

6. **Executive Session**
   At 9:16 a.m., Mr. Gorzell and Mr. Klausner arrived at the meeting. At this time, 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 10:38 a.m. All members of the Board who had been present when the Board went into Executive Session were again present.

7. **Consider and Act on Appointment of General Counsel**
   Mr. Gavia discussed the position vacancy for General Counsel, reporting that over ninety (90) resumes had been received. He explained the interview process, which included both phone interviews and in-person interviews and he reviewed the process by which the two finalists were selected.

   Mr. Simpson moved that the Executive Director be authorized to negotiate with the top candidate and, if an agreement cannot be reached, to negotiate with the second candidate, if necessary. Ms. Linér seconded the motion, which passed unanimously.

8. **Consider and Act on Performance and Compensation of Internal Auditor**
   This agenda item was skipped.
9. **Consider and Act on Real Return Interim Target Allocation and Ratification of Manager Search**

Mr. Gavia first recognized Russ Kuhns and congratulated him on his retirement. He thanked Mr. Kuhns for his service to TMRS over the years. Mr. Gorzell added his thanks and appreciation to Mr. Kuhns as well.

Ms. Goerdel began reviewing the previous discussion on the Real Return Allocation. She said the board adopted its strategic asset allocation policy that includes 2% of a 5% allocation to Real Return. She said that inflation-linked securities meets the requirement of this allocation and provides liquidity and diversification. She said the recommendation to the Board today will be to fully fund the 5% allocation to this asset class.

Ms. Beard recapped the previous presentation on this asset class. She stated that the strategy is to protect against inflation, which uses a blended benchmark, and discussed the potential components of a real return strategy. She described Treasury Inflation-Protected Securities (TIPS) in comparison to Global Linkers. She further discussed the key features of securities in this class. She gave an example of how the coupon is adjusted based on inflation. Mr. Madsen pointed out that both interest payments and principle are protected against inflation. Ms. Beard summarized the best environment and worst environment for inflation-linked bonds, which should perform to a slight return premium to the core bond market. Risk is lower when compared to equities, but slightly higher than the core bond asset class. Active management adds value by hedging currency risk, resulting in higher returns and lower risk. The highest correlation is to the core bond market, and the lowest correlation is to the equity market.

Ms. Beard summarized the benefits of Global Linkers over TIPS. Mr. Madsen added that since the benefits outweigh the risks, R.V. Kuhns recommends adding Global Linkers to the asset allocation and also recommends that TMRS implement a long-term policy target of 5%. He also proposed a tentative timeline that extends to December 31, 2011. Mr. Gorzell said that the change from 2 to 5% is simply speeding up the interim target to the full allocation.

Ms. Goerdel then briefly discussed currency forwards. She defined currency forwards and how these are used to hedge currency risk. She pointed out that the current IPS allows for the use of currency forwards for operational purposes. The change here is to use currency forwards to hedge currency risk. She discussed the impact on the portfolio of not having the ability to hedge foreign currency. She discussed currency forward risk management, showing the risks and the mitigating features. Her conclusion was that the staff, consultant and investment managers favor allowing the use of currency forwards to manage currency risk. The IPS will be revised to allow currency forwards for managing currency risk and will be presented to the board at a future meeting prior to Board action.

Mr. Simpson moved that the Board ratify the manager search that was begun after the February 2010 meeting, and that the interim target be increased from 2% to 5% and that the implementation timeline be extended to December 31, 2011. Ms. Nixon seconded the motion, which passed unanimously.
10. **Consider and Act on Equity Interim Target Allocation, Further Diversification of International Equity Allocation and Conforming Changes to the Investment Policy Statement (IPS)**

Mr. Madsen reported that the first part of this item is a proposal to extend the interim equity target date out one year, and the second portion is a proposal to convert the current TMRS International Equity Portfolio to a passive ACW ex US IMI approach rather than a passive EAFE. This second proposal will offer better coverage of the broad non-US equity markets and add emerging markets and small cap exposure to provide higher expected long-term returns. This will also increase diversification with the addition of Canada (8.3% of ACW ex US IMI). Mr. Madsen illustrated what is added to the EAFE index by an index comparison. He also reviewed the countries that are added with the split being roughly 76% developed and 23% non-developed. Mr. Madsen pointed out that there is not a dramatic change to the risk return profile, but the ACW ex US IMI adds a slight return premium.

He stated that the benefits include portfolio diversification, increased diversification within the asset class and expected enhanced returns. The risks are increased slightly due to volatility, currency risk and geo-political risk. He added that fees would increase slightly, from approximately 3 to 4.5 basis points.

Mr. Madsen stated that R. V. Kuhns recommends making this change and presented the expected implementation timeline should the Board approve the proposals. Ms. Goerdel introduced the IPS changes necessary to conform to this change.

Mr. Rodriguez moved that the Board approve: (1) extending to 12/31/11, measured implementation of the domestic and international equity allocations toward targets of 20% each with regular progress reports provided to the Board; (2) expanding the passive international equity allocation to include emerging markets, by changing the mandate from an MSCI EAFE passive strategy to an MSCI ACW ex US IMI passive strategy, to be implemented through NGTI non-lending commingled funds, and authorize the Executive Director to amend the contract with NTGI reflecting this change in the mandate at an annual fee of 4.5 bps (.045%) of assets under management; and (3) revise the TMRS Investment Policy Statement to reflect the change in the benchmark for the international equity allocation from the MSCI EAFE Index to the MSCI ACW ex US IMI and other conforming changes. Ms. Linér seconded the motion, which passed unanimously.

11. **Investment Report**

Mr. Madsen presented the performance report as of May 31, 2010. He reported that May was one of the worst months on record for the S&P 500. The one month return for May was negative but the Year-to-Date return is still positive at 2%. He also reviewed the asset allocation by manager. Ms. Goerdel highlighted the one page snap shot status report which was provided as a resource for the Board. Ms. Goerdel also reported the departure of eight (8) individuals from the State Street Securities Lending Group. Staff will monitor the situation to insure that services provided to TMRS by this group are not impacted.
12. **Discuss Potential Board of Trustees Meeting Dates and Locations for 2011**  
Mr. Gavia presented this item for the Board’s review. It will be provided to the Board at the September meeting for action.

13. **Executive Director and Staff Reports**  
Mr. Gavia presented this item. There were no questions or comments on the staff reports.

14. **Call for Future Agenda Items**  
As there was no further business, Mr. Gorzell adjourned the meeting at approximately 12:08 p.m.

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David Gavia  
Executive Director

Ben Gorzell  
Chair, Board of Trustees