

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

December 4, 2009

On December 4, 2009, the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a meeting at 8:30 a.m. at TMRS Headquarters, located at 1200 North IH 35 in Austin, Texas, with the following members present:

Board of Trustees

Carolyn Linér, Chair
Ben Gorzell, Jr., Vice Chair
Pat Hernandez
Roel ("Roy") Rodriguez
H. Frank Simpson

Absent: April Nixon

Present also were:

David Gavia, Acting 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
Robert Klausner, Klausner & Kaufman
Peter Madsen, R. V. Kuhns & Associates, Inc.
Holly Macki, Director of Fixed Income
Michelle Mellon-Werch, Associate General Counsel
Jeremy Miller, R. V. Kuhns & Associates, Inc.
Cindy Morse, Executive Assistant
Debbie Munoz, Director of Member Services
Joe Newton, Gabriel, Roeder, Smith and Company
Mark Randall, Gabriel, Roeder, Smith and Company
Eddie Solis, Director of Government Relations
Bill Wallace, Director of Communications
Nancy Williams, Ennis Knupp + Associates, Inc.
Scott Willrich, Director of Information Resources

Guests:

Steve Alexander, Alexander Financial Management
David Crow, President, Arlington Professional Fire Fighters
Debbie Farahmandi, Investment Operations Specialist
Natalie Foerster, Governor's Office
Christopher Hansen, Pension Review Board
Pete Krnavek, Manager of Information Systems

Randle Meadows, City of Arlington Police Department
Jim Moore, City of Mesquite Fire Fighters
Lorraine Moreno, Regional Manager, City Services
Kristin Qualls, Assistant Investment Officer
David Rodriguez, Regional Manager, City Services
Bob Scott, Director of Finance, City of Carrollton
Sean Thompson, Regional Representative, City Services

The meeting was called to order by Ms. Linér at 8:30 a.m., and Mr. Rodriguez gave the invocation.

1. Executive Session

At 8:33 a.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 9:06 a.m. All members of the Board who had been present when the Board went into Executive Session were again present.

2. Consider and Act on Consent Agenda

Mr. Gavia introduced this item and gave a brief overview of what is contained in the Consent Agenda, including Minutes from the September 25, 2009 Regular Meeting of the Board, quarterly reports on service retirements, disability retirements, death benefits and financial statements. Mr. Gavia noted that additional reports are presented in the Consent Agenda each December, including *Seven Year Inactive Report/Transfer of Inactive Accounts; Seven Year Inactive Report/Transfer of Unclaimed Refunds and Updated Service Credit and Annuity Increase Ordinances Adopted*. He also called the Board's attention to updated financials that were placed at the Board's table prior to the meeting. There were no questions and no revisions to the proposed Minutes.

Mr. Rodriguez moved that the Consent Agenda be adopted. Mr. Simpson seconded the motion, which passed unanimously.

3. Consider and Act on Adoption of Reserve Guidelines and Consider and Act on Actuarial Smoothing Policy

Mr. Randall and Mr. Newton presented these items, combining agenda items number 3 (concerning the reserve policy) and number 4 (concerning asset smoothing). Mr. Randall stated the recommendation regarding asset smoothing is a 10-year smoothing policy with a 25% "soft corridor" (amounts outside corridor to be phased in over 3 years), using the current amortization policy, and an initial reserve target of 20% of the portfolio, with a target interest credit rate of 7.5% and amounts in excess of this amount to be reserved.

Mr. Randall said that asset smoothing is used due to the annual fluctuations in investment markets. Smoothing is a technique used to promote consistency in funding and reporting, as well as benefits. Mr. Randall showed, for a sample retirement system, how the actuarial value of assets behaves versus the market value, in a smoothed environment. He next discussed the

three components of smoothing: the period, the corridor and the amortization period. He mentioned that the recommended method complies with Actuarial Standards of Practice.

Mr. Randall turned to the initial reserve guidelines for reserving excess earnings for future adverse experience. The target interest rate will be 7.5%, starting with the 2009 crediting rate. GRS will provide an annual recommendation to the Board with regard to the interest crediting rate and the amount to be reserved.

Mr. Newton then walked the Board through an example of how the Actuarial Value of Assets (AVA) is calculated in comparison under the "adjustment method" of smoothing. This method keeps market gains and losses in synch with actuarial gains and losses. This produces more realistic measures of assets and rates. He also showed an example of how the corridor works in relation to AVA.

Mr. Newton then went through an example of a simulation of smoothing with no reserves that showed the math over a 10 year period. The example showed how contribution rates remained more stable over the period, including a period where the corridor was hit. He then discussed an example with a full reserve. This example showed how the reserve would be used to smooth the interest rate credited, and how the smoothing policy would be used in conjunction with the reserve policy.

Mr. Newton stated that until reserves are built, the Board should not use reserves to increase the average crediting rate beyond the 7.5% target rate. Mr. Randall then recapped the recommendations for both smoothing policy and reserve policy.

