

TEXAS MUNICIPAL RETIREMENT SYSTEM

SPECIAL MEETING OF THE BOARD OF TRUSTEES

TMRS Headquarters

1200 North IH 35

Austin, Texas

February 25, 2011

On February 25, 2011, the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a special meeting at 8:30 a.m. at the Texas Municipal Retirement System Headquarters, 1200 North IH 35 in Austin, Texas, with the following members present:

Board of Trustees

April Nixon, Chair

Frank Simpson, Vice Chair

Ben Gorzell, Jr.

Julie Oakley

Jim Parrish

Roel ("Roy") Rodriguez

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

Holly Macki, Director of Real Estate

Cindy Morse, Executive Assistant

Debbie Munoz, Director of Member Services

Dev Outlaw, Director of Fixed Income

Dimitry Shishkoff, Director of Risk Management

Christine Sweeney, General Counsel

Bill Wallace, Director of Communications

Dan Wattles, Director of Governmental Relations

Scott Willrich, Director of Information Resources

Robert Klausner, Klausner & Kaufman

Ron Lewis, Ron Lewis & Associates

Marcia Beard, R. V. Kuhns & Associates, Inc.

Jeremy Miller, R. V. Kuhns & Associates, Inc.

Mark Randall, Gabriel Roeder Smith & Company

Joe Newton, Gabriel Roeder Smith & Company

Guests:

Sherry Chapman, Investment Accountant
Calab Crow, Weatherford Fire Fighters Association
David Crow, Arlington Firefighters Association
Debbie Farahmandi, Investment Operations Specialist
Glenn Johnson, Garland Fire Fighters
George Kaufman, City of Garland
Scott Kerr, Texas State Association of Fire Fighters
Michelle Mellon-Werch, Associate General Counsel
Mitch Landry, TMPA
Darlene, Lanham, TMPA
Randle Meadows, Arlington Police Association
Jim Moore, City of Mesquite Firefighters
Candace Nolte, Controller
Dev Outlaw, Director of Fixed Income
Kristin Qualls, Assistant Director of Equities
Kate Reed, Investment Analyst, Equities
Katie Reissman, Investment Analyst, Fixed Income
David Rodriguez, Regional Manager, City Services
Dimitry Shishkoff, Director of Risk Management
Sean Thompson, Regional Representative, City Services
Greg Vick, Texas City Management Association

The meeting was called to order at 8:35 a.m., and the invocation was given by April Nixon.

1. **Executive Session**

At 8:37 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 9:32 a.m. All members of the Board who had been present when the Board went into Executive Session were again present. Ms. Nixon took a moment at this time to introduce and welcome TMRS' newly appointed Board member, Jim Parrish, Deputy City Manager of McKinney.

2. **Consider and Act on Adoption of Minutes from the December 3, 2010 Regular Meeting of the Board**

Mr. Gavia introduced this item and asked if there were any questions or revisions to the Minutes. As there were none, Mr. Gorzell moved that the Board adopt the Minutes as presented. Mr. Simpson seconded the motion, which passed unanimously.

3. **Legislative Update and Overview of 82nd Legislative Session, Including Discussion on Status of TMRS Legislation (HB 997 and SB 350) and Other Filed and Proposed Legislation, Pension-related Seminars and Briefings, and Filed Federal Legislation**

Mr. Gavia introduced Dan Wattles and Ron Lewis. Mr. Lewis began his overview of the legislative session by discussing the state budget situation and the redistricting issue. Mr. Lewis indicated that the budget situation is serious and legislators are faced with the

decision about whether they will use the rainy day fund. Mr. Lewis predicted they will use a large portion of the rainy day fund; however, he said that because of turmoil in the Middle East, the rainy day fund will continue to grow. He does not see a quick solution to the budget crisis and it may require a special session. Mr. Lewis then said that due to Federal requirements, the redistricting issue is expected to be complicated with many districts changing as a result.

Mr. Wattles then presented an update on where the TMRS bill currently is in the legislative process. He noted that the next upcoming deadline is the bill filing deadline. He mentioned that pensions have received a lot of attention, with many interested parties trying to get information (good and bad) out to legislators during some educational meetings at the Capitol. He said that Mr. Gavia has made presentations at a couple of these educational meetings. Mr. Wattles next updated the Board on bills affecting TMRS directly. He mentioned the TMRS bill (SB 350/HB 997), the return to work bills (HB 159, SB 812), the alternate COLA bill (SB 642) and he noted that one new bill has been filed that would change the hours-required provision in the definition of "employee." Mr. Wattles discussed funding of the Pension Review Board and possible mandatory fees of the public retirement systems. Mr. Wattles also briefly discussed the Federal Public Employee Pension Transparency Act.

Mr. Simpