

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

February 21, 2013, 2:00 p.m.

February 22, 2013, 8:30 a.m.

On February 22, 2013, the Board of Trustees of the Texas Municipal Retirement System (TMRS) reconvened 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

Julie Oakley, Chair

Roel ("Roy") Rodriguez, Vice Chair (left the meeting at 11:25 a.m.)

Ben Gorzell, Jr.

April Nixon (left the meeting at 11:10 a.m.)

Jim Parrish

Frank Simpson

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, Staff Actuary

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

Bill Wallace, Director of Communications

Dan Wattles, Director of Governmental Relations

Scott Wilrich, Director of Information Resources

Joe Newton, Gabriel Roeder Smith & Company

Robert Klausner, Klausner Kaufman Jensen & Levinson

Also in attendance:

David Crow, Arlington Fire Fighters

Debbie Farahmandi, Investment Operations Specialist

Chris Jones, Combined Law Enforcement Associations of Texas (CLEAT)

George Kauffman, City of Garland

Scott Kerr, Texas Association of Fire Fighters

Candace Nolte, Controller

Kate Reed, Investment Risk Analyst
David Rodriguez, Regional Manager – City Services
Jon Scolnik, UniteHere
Bob Scott, GFOA/City of Carrollton
Mel Thomas, Editor

Ms. Oakley called the meeting to order at 8:40 a.m. and Roy Rodriguez gave the invocation.

8. Consider and Act on Adoption of Minutes from the December 6-7, 2012 Regular Meeting of the Board of Trustees

Mr. Parrish made a motion that the Board adopt the minutes from the December 6-7, 2012 Meeting of the Board of Trustees. April Nixon seconded the motion; which passed unanimously by the members of the Board present, 6-0.

9. Legislative Update and Overview of 83rd Legislative Session, Including Discussion on Filed and Proposed Legislation

Mr. Dan Wattles and Mr. Ron Lewis, Ron Lewis & Associates, provided a general overview of the current legislative session. Mr. Wattles reported that the bill filing deadline is two weeks away and to date there have been approximately 400 fewer bills filed this session compared to this time last session, which is likely due to a large number of freshman legislators. To date, approximately 80 pension bills have been filed with almost all relating to ERS and TRS.

Mr. Wattles next updated the Board on bills affecting TMRS. HB 626 and HB 651 propose to modify participation in TMRS for city employees from the current 1,000 hours to 1,500 hours per year. HB 626 would be mandatory for all new and existing city employees while HB 651 would be at the option of each city and it would only affect new employees. HB 718 filed by Representative Smithee was also discussed. This bill proposes a new flat rate COLA and is identical to the COLA bill filed last session by Senator Seliger.

Mr. Ron Lewis stated that the big challenge for this session is to educate the members of the legislature that all retirement systems are not the same and they should not be compared to one another.

Mr. Wattles discussed the Sunset review of the Pension Review Board as well as the Fire Fighters Pension Commission.

10. Consider and Act on 2012 Interest Credit Allocation to the Benefit Accumulation Fund and Interest Reserve Account

Mr. Gavia began with an overview of TMRS' interest crediting process. He discussed that with the adoption of SB 350, the TMRS Fund Restructuring bill, the leverage that was inherent in the old fund structure was removed and the adoption of HB 360 changed interest crediting to a total return basis. Mr. Gavia added that Gabriel Roeder Smith, TMRS' consulting actuary, has advised the Board that with investment return volatility now within normal ranges, the asset smoothing methodology adopted by the Board is able to adequately

manage contribution rate stability as it relates to investment returns. At this point, the Board had questions on the smoothing policy versus a reserving method.

Mr. Newton stated that based on 2012 returns excluding fourth quarter real estate adjustments, the recommended Benefit Accumulation Fund (BAF) interest credit is 9.95%. This will maintain the \$100 million reserve before the fourth quarter real estate valuation adjustments. Based on anticipated final real estate valuation numbers, GRS and TMRS staff feels that the 9.95% is not going to over credit interest.

Mr. Newton next discussed the 10-year smoothing method with a 15% "soft" corridor. The smoothing method will produce an actuarial rate of return of approximately 7.43% for 2012; leaving approximately \$700 million in deferred gains as of December 31, 2012. Mr. Newton illustrated the market and actuarial value and briefly reviewed the potential economic impact on cities.

In response to a question from Mr. Gorzell, Leslee Hardy responded that in future years, TMRS will have valuation estimates for the fourth quarter from the Real Estate Managers within 60 days following year-end, increasing the accuracy of the recommended BAF interest credit. Mr. Gavia explained that, in the future, the calendar for the interest credit and actuarial valuation presentations may have to shift back a week or two while still retaining a June calendar date for the CAFR presentation.