Mr. Simpson moved that the Board accept the reserving guidelines recommended by GRS that (1) calls for excess investment returns to be reserved; (2) sets the initial target reserve to build towards 20% of the fund; and (3) sets the target interest credit to the Municipality Accumulation Fund to be 7.5% (with a 10-year average credit used as a benchmark). Mr. Simpson also moved that the Board adopt GRS' recommendation of a 10-year smoothing period, using a 25% "soft" corridor with asset gains and losses outside of the corridor averaged over a three-year period, and amortizing gains or losses using the existing amortization period. Mr. Rodriguez seconded the motions, which passed unanimously.

4. **Quarterly Investment Report**

Mr. Madsen began this presentation by reviewing the September 30 returns. Mr. Miller made some brief remarks regarding the market since the 2008 decline. He said that R. V. Kuhns feels comfortable that the portfolio is well positioned to take advantage of opportunities that may be coming. The managers have added value compared to the benchmarks.

Mr. Madsen then moved to the October 31 returns and reiterated that returns continue to remain volatile. He gave an update of the investment program status, focusing on the timeline, and potential asset class changes in 2010. He mentioned that there is weakness in the market, but TMRS is well positioned to take advantage of the opportunities.

Ms. Goerdel mentioned that both TCW and PIMCO were funded at approximately 50% of their mandate with the remaining 50% to be funded in January 2010.

She mentioned that responses to the real estate manager search are due today.

She also gave the Board an update concerning State Street and issues with the California Attorney General and two Missouri plans that participate in State Street's Quality D Securities Lending fund. Mr. Klausner added that this is very early in the process. Mr. Gavia and Ms. Goerdel agreed that over time, staff would like more control over the collateral in the securities lending program, and as a result may look at changing from the Quality D fund.

5. Discuss Proposed Amendments to the Investment Policy Guidelines

Mr. Gavia stated that since adopting this policy recently, staff has had a chance to work on this policy with R. V. Kuhns and improve the policy. R. V. Kuhns has reviewed all of the recommended changes and are in agreement with staff. Ms. Goerdel mentioned that the changes break down into 4 categories: (1) expand investment authority; (2) restrict investment authority; (3) clarify investment policy; and (4) correct investment authority. Mr. Gorzell asked about the types of municipal bonds used by the managers.

Concerning the revisions that would restrict authority, Ms. Goerdel said that the first change formalizes the steps needed regarding the authority of investment staff who resign their position. One item deals with the concentration of risk, limiting risk to 5% per issuer. The remaining items in this category deal with securities lending, borrower limits and other items that will be important if we move to a separate securities lending collateral pool. The revisions to clarify the policy arise out of the risk reporting measurements we have found since funding the core plus managers. The final category concerns correction of issues found in the policy.

6. Executive Session

At 12:25 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 12:55 p.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 Amendments to the Strategic Plan

Mr. Gavia introduced Ms. Williams to present this agenda item. Ms. Williams discussed that the current strategic plan was initiated in December 2008 and is a model for others to follow. Many of the items listed in the plan have been completed, while others are ongoing. Ms. Williams recommended reviewing the plan thoroughly in mid-2010.

Mr. Gavia presented the in depth review of each goal in the Strategic Plan and whether the items were completed or ongoing. On Goal 5, Mr. Gavia mentioned that one item that could be added to this goal is a peer review of the internal auditor. Mr. Simpson mentioned that he thought a generic outline of the legislative development process should be included. Ms. Williams mentioned that review of criteria and process for reviewing the Executive Director should be done as well. Mr. Gavia mentioned that staff will bring back a revised version of

this plan for future action by the Board, including the addition of peer review of the internal auditor.

8. Consider and Act on Proposed 2010 Budget

Mr. Gavia introduced this item and briefly commented that this budget presents core requests, plus expanded requests. Ms. Covarrubias presented each part of the budget in relation to the Strategic Plan. With regard to Goal 2, she said that three additional investment personnel were requested, along with an outside real estate consultant, and the acquisition of a risk management system. The biggest budget changes result from Goal 2. Ms. Covarrubias then reviewed the Executive Summary. She mentioned the new investment related positions listed in Appendix A of the proposed budget. Mr. Gorzell asked about the risk management software that is being contemplated. Ms. Goerdel mentioned that these products are currently being reviewed by staff with the assistance of R. V. Kuhns. Mr. Gorzell asked for a future update of how all the pieces of the investment program fit together. Ms. Covarrubias then reviewed the Personnel Services category. Regarding the Professional Services category, Ms. Covarrubias mentioned that the increases in this category are due to the real estate consultant, as well as the File Net upgrade. The other items in this category are either consistent with last year or slightly reduced. Ms. Covarrubias indicated that savings were found in the Communications category. The savings in Rentals & Equipment Maintenance are due to the decision to not purchase a third party identity management software package. Ms. Covarrubias mentioned that the Miscellaneous category remains largely unchanged.

Mr. Simpson moved that the Board adopt the proposed 2010 Budget as presented. Mr. Rodriguez seconded the motion, which passed unanimously.

