

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

September 20, 2012 – 3:30 p.m.

September 21 2012 – 8:30 a.m.

On September 21 2012, 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

Frank Simpson, Chair

Julie Oakley, Vice Chair

April Nixon

Jim Parrish

Roel (“Roy”) Rodriguez

Absent: Ben Gorzell, Jr.

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, 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

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

Nancy Williams, Hewitt EnnisKnupp

Mark Randall, Gabriel, Roeder, Smith & Company

Marcia Beard, R. V. Kuhns & Associates

Sean Ealy, R. V. Kuhns & Associates

Also in attendance:

Sherry Chapman, Investment Accountant
David Crow, Arlington Fire Fighters
Debbie Farahmandi, Investment Operations Specialist
Chris Jones, Combined Law Enforcement Associations of Texas (CLEAT)
Glenn Johnson, Garland Fire Fighters Association
George Kauffman, City of Garland
Randall Meadows, Arlington Police Association
Jim Moore, Mesquite Fire Fighters
Cindy Morse, Investment Support Analyst
Candace Nolte, Controller
Nick O'Keefe, Senior Staff Attorney
Kate Reed, Investment Risk Analyst
David Rodriquez, Regional Manager – City Services
Jon Scolnik, UniteHere

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

2. Consider and Act on Consent Agenda

Mr. Gavia presented the items contained in the consent agenda which included the minutes from the August 16-17, 2012 Special Meeting of the Board and the Advisory Committee on Retirement Matters, along with quarterly reports on service retirement, disability retirements, death benefits and financial statements. There was no discussion on this item and no revisions to the minutes. Mr. Parrish moved that the Board adopt the Consent Agenda as presented. Ms. Nixon seconded the motion, which passed unanimously by all Board members who were present, 5-0.

3. Consider and Act on Equity Manager Search Presentation/Selection

Mr. Gavia introduced Kristin Qualls and Sean Ealy, Director of Research for Manager Research at R.V. Kuhns. Mr. Gavia reminded the Board that at its March 29-30, 2012 meeting, the Board approved a recommendation by TMRS staff and R.V. Kuhns to adopt a 50/50 core/satellite structure for both the domestic and international equity allocation. Ms. Qualls began by reviewing the Core Satellite Target Equity Structure. She discussed the allocation of complementary Rules-Based Strategies stating that the initial allocation will be equally distributed between Fundamental Equity Index and Minimum/Low Volatility Index strategies. She discussed the characteristics of each, and added that the specific benchmark indexes would be selected based on further analysis, but would be within the Russell and MSCI families. Mr. Ealy added that these strategies are a good first step into active management as they are more like passive strategies from a fee structure, but mimic active strategies. Mr. Ealy reviewed the manager search and the overall screening process. Both of these strategies are relatively young with short performance track records, so R.V. Kuhns wanted to cast a wide net so as not to exclude managers. This process resulted in 29 initial candidates being identified to receive RFI questionnaires. Eight firms responded to the questionnaire, and all but one firm applied for both the fundamental and minimum/low

volatility strategies. Mr. Ealy stated that the objective was to identify a strong manager that understood the philosophy and process of the underlying indices, importance of trading cost management, and expertise in non-standard benchmarking. Mr. Ealy reviewed the list of minimum qualifications developed by TMRS and R.V. Kuhns. Mr. Simpson asked for clarification concerning the requirement that the manager be an SEC- registered investment advisor under the Investment Adviser's Act of 1940, as amended. Ms. Qualls explained the analysis of this issue, stating that banks are regulated under the federal regulatory authorities other than the SEC and since State Street is a bank, the group responsible for this advisory business falls under the supervision of the Federal Reserve. Ms. Goerdel added that the purpose of the IPS requirement is to have an additional layer of oversight through regulation. Mr. Simpson asked if any managers did not respond due to the requirement that they be registered under the Investment Advisor's Act. Mr. Ealy stated that this search did capture all the major players.