Mr. Gorzell moved that the Board credit the Benefit Accumulation Fund (BAF) with estimated net investment income which excludes the fourth quarter real estate valuation adjustments, but reflects adjustments for the statutory interest credit requirements, budget transfers, and maintains an initial \$100 million Interest Reserve Account balance, an estimated 9.95% and that the fourth quarter real estate valuation adjustments be reflected in the final Interest Reserve Account balance as of December 31, 2012. Ms. April Nixon seconded the motion which passed unanimously by the members of the Board present, 6-0.

11. Consider and Act on Adoption of 2013 Risk-Based Audit Plan

Mr. Gavia introduced Mr. Allan to present the 2013 Risk-Based Audit Plan to the Board. Mr. Allan said that this presentation is a requirement of auditing standards and that it has been performed each year since 2008.

Mr. Allan said the annual audit plan consisted of three elements: the narrative audit plan, a list of proposed audit engagements for 2013, and a spreadsheet containing the risk assessments that supported the choice of those audit engagements.

Mr. Allan said internal audits were conducted in accordance with *Government Auditing Standards* and the *International Standards for the Professional Practice of Internal Auditing*. Mr. Allan said the former were used primarily in the conduct of audit work, while the latter were more useful in the area of internal audit management and governance.

Mr. Allan said there were limitations on the internal audit function as a consequence of its one-person nature, particularly the inability to conduct independent review of reports and

working papers. Mr. Allan noted the lack of a history of conducting audits also contributes to the time it takes to complete audits, although that should improve over time.

Mr. Allan said the plan includes a provision whereby should any issue arise needing the internal auditor's immediate attention, the audit plan adopted can be changed to accommodate such a need.

Mr. Allan discussed the risk assessment found in Appendix A including the risk rating process. Mr. Allan said the risk assessments were updated annually and that the highest rated audit engagements were found on the proposed list of audit engagements that can be seen in Exhibit 1.

Mr. Allan next reviewed the status of the 2012 audit plan, noting that an audit of the payroll reporting and contributions processes had been presented to the Board in June and that an information systems security audit had been recently completed.

Mr. Allan said the current audit of the fixed-income investment program was in the fieldwork phase. Mr. Allan said he had come across a number of specific audit issues and some process-related issues to date, but it was premature to say if they would become audit findings. Mr. Allan said he had not come across any issue he considered to be significant enough to warrant the Board's immediate attention.

Mr. Parrish asked if Mr. Allan would inform the Board immediately if something significant should arise. Mr. Allan said that he would.

The Board discussion then centered around the potential future need for additional resources, utilizing either internal or external resources but agreed that the Internal Auditor needs to raise the issue as concerns arise.

Mr. Roy Rodriguez moved that the Board adopt the 2013 Risk-Based Audit Plan. Mr. Jim Parrish seconded the motion, which passed unanimously by the members of the Board present 6-0.

12. Consider and Act on Appointments to the Advisory Committee on Retirement Matters

Mr. Gavia introduced this item by reviewing the make-up of the current advisory committee and informed the Board that Mike Staff, CLEAT's representative, is resigning from the committee. CLEAT has nominated Greg Shipley of Corpus Christi as their primary member and Matt Novosad of La Porte Police Department as their alternate representative. Mr. Gavia thanked Mike Staff for his service to the Committee.

Mr. Gavia also mentioned that Ron Cox's term has expired. Due to limits specified in the Charter, Mr. Cox cannot serve another term. Mr. Gavia also reported that Dean Frigo will be retiring and has requested to continue to serve on the Committee but as a retiree.

Mr. Frank Simpson moved that the Board approve the nomination of Greg Shipley to replace Michael Staff to represent the Combined Law Enforcement Associations of Texas (CLEAT)

in the Group Class of membership and the approval of Matt Novosad as the designated alternate to Greg Shipley on the Committee. Mr. Jim Parrish seconded the motion which passed unanimously by the members of the Board present, 6-0.