9. Consider and Act on Resolution Transferring Monies from Interest Reserve Account to Expense Fund

Mr. Gavia and Ms. Covarrubias discussed the amount that needs to be transferred to the expense fund. Ms. Covarrubias showed that \$1.3 million of excess reserves could be used and that only \$12.4 million be transferred.

Mr. Rodriguez moved that \$12,484,950 be transferred to the expense fund. Mr. Gorzell seconded the motion, which passed unanimously.

10. Consider and Act on Adoption of 2010 Risk-Based Audit Plan

Mr. Allan briefly updated the Board on activities to date. He then explained that the 2010 risk-based audit plan was developed in accordance with the International Standards for the Professional Practice of Internal Auditing. He discussed enterprise risk management and mentioned several potential proposed audit engagements.

Mr. Simpson thanked Mr. Allan for his good work, and said that it is necessary to keep the Board fully apprised of the activities of TMRS. Mr. Rodriguez echoed Mr. Simpson's comments and suggested that staff should consider a "peer review" of the audit. Mr. Gorzell inquired about the IT security audit.

Mr. Rodriguez moved that the 2010 Risk-Based Audit Plan be adopted. Ms. Hernandez seconded the motion, which passed unanimously.

11. Consider and Act on Proposal for Decision in the Matter of James C. Henderson, Deceased

Mr. Gavia briefly outlined TMRS' use of State Office of Administrative Hearings (SOAH) and then asked Mr. Klausner to present the case. Mr. Klausner outlined the facts of the case. He said he has reviewed the Proposal for Decision, the documentary evidence in the case and the appropriate statutes. Mr. Klausner concluded that TMRS is bound by law and recommended that the Board adopt the Administrative Law Judge's Proposal for Decision.

Mr. Simpson moved that the Board adopt the Administrative Law Judge's Proposal for Decision in this matter. Mr. Rodriguez seconded the motion, which passed unanimously.

12. Consider and Act on Proposal for Decision in the Matter of J. C. Roberts, Deceased

Mr. Klausner continued with the second case, stating that he has reviewed the Proposal for Decision, the documentary evidence in the case and the appropriate statutes. Mr. Klausner recommended that the Board adopt the Administrative Law Judge's Proposal for Decision.

Mr. Gorzell moved that the Board adopt the Administrative Law Judge's Proposal for Decision in this matter. Ms. Hernandez seconded the motion, which passed unanimously.

13. Consider and Act on New Appointments and/or Reappointments to the Advisory Committee on Retirement Matters

Mr. Gavia and Mr. Solis reviewed the process for, and rules surrounding, appointments to the Advisory Committee on Retirement Matters (Advisory Committee) and briefly reviewed the names of people who applied to be on the Committee.

Mr. Simpson moved that the Board appoint Ron Cox, Steven Segal and Dean Frigo to the Advisory Committee. Ms. Hernandez seconded the motion, which passed unanimously.

14. Report on Advisory Committee

Mr. Solis gave a recap of the Advisory Committee meeting that was held on November 20, 2009. He stated that Ms. Goerdel gave an update on investment program diversification and GRS gave presentations on Asset Smoothing and Reserve Guidelines. He said this meeting also included a brainstorming session with focus centering on TMRS fund restructuring. Mr. Solis said this meeting was attended by the Governor's Office and by other legislative offices and interested parties.

Mr. Rodriguez reiterated the success of the first meeting. He mentioned that he hoped the TML Committee continues to interact with the TMRS Advisory Committee, too. Mr. Solis added that TMRS will continue to be a resource where invited.

15. Consider and Act on Election of 2010 Board Officers

Mr. Gavia presented this item and outlined the historical process for the election of Board officers. He mentioned that no Board policy governs the election of Board officers.

Mr. Rodriguez moved that Mr. Gorzell be elected to be the Chair of the TMRS Board and that Ms. Nixon be elected to be the Vice-Chair. Ms. Hernandez seconded the motion, which passed unanimously.

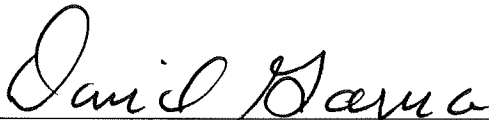
16. Acting Executive Director and Staff Reports

Mr. Gavia introduced this item and asked if there were any questions or comments. As there were none, the Board continued on to the next agenda item.

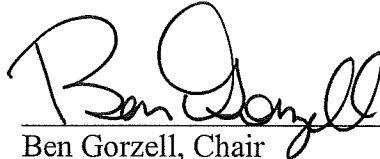
17. Call For Future Agenda Items

Mr. Gorzell asked for a future review of the Investment Department structure. Mr. Gorzell also thanked Ms. Linér for her leadership during the past year and stated that he looked forward to working with the Board and staff in the upcoming year.

As there was no further business, the meeting adjourned at 1:23 p.m.



David Gavia
Acting Executive Director



Ben Gorzell, Chair
TMRS Board of Trustees