Mr. Ealy then reviewed the overall scoring matrix, which was tailored to this mandate and addressed background and experience; philosophy and process; capabilities in research, trading, compliance, reporting and risk management; performance history and fees. The scoring matrix was designed to be as quantitative as possible, leaving the qualitative analysis to interviews and on-site visits.

Ms. Qualls and Mr. Ealy then reviewed the characteristics of the top candidate for each strategy, as ranked by TMRS and R.V. Kuhns. Ms. Qualls first highlighted State Street Global Advisor's (SSgA) characteristics, pointing out that SSgA has \$9 billion in rules-based fundamental strategies, a stable and experienced management team, with competitive pricing and low trading costs. Mr. Ealy outlined UBS' characteristics highlighting that they have \$2.1 billion in global minimum/low volatility strategies, strength in operations and compliance, and a dedication to TMRS. Ms. Oakley asked for the pros and cons to already having exposure to a manager. Mr. Ealy explained that simplicity (fewer managers) and fee breaks are pluses and that the negative could be concentration of exposure to a single manager.

Mr. Parrish asked if the Investment Policy Statement (IPS) has other areas where exceptions or waivers might need to be made. Ms. Goerdel responded that this would be addressed during the IPS annual review, and that staff is scheduled to bring revisions to the Investment Policy Statement to the Board in October. Mr. Parrish asked whether this policy revision needs to be made before selecting the manager, and Mr. Klausner pointed out that SEC registration is more of an issue in alternative strategies than in these passive strategies.

Mr. Rodriguez moved that: (1) the Board make an exception to the TMRS Investment Policy Statement requiring that managers be registered as investment advisors under the Investment Advisers Act of 1940, as amended, due to their exempt status from that act, and select State Street Global Advisors (SSgA) for US and Non-US Fundamental Index Passive strategies, and authorize the Executive Director to negotiate a contract satisfactory to the System for fees substantially as proposed in the Board Communication; (2) UBS Asset Management be selected for US and Non-US Minimum Volatility Passive Strategies, and authorize the Executive Director to negotiate a contract satisfactory to the System for fees substantially as

proposed in the Board Communication; and (3) initial allocations of \$200 million be made to each of the four portfolios towards rules-based target allocations of 11.5% to each of the domestic and international equity allocations. Jim Parrish seconded the motion; which passed unanimously by all Board members who were present, 5-0.

4. Quarterly Investment Report

Ms. Beard with R.V. Kuhns presented the quarterly investment performance report as of June 30 noting that the second quarter was an uneven time in the market with a slowing from the first quarter. She added that mixed domestic economic news contributed to uneven and divergent markets, while uncertainty in Europe continued to linger during the second quarter of 2012. Ms. Beard noted that in the second quarter, as a point of comparison but not a driver of the asset allocation decision, the TMRS actual allocation had more exposure to fixed income than its peers. She added that the portfolio continues to move towards a well-diversified structure as fixed income is reduced to fund other asset classes and that it continues to move at a measured pace. She then reviewed performance versus benchmarks.

The Total Fund Composite met its policy objectives on a five-year trailing basis, it returned 6.92% compared to a 6.57% policy expectation, and was very close to the actuarial assumption. Mr. Simpson asked how many funds are in the peer universe to which TMRS total performance was being compared. Ms. Beard responded that she will provide that information to Mr. Simpson and will include that in her report going forward. The risk/return profile versus peers placed TMRS in an enviable position in both the short and long-term. Ms. Beard reviewed the Asset Class Composite Performance results and noted that they continue to be in-line with policy objectives.

Ms. Goerdel began the staff investment report by discussing the current market environment. She reviewed the fixed income market and volatility in the 10-year US Treasury yields due to fluctuation in investors' willingness to take on risk, and pointed out that equities, particularly in the domestic markets, have delivered strong performance year to date. Ms. Goerdel reviewed the August 2012 and year-to-date performance, reporting that the total TMRS return year to date is at 6.79% with positive performance from all asset classes. She reviewed the current and target asset allocation, indicating that there has been relatively little change since the last report. She gave a status update on portfolio diversification, focusing on activity in each asset class. Mr. Rodriguez asked why TMRS is lagging so far behind the benchmark in Real Estate. It was explained that TMRS is very early in this strategy, and the benchmark is more focused on mature portfolios, so the current lag reflects the "J-curve" effect. Ms. Goerdel then reviewed the June 30 risk report, noting that there were no compliance test violations to report and pointed out that the risk report reflects no risk concerns.

