MINUTES OF THE
TEXAS MUNICIPAL RETIREMENT SYSTEM
Joint Meeting of the Board of Trustees
and the Advisory Committee on Retirement Matters

August 21, 2009

On April 24, 2009, the Board of Trustees of the Texas Municipal Retirement System (TMRS) and the TMRS Advisory Committee on Retirement Matters convened for a joint 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**
Carolyn Linér, Chair
Pat Hernandez
April Nixon
Roel (“Roy”) Rodriguez
H. Frank Simpson

Absent: Ben Gorzell, Jr., Vice Chair

**Advisory Committee on Retirement Matters**
Allen Bogard, City Manager, City of Sugarland
Keith Brainard, Councilman, City of Georgetown
David Crow, Arlington Professional Fire Fighters
Chris Heaton, Texas Municipal Police Association
Scott Kerr, Texas State Association of Fire Fighters
Suzanne Levan, City of San Antonio
Debbie Maynor, Texas Municipal Human Resources Association
Jim Moore, City of Mesquite, Firefighters
Mike Perez, Texas City Managers Association
Bob Scott, Government Finance Officers Association
Monty Wynn, Texas Municipal League

Present also were:
Eric Henry, Executive Director and CIO
Ian Allan, Director of Internal Audit
Rhonda Covarrubias, Director of Finance
Eric Davis, Deputy Executive Director
Bernie Eldridge, Director of Human Resources
David Gavia, General Counsel
Nancy Goerdel, Director of Public Investments and Asset Allocation
Leslee Hardy, Decision Support Actuary - Director
Robert Klausner, Klausner & Kaufman, P.A.
Russ Kuhns, R. V. Kuhns & Associates, Inc.
Holly Macki, Director of Fixed Income
Pete Madsen, R. V. Kuhns & Associates, Inc.
Michelle Mellon-Werch, Associate General Counsel
Cindy Morse, Executive Assistant
Debbie Munoz, Director of Member Services
Joe Newton, Gabriel Roeder Smith and Company
Mark Randall, Gabriel, Roeder, Smith and Company
Todd Shupp, R. V. Kuhns & Associates, Inc.
Eddie Solis, Director of Government Relations
Bill Wallace, Director of Communications
Scott Willrich, Director of Information Resources

Guests:

Sherry Chapman, Investment Accountant
Colin Davidson, Regional Representative – City Services
Debbie Farahmandi, Investment Operations Specialist
Christopher Hanson, Pension Review Board
Chris Jones, Combined Law Enforcement Associations of Texas
Anthony Mills, Regional Manager, City Services
Lorraine Moreno, Regional Manager, City Services
Candace Nolte, Controller
Kristin Qualls, Assistant Investment Officer
Kate Reed, Investment Analyst
David Rodriguez, Regional Manager – City Services
Melanie Thomas, Editor
Sean Thompson, Regional Representative – City Services
Greg Vick, Texas City Managers Association

The meeting was called to order by Ms. Linér at 9:10 a.m., and Mr. Simpson gave the invocation.

1. Executive Session
At 9:10 a.m., the Board entered into Executive Session, pursuant to Texas Government Code, §§551.071 and 551.074 to seek and receive the advice of its Legal Counsel and to discuss personnel matters, including reviewing and considering the duties, performance, compensation and resignation of the current Executive Director, as well as discussing the duties, compensation, selection and appointment of a new Executive Director and Chief Investment Officer. No action was taken during the Executive Session and the meeting was opened to the public again at 9:58 a.m. All members of the Board who had been present when the Board went into Executive Session were again present.

Ms. Linér then asked for a motion to appoint an acting Executive Director. Mr. Simpson moved that David Gavia be named Acting Executive Director until a permanent replacement can be found, and that his salary be temporarily increased by ten percent during this interim period. Mr. Rodriguez seconded the motion, which carried unanimously.
Ms. Linér also asked for a motion to appoint an acting Chief Investment Officer. Ms. Nixon moved that Nancy Goerdel be named Acting Chief Investment Officer until a permanent replacement can be found, and that her salary be temporarily increased by ten percent during this interim period. Ms. Hernandez seconded the motion, which passed unanimously.

