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

March 21, 2013, 2:00 p.m.
March 22, 2013, 8:30 a.m.

On March 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
Jim Parrish
Frank Simpson

Absent: Ben Gorzell, Jr.
April Nixon

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
Bonnie Mitra, Director of Fixed Income
Debbie Munoz, Director of Member Services
Kristin Qualls, Director of Equities
Bill Wallace, Director of Communications
Dan Wattles, Director of Governmental Relations
Scott Willrich, Director of Information Resources
Robert Klausner, Klausner Kaufman Jensen & Levinson
Marcia Beard, R. V. Kuhns & Associates
Ron Lewis, Ron Lewis & Associates
Joe Newton, Gabriel Roeder Smith & Company
Mark Randall, Gabriel Roeder Smith & Company
Susan Warren, KPMG

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
Randle Meadows, Arlington Police Association
Michelle Mellon-Werch, Associate General Counsel
Lorraine Moreno, Regional Representative – City Services
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
Bob Scott, GFOA/City of Carrollton
Sean Thompson, Regional Representative – City Services
Mel Thomas, Editor

Ms. Oakley called the meeting to order at 8:32 a.m. and Jim Parrish gave the invocation.

7. **<u>Consider and Act on Consent Agenda</u>**
Mr. Gavia presented the items contained in the consent agenda. He asked if there were any questions or revisions to the Minutes and there were none. Mr. Parrish moved that the Board adopt the Consent Agenda as presented. Mr. Simpson seconded the motion, which passed unanimously by all Board members who were present, 4-0.

8. **<u>Review and Discussion of 2012 External Audit (SAS-114)</u>**
Mr. Gavia introduced Ms. Susan Warren of KPMG and Ms. Rhonda Covarrubias to present this agenda item. Mr. Gavia reported that at the December 2012 Board of Trustees meeting, the Board approved the selection of KPMG, LLP as its external auditor for the fiscal years ending December 31, 2012 through 2016. Ms. Covarrubias reminded the Board that this is a required communication between the External Auditor and the Board. Ms. Warren stated that the audit standards have not changed from last year and reviewed the client service team and their duties related to the audit. She then discussed the objective of an audit, which is to enable the auditor to express an opinion, with reasonable assurance, that the statements are presented fairly in all material respects and in conformity with generally accepted accounting principles (GAAP). She indicated that KPMG will perform the audit to obtain reasonable, not absolute, assurance that the financial statements as a whole are free from material misstatements, whether from error or from fraud. The test of controls is designed to obtain evidence to support the auditor's control risk assessments for the purpose of conducting the audit. Ms. Warren then discussed the responsibilities of management and the Board, both as individual groups and collectively, and stated that an audit of the financial statements does not relieve management or the Board of their responsibilities. She then outlined KPMG's responsibilities in the audit, as well as KPMG's audit approach and methodology. She outlined the scope of the audit plan, and defined "materiality" stating that it is a matter of

professional judgment. She indicated that information is considered material if it is an omission or misstatement that could influence the economic decision(s) of users taken on the basis of the financial statements. Materiality further depends on the size and nature of the omission or misstatement.

In response to questions from Ms. Warren, the Board agreed that the auditor and the Executive Director should bring items of concern to the Board Chair. It was confirmed that there were no reallocation of responsibilities between management and the Board of Trustees or to the System's objectives, strategies and related business risks that would affect the audit.

Ms. Warren also discussed that as part of the audit plan, KPMG will obtain the 2012 SOC1 (formerly SAS 70) reports and will review them for any qualifications or exceptions that could impact the planned audit approach for TMRS.

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

Mr. Gavia introduced Mr. Ron Lewis and Mr. Dan Wattles who presented a brief overview of their assessment of the Session to date. Mr. Lewis noted that the 83rd Legislative Session is halfway through. He discussed the budget deliberations. The new Pension Committee has been a challenge due to lack of institutional knowledge. The one thing to watch is the amendments that will start flying as the end of the Session nears; we will have to play a lot of defense.

Mr. Wattles discussed certain key bills that affect TMRS and the other state and local pension systems including funding for ERS and TRS, as well as the Pension Review Board and the Fire Fighters Pension Commission. He discussed the large number of bills that were filed to beat the filing deadline. TMRS is currently tracking a total of 189 bills; 21 of these bills directly impact TMRS. The next notable deadline is May 6 when House bills have to be reported out by the House Committees. Mr. Wattles reminded the Board that May 27 is Sine Die, the last day of Session. Mr. Wattles added that Public Education is likely the only topic that could cause a special session to be called for, which most likely will occur in 2014.

Mr. Wattles discussed the bills directly relating to TMRS' plan design. He discussed HB 626 relating to the definition of "employee". The filed version would change the eligibility threshold for participating in TMRS for all current and future employees from 1,000 to 1,500 hours per year. A substitute bill is being prepared that would significantly change the bill, including making the 1,500 hours per year threshold an optional definition and allowing it only for new employees hired after adoption by a municipality. The Board discussed the legislative resolution adopted at its December 2012 meeting and its desire not to have different benefits for different employee groups. The Board asked why the cities supporting this want this change and added that the Board, as a whole, felt this was in conflict with its adopted resolution. Mr. Wattles next discussed HB 718, the COLA bill. Additionally, Mr. Wattles indicated there are four or five bills that would affect the confidentiality of personal information maintained by all pension systems. These bills are attempting to roll back the "sole discretion" authority granted to all systems last legislative session.

Mr. Wattles discussed HB 819, the Iran divestiture bill, and HB 1577 relating to terminating benefits of individuals convicted of certain crimes, as well as legislation that would require additional Board training.