5. Additional Educational Presentation on Investment Decision-Making Process

Mr. Gavia introduced this item by stating that it is a continuation of the discussion on the same topic in the August meeting, and reminded the Board that at the August meeting, they had given staff direction that it was no longer necessary for the Board to hear manager presentations during the selection process allowed by the IPS. Ms. Williams set the stage by discussing what the optimal role for the Board is in the investment decision-making process.

The items that the Board needs to consider in order to determine the best use of everyone's time, as well as the most prudent and efficient approach, is to define each party's role and the proper balance between the three fiduciaries (board, staff and consultants). Ms. Williams reviewed the potential for delegation of duties including what duties are usually retained by Boards; sometimes delegated and sometimes not; and those that are usually delegated by Boards.

In reviewing the list of items usually retained, it was noted that all items on the list have been retained by the TMRS Board. The selection of investment consultants was discussed, and Ms. Williams noted and Mr. Klausner confirmed that in addition to the Board's consultant, some of the larger funds also select specialty investment consultants as a resource for staff. Ms. Williams further emphasized that both policy and practice should reflect the intent of delegation.

Ms. Williams next reviewed with the Board the list of duties usually delegated by Boards. Again, it was noted that all of these items have been delegated by the TMRS Board. The only "gray area" on this list is asset class rebalancing. There are tight Board policy constraints around rebalancing, but staff does have some discretion on how to implement rebalancing. Ms. Williams stated that given the stage of diversification TMRS is at, it has not been an issue yet, but it should be discussed before, or at the time rebalancing does come into play.

Ms. Williams then moved to items that either may or may not be delegated. She stated that delegating should not feel like the Board is taking on more risk by delegating; rather, the Board should be able to delegate if they feel they are getting assistance in risk mitigation. Mr. Klausner added that delegation is often a cultural issue, and that effective delegation is difficult. He suggested that with the Board still in the learning and exploration process, they have to get comfortable with delegation, but added that the Board has staffed up, so greater delegation is appropriate when they are ready. Mr. Gavia reiterated that if something is delegated to staff, the Board's job then takes on the role of monitoring, so it is not absolved of responsibility. Mr. Rodriguez felt the Board should retain all items in the "sometimes delegated and sometimes not" category, except the manager selections/terminations and the selection of securities lending agents. There was not a consensus at this time for that idea, and Ms. Williams added that making specific mandates/allocations to each manager could easily be delegated, and it was generally agreed that this should be considered.

Ms. Williams stated that there really is no advocacy to change current process, but rather this discussion is to further address the time requirements that may arise in future board meetings. She further stated that the amount of time required of the Board for both meetings as well as preparation is considerable and will continue to grow, and that the Board should not short-change the items listed as "usually retained" for those listed as "usually delegated". Mr. Klausner stated that the decision to take a risk should remain with the Board, and implementation can be delegated to staff. Discussion followed regarding the Board compared to peers in dedicating time to meetings. Mr. Simpson requested that Ben Gorzell be given a recap of this discussion.