Ms. Linér then presented a plaque to Mr. Henry as a token of the Board’s appreciation for his outstanding leadership and service during his brief time at TMRS.

2. **Consider and Act on Adoption of Minutes from the June 19, 2009 Board of Trustees Meeting**

Mr. Henry introduced this item and asked if the Board had any questions about the Minutes or revisions to them. As there were none, Mr. Rodriguez moved that the Minutes from the June 19, 2009 Board of Trustees meeting be adopted as presented. Ms. Hernandez seconded the motion, which passed unanimously.

3. **Recap of 81st Texas Legislative Session and House Bill 360**

Mr. Solis presented this recap of the 81st Legislative Session. He stated that the work done by the Advisory Committee made passage of House Bill 360 a much easier process. He mentioned non-TMRS sponsored bills that would have affected TMRS if they had passed, and stated that several of the issues in these bills are likely to be studied in the interim. He also briefly referenced confirmation of Board appointments that occurred during the session.

Mr. Henry encouraged the Advisory Committee to continue to move forward with the good work they have done. He said there will be many opportunities to work with the Board members in the future.

4. **TMRS Investment Program Looking Ahead Three Years**

Mr. Madsen began by discussing recent portfolio events. He mentioned the passive exposure in equities and the diversification of the fixed income portfolio. Mr. Madsen discussed the Core Plus Manager search and briefly described the Core Plus asset class. Core Plus will be allocated 10% of the total portfolio. Mr. Madsen briefly described the manager selection criteria and selection process. He reported that the search started with nine managers, and has now been narrowed to four managers. The next steps include on-site meetings, followed by bringing the finalists to the Board.

Mr. Madsen and Ms. Goerdel both mentioned that international small cap and emerging markets will be the next equity classes to be discussed with the Board, along with the potential use of active management. Mr. Madsen discussed the possible addition of real estate to the portfolio, as well as the possible addition of real return, private equity and absolute return.

5. **Investment Performance Report as of June 30, 2009**

Mr. Madsen began the performance review by looking at the risk/return profile of the portfolio. He reported that TMRS, on a seven-year basis, had a high return, but also a high risk profile. He indicated that this increased risk was due to the high concentration in long duration bonds. It would have been higher had TMRS not worked to reduce the duration of the fixed income
portfolio over the last year. Mr. Henry pointed out that reduction of this risk factor is a big part of the overall diversification plan.

Mr. Madsen then moved to July performance. He reiterated the need for a very gradual and methodical progression on the diversification program. Ms. Goerdel highlighted the asset allocation by manager. She reported that as of July, the equity portion had a positive return.

6. **Review of Actuarial Changes, Including Change to Projected Unit Credit (PUC), Assumption Changes, Phase-In/Lag, Closed Plan Policy**

Mr. Newton began his presentation by discussing the change to Projected Unit Credit (PUC). He then mentioned the three actuarial assumption changes made with the 12/31/2008 valuation. He touched on the contribution rate lag, and stated that the "lag" should have very small impact in the future. Mr. Newton briefly discussed the actions taken at the June 19, 2009 Board meeting regarding funding for closed plans and ad hoc benefit enhancements. With regard to the ad hoc benefit adoptions, he stated that if those are done on a regular basis, the optimal solution is to advance fund the benefit enhancement.