13. Discuss and Review the TMRS Statutory Maximum Contribution Requirements

Mr. Gavia began the discussion by defining statutory maximum, which is a statutorily determined maximum contribution rate liability limit for a participating city. The TMRS Act sets a limit on the maximum rate that a city can be required to contribute for the retirement portion of its plan (the cost of Supplemental Death Benefits is excluded from this limit) based on the combination of the employee contribution rate and the employer matching ratio. He noted that the Stat Max rate limits have never been actuarially determined, but rather are reasoned, but imprecise, estimated rates of a city's liability limit based on basic employee contribution deposit/employer match plan benefit designs, without taking into account COLAs or other additional optional benefit enhancements available to cities that have been added to the TMRS Act over the years. Mr. Gavia stated that the TMRS Act does allow cities to amend the stat max in certain cases, and a city can pay more than the stat max without affecting the stat max. He stated that if the calculated rate exceeds the city's stat max rate limit, several options are available: remove the statutory maximum contribution rate limit; increase the statutory maximum contribution rate limit; pay the retirement cost contribution rate; or pay only the statutory maximum contribution rate. Mr. Gavia stated that any city who experienced an increase in their 2009 contribution rate of more than 0.5% due solely to the change in actuarial assumptions and funding method was automatically granted, by Board action, the 8 year phase-in period and 30 year closed amortization of their Unfunded Actuarial Accrued Liability (UAA). Mr. Gavia provided statistics on the number of cities that have taken action regarding their stat max.

14. Consider and Act on Ratification of Ordinances Adopting updated Service Credit and/or Annuity Increases Effective January 1, 2013 (Received After the December 7, 2012 Board Meeting for the Cities of Brenham, Brookshire, Corpus Christi, Killeen, McAllen, Missouri City, Nash, Pleasanton, Spur, Waco and Weslaco

Mr. Gavia introduced this agenda item as a follow up to the action taken by the Board in December 2012, when the Board approved the Updated Service Credit (USC) Ordinances, with or without annuity increases, which had been received at that time. Mr. Davis reported that the action is necessary to ratify the ordinances received after the initial list and before the December 31, 2012 deadline. He reported that, in accordance with Fiduciary Counsel's recommendation, Ordinances received after the last Board meeting, although they have already been implemented, should be ratified by the Board at this meeting.

Mr. Jim Parrish moved that the Board ratify those ordinances adopting Updated Service Credit and/or Annuity Increases that were not included on the listing presented at the December 7, 2012, Board meeting, in accordance with the advice of Fiduciary Counsel. Ms. April Nixon seconded the motion; which passed unanimously by the members of the Board present, 4-0. Mr. Roy Rodriguez and Mr. Frank Simpson abstained from the vote.

15. Strategic Plan Update

Mr. Gavia presented an update on the status of the objectives in the Strategic Plan. He reminded the Board that the Strategic Plan was developed in 2007 and 2008, and in 2011, Nancy Williams, the Board's governance consultant, documented the completed objectives. He noted that at the December 2011 Board meeting, the Board adopted additional objectives for the Strategic Plan.

Mr. Gavia then highlighted select objectives and gave the Board a progress report on the current objectives. These objectives included, under Goal 1(a), progress toward implementation of the new GASB standards.

Mr. Gavia and Ms. Goerdel highlighted milestones that had been completed within the goals, touching on a few of the on-going activities.

16. Discuss Personnel Positions Budgeted for 2013 and Other Staffing Related Matters

In response to a discussion at the December 7, 2012 Board meeting, Mr. Gavia provided the Board with some basic statistics over the last 10 years to show trends on items such as a number of employee accounts, retirement, number of cities, and other items that tend to drive TMRS' work load. He gave examples of how TMRS has leveraged technology to keep head count down regarding actuarial services, through the staff actuary and travel team to cities. Mr. Gavia next discussed the pattern of staffing requests and needs of the investment department.

He stated that the modest staffing increases in member services over the years is again due to leveraging the use of technology, allowing the employees to perform higher level services. Mr. Gavia reviewed certain statistics regarding membership related services for the past ten years.

Mr. Simpson pointed out that his concern was whether it is better to hire an internal person as opposed to contract for external services. Mr. Gavia discussed that staff does review whether an outside consultant is better utilization in various situations. In the case of these two positions, Mr. Gavia stated that staff agree it would be best served with an internal employee.

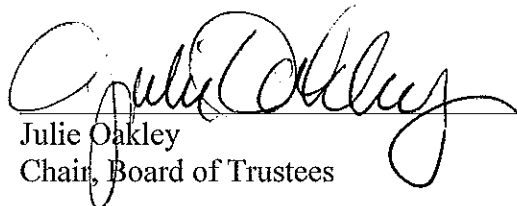
Mr. Simpson and Mr. Parrish both indicated that their concerns were more along the lines of where we are going with staffing in the long-term than just focusing on these two positions.

17. Call For Future Agenda Items

As the Board had none at this time, the meeting was adjourned at 11:34 a.m.



David Gavia
Executive Director



Julie Oakley
Chair, Board of Trustees