6. Consider and Act on 2013 Legislative Agenda

Mr. Gavia began by reviewing the process that staff and the Advisory Committee went through during the legislative interim. TMRS Board Chair, Frank Simpson and Vice-Chair Julie Oakley chaired the Advisory Committee over the past year and presided over five Advisory Committee meetings. At the first meeting in December, the Advisory Committee settled on four benefit design areas to review: (1) alternate COLA proposals; (2) using additional employee contributions to maintain or secure benefits such as COLAs; (3) increasing retirement eligibility requirements such as age or years of service requirements; and (4) gain sharing options. Following the fourth meeting held on June 21, 2012, two of the broad topics, additional employee contribution to maintain benefits and gain sharing options did not garner adequate Advisory Committee member support. TMRS staff then conducted a straw poll among the Advisory Committee members to determine the level of support for the remaining benefit design proposals. Based on the results of the straw poll, TMRS staff and Nancy Williams developed six benefit design proposals that attempted to reflect the preferences based on the results of the straw poll. At the August meeting, however, it was apparent, based on Advisory Committee member comments, that Committee members felt that the 2013 session would not be the session to push forward with any legislative proposal. Mr. Wattles pointed out that there was not unanimous or near unanimous support for any specific proposal. The two general feelings of the Advisory Committee were to (1) educate legislators on TMRS and the changes made in the past two sessions; and (2) to play active defense in protecting TMRS benefits. Mr. Gavia pointed out that the presentation to the House Pensions, Investments and Financial Services (PIFS) Committee was positive, but that there are still legislative concerns regarding other systems.

Mr. Simpson asked for the Board's feeling on how to proceed. Mr. Rodriguez made a motion and Julie Oakley seconded that the Board not file legislation and that the Board adopt a resolution that will provide guidance on how TMRS will react to other bills filed. This position statement should have broad parameters for staff.

April Nixon amended the previous motion and the amended motion provides that TMRS not propose any legislation for the 83rd Session. Jim Parrish seconded the motion; which passed unanimously by the Board members present, 5-0.

The Board asked staff to provide background materials for the Board to craft a position statement on legislative action. Mr. Simpson also asked staff to provide the Board with past actions taken by the Board regarding legislation and the Board policy for testifying on a bill.

7. Consider and Act on Appointments to TMRS Medical Board

Mr. Davis presented this item, highlighting the Board's statutory requirements to appoint a Medical Board for the review of disability retirement applications, and the requirements to serve on the medical board. He discussed the two potential appointees' medical qualifications, that they are both licensed physicians in good standing in the medical community. He highlighted the medical specialties represented on the medical board. Mr. Davis reported to the Board the number of applications reviewed in a given year, the number approved/disapproved, and instances where additional information is requested. He also provided fees paid to the Medical Board.

Mr. Davis responded to a question from Mr. Simpson stating that no findings had been appealed in the last ten years.

Mr. Jim Parrish moved that the Board approve the appointments of Dr. William F. McCarron and Dr. John A. Genung to the Medical Board, and authorize the Executive Director to negotiate a personal services contract with each physician on the Medical Board for their services. April Nixon seconded the motion, which passed unanimously by the Board members present, 5-0.

8. **Consider and Act on Filing Proposed Amendments to TMRS Rule §127.4 to Address Compliance with the Federal HEART Act and Compliance with the USERRA Payments (Use of Rollover Monies) with the Texas Register**

Ms. Sweeney presented these amendments to existing TMRS rules. The Board has previously adopted TMRS Rule §127.4 regarding credited service under USERRA which permits eligible TMRS members to establish service credit in TMRS and to deposit employee contributions to his or her individual account for periods in which the member served in the Uniformed Services subject to USERRA. The proposed amendment specifies that an eligible TMRS member will be permitted to deposit employee contributions to his or her individual account that would have been made to the account during period of confirmed uniformed service provided the deposits are either paid directly to TMRS by the eligible member or are paid by the member utilizing a rollover or transfer of funds in accordance with the provisions of TMRS Rule §127.6 (relating to the Acceptance of Rollovers and Transfers).