Chris Jones of CLEAT, asked to address the Board. Mr. Jones stated that he does not want to see legislation pass that TMRS is not in full support of. He stated that the Board may need to draw a line in the sand and make a stand against some of these bills.

10. <u>Consider and Act on Appointment(s) to the Advisory Committee on Retirement Matters</u>

Mr. Gavia introduced this item by reviewing the group class and individual class membership. TMRS' goal is to maintain three active members in the individual class, three elected officials and three retirees/former trustees. There are several individual class positions vacant.

Roy Rodriguez moved that Dean Frigo be reappointed for a second term, and that replacements be sought for Ron Cox's and Mayor Riddle's positions. Jim Parrish seconded the motion; which carried unanimously by the Board members present, 4-0.

11. <u>Consider and Act on Amendments to the TMRS Compensation Administration Guidelines</u>

Mr. Gavia and Mr. Eldridge presented this item. Mr. Eldridge stated that at its September 2006 meeting, the TMRS Board of Trustees adopted the "TMRS Compensation Administration Guidelines" to establish and administer an equitable compensation program that provides consistent treatment for all employees. Currently, the guidelines state that if a promotion is granted, the salary increase should not exceed 15% unless approved by the TMRS Board Personnel Committee. This has been problematic in terms of timeliness of the approval process. The suggested change would be to keep the increase limit at 15%, unless an amount of more than 15% is needed to bring that person to the minimum of the pay grade, which would require approval of both the Executive Director and the Director of Human Resources. A salary increase of more than $15,000 would require approval by the Board's Personnel Committee. This maintains the original intent of the rule, while giving staff flexibility to maintain the policy. It was pointed out that in no instance since the TMRS Compensation Administration Guidelines were approved, have promoted employees been given increases of more than 15%, other than instances of bringing them to the minimum of their new Pay Group.

Jim Parrish moved that the TMRS Compensation Administration Guidelines be modified to change the promotional guidelines to read "In all cases, the amount of a promotional increase should be no greater than a 15% increase, unless an amount of more than 15% is needed to bring the employee to the minimum of the new classification. All promotional increases of more than 15% require the approval of both the Executive Director and the Director of Human Resources. Any promotional increase of more than $15,000 requires TMRS Board Personnel Committee approval." Roy Rodriguez seconded the motion; which carried unanimously by the Board members present, 4-0.

12. **<u>Review and Discussion of Actuarial Funding Policies Including Actuarial Cost Methods</u>**
<u>(taken out of order)</u>
Mr. Gavia introduced Mark Randall and Joe Newton of Gabriel Roeder Smith to present this item. Mr. Newton began by reviewing the agenda including a definition of funding policy and actuarial cost methods. Mr. Newton stated that the new GASB standards are drawing more attention to funding policy. TMRS has a funding policy, but it has not been consolidated into a single concise document. The funding policy is the primary driver of how contributions will be made for ongoing benefits as well as how to finance gains or losses as experience occurs. Mr. Newton discussed the items that must be included in a written policy for GASB purposes. He discussed the components of TMRS' current policy and reviewed how the GASB blended discount rate is determined. According to GASB standards, in GRS' opinion, most if not all TMRS cities will not have to use the GASB blended rate. The duty to inform cities about these issues was also discussed.

Mr. Newton next discussed actuarial cost methods by building an example for funding the accrued benefit of a career employee. He provided definitions of several terms and built the example as each of these terms was added. Mr. Newton discussed Present Value of Benefits, Normal Cost, Actuarial Accrued Liability, Unfunded Actuarial Accrued Liability, Amortization Payment and Annual Required Contribution (ARC).

Mr. Newton then compared cost methods: Projected Unit Credit (PUC) and Entry Age Normal (EAN). PUC attempts to fund the "true" present value of the benefits as it accrues, and does not consider spreading of costs. He provided a numerical example of PUC and graphically showed the cost increasing over time as the employee nears retirement.

Mr. Newton next moved to EAN. EAN is important because GASB is going to require its use for financial reporting. EAN is a contribution accrual method, and is by far the most utilized method in the public sector. Entry Age Normal attempts to create level contributions throughout the working career of the employee. He gave a numerical and graphical example of this method. It has higher initial costs versus PUC, but costs do not increase with increasing age. He reported that there are pros and cons to this cost method: the pro is stable rates from year to year and the con is higher initial costs. By design, the accrued liability is higher under EAN than under PUC. This is an issue for TMRS cities that soon will be required to report liabilities based on EAN. He gave an example of a representative city, changing only the funding method. He pointed out that system-wide, if TMRS changed to EAN, the UAAL would go up by about $2 billion, even though the benefits have not changed. He graphically showed the distribution of impact on rates for all cities in TMRS, and for cities with more than 100 active members. He next showed a comparison of volatility in rates between different funding methods.

Mr. Newton shifted the discussion to other factors relating to the funding policy. He began with contribution rate stabilization techniques. He suggested several options TMRS could consider with regard to keeping rates more stable by preventing rates from dropping and then increasing at a later date. He discussed options with regard to UAAL amortization including more aggressive funding if the funded ratio dropped below a certain threshold. He discussed several surplus management techniques and provided examples of how several of these techniques could be combined.

Mr. Newton summarized by saying that TMRS was already ahead of the game. With the new GASB standards, TMRS should consider consolidating its written funding policy and, at the same time, look at the different provisions and possibly consider making changes, such as further rate stabilization and other management techniques.

13. Executive Director and Staff Reports

Mr. Gavia presented the staff reports and the Board had no questions or comments.

14. Call For Future Agenda Items

As the Board had none at this time, the meeting was adjourned at 10:59 a.m.

David Gavia
Executive Director

Julie Oakley
Chair, Board of Trustees