7. **Discussion on Actuarial Expectations for 2011 and Preview of 12/31/10 Experience Study**

Mr. Newton began his presentation by stating that no assumption or method changes are expected for the 12/31/09 valuation. He indicated that an asset smoothing method may be added, but stated that this will be a positive addition. Mr. Newton briefly discussed the impact of different investment returns on the Municipality Accumulation Fund (MAF). He stated that a 5.9% total return would allow the MAF to be credited 7.5%, while a 3.1% total return results in a 0% crediting rate to the MAF. Mr. Newton then discussed the impact of paying the full-rate and the phase-in rate on various plan groups. He also showed the impact on rates with a 0% credit to MAF. He indicated that the System should expect to see rate stability if cities are paying the full rate.

8. **Introduction to Reserve Policy and Discussion on Funding the Municipality Accumulation Fund (MAF), the Employee Savings Fund (ESF) and the Current Service Annuity Reserve Fund (CSARF)**

Mr. Randall began the discussion on reserving. He stated that the 5% guarantees on the Employee Savings Fund (ESF) and the Current Service Annuity Reserve Fund (CSARF) create volatility which must be absorbed by the MAF. He stated that by building a reserve fund, much of this volatility can be mitigated. He said that the 2008 financial meltdown illustrated that the reserve fund must be set at a very high rate. He showed the impact of the recent financial meltdown on Texas County and District Retirement System (TCDRS), which had what was felt to be an adequate reserve.

Mr. Newton noted the CSARF will continue to grow as compared to the MAF, increasing volatility to the MAF. Using the TCDRS experience as an example, Mr. Newton said TMRS reserves might need to be 30% of the total portfolio. Mr. Randall then discussed how long it would take to build this 30% reserve. He said the ultimate reserve policy would utilize both reserve building and the addition of an actuarial smoothing technique. He said that this leads to the question of whether there are more efficient solutions than reserving, which may include the
asset pool structure – primarily CSARF. These other options could reduce the recommended level of reserves required.

The discussion then changed to the TMRS fund structure. Mr. Newton described the CSARF as the pooled risk fund used to pay retirement benefits. He said there is no direct funding source of CSARF other than the transfer at retirement. He indicated that due to mortality risk, this fund needs to be self-sustaining. Mr. Newton stated that this structure is fairly unique to TMRS. Mr. Newton discussed some of the advantages and disadvantages of the CSARF structure. The advantages center around mitigating mortality risk, and the perception of income security. The disadvantages include volatility on the MAF, cash flow pressure on mature plans, and higher contributions requirements based on “settlement” or transfer to CSARF at retirement. Mr. Newton stated that from an actuarial perspective, employers are not treated equitably under the current structure. An alternative solution could be to stop transfers to CSARF and redistribute current CSARF liabilities and assets back to the MAF. This would result in (a) normal volatility on the MAF; (b) a decrease of reserve requirements; (c) lower contribution requirements without lower benefits; and (d) a reduction of cash flow pressure on mature plans. Employers would bear the risk of paying annuities.

Mr. Newton then worked through an example of how changing the fund structure decreases cost. In summary, he reported that due to the current structure, TMRS cities’ contribution rates are 10-20% higher than a typical pension plan. He outlined the impact on redistributing the CSARF, stating that it would result in: (a) no changes in benefit procedures; (b) a higher probability of employers sustaining current benefit levels; (c) lower contribution rates for cities; (d) lower requirement for reserves; (e) increased flexibility in asset allocation; and (f) increased flexibility in smoothing techniques.

Mr. Randall stated that it is the actuaries’ job to make these options known to the Board so that the Board can make informed decisions.

9. Notice Regarding Selection of Chair and Vice-Chair for the Advisory Committee on Retirement Matters
Ms. Linér appointed April Nixon as Chair of the Advisory Committee on Retirement Matters, and Roy Rodriguez as the Vice-Chair.

10. Call for Future Agenda Items
As there was no further business, Ms. Nixon moved that the meeting be adjourned. Mr. Rodriguez seconded the motion, which passed unanimously. The meeting adjourned at 12:05 p.m.

David Gavia, Acting Executive Director
Carolyn Linér, Chairman, Board of Trustees

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