Texas Government Code Section 855.607 of the TMRS Act provides that the TMRS Act is to be construed and administered in a manner that the TMRS benefit plan will be considered a tax-qualified plan under Code §401(a), and allows the Board to adopt rules that modify the plan to the extent the Board considers necessary for TMRS to be considered a qualified plan. The HEART Act requires that for governmental plans, such as TMRS, plan amendments to require qualified retirement plans to provide the beneficiary of a participant who dies while performing "qualified military service" with any additional benefits (other than benefit accruals related to the period of qualified military services) that would have been provided under the plan had the participant resumed employment and then terminated employment on account of death. The Rule will be amended to (1) provide the beneficiary of a member who dies while performing "qualified military service" with any additional benefits (other than benefit accruals related to the period of qualified military service) that would have been provided to the member had the member resumed employment and then died, (2) expressly state that (a) for TMRS purposes, compensation includes military differential pay made by a city to a member while performing qualified military services and (b) for Internal Revenue Code purposes, effective January 1, 2009, a member receiving military differential pay is treated as an employee of the employer making the payment and such differential pay will be treated as compensation, and (3) provide that the Rule is intended to comply with, and will be construed to be consistent with, USERRA and Code §§401(a)(37) and 414(u).

Roy Rodriguez moved that the Board authorize the Executive Director (1) to file the proposed amendments to TMRS Rule §127.4 with the *Texas Register* with permanent

adoption of the amended rule to take place at a later Board meeting, and (2) to make non-substantive changes to the proposed rule amendments as necessary or desirable to conform the rule amendments to *Texas Register* requirements. Jim Parrish seconded the motion; which passed unanimously by the Board present, 5-0.

9. Consider and Act on Filing Proposed Amendments to TMRS Rule §125.7 to Address Terminology Changes Due to Enactment of SB 350 with the Texas Register

Ms. Sweeney reported that the Board has previously adopted TMRS Rule §125.7 which allows a participating municipality to make optional additional contributions, either in a lump sum or in series of periodic payments, to its account "in the Municipal Accumulation Fund."

She added that during the last Texas legislative session, Senate Bill 350 was enacted into law, which provided for the restructuring of fund obligations and accounts of TMRS. As part of such fund restructuring, the fund account known as the "municipality accumulation fund" was renamed the "benefit accumulation fund" and the assets and liabilities of the fund accounts formerly known as the "employees saving fund" and the "current service annuity reserve fund" were transferred to the benefit accumulation fund as described in Senate Bill 350. Ms. Sweeney noted that the Rule will be amended to replace the term "municipal accumulation fund" with the term "benefit accumulation fund".

Jim Parrish moved that the Board authorize the Executive Director (1) to file the proposed amendments to TMRS Rule §125.7 with the *Texas Register* with permanent adoption of the amended rule to take place at a later Board meeting, and (2) to make non-substantive changes to the proposed rule amendments as necessary or desirable to confirm the rule amendments to *Texas Register* requirements. April Nixon seconded the motion; which passed unanimously by the Board present, 5-0.

10. Executive Director and Staff Reports, including Reports from Administration, Communications, Staff Actuary, Finance, Governmental Relations, Human Resources, Information Resources, Internal Audit, Legal and Member Services

There was nothing to add to the reports presented. Mr. Parrish stated that the reports were well done and informative.

11. Consider and Act on Meeting Dates and Locations for 2013 Board of Trustees Meetings (taken out of order)

Mr. Gavia presented the recommended meeting dates for 2013. He pointed out that there are alternative dates for the meetings in March, June and October. He explained that the October meeting has been scheduled in the past to coincide with the TML Conference which will be held in Austin in 2013.

Roy Rodriguez moved that the Board set the following dates as the 2013 meeting dates, noting that all of the meetings will be held in Austin: February 21-22, March 21-22, May 9-10, June 19-20, August 22-23, September 19-20, October 9 and December 5-6. April Nixon seconded the motion; which passed unanimously by the Board members present, 5-0.

12. Call for Future Agenda Items

Mr. Simpson asked the Board if there were any future agenda items to be discussed. Mr. Simpson noted that because of the lengthy agenda for the October meeting, the meeting on Thursday, October 25 may begin as early as 2:30 p.m. if needed. As there was no further business, the meeting adjourned at 12:05 p.m.



David Gavia
Executive Director



Frank Simpson
Chair, Board of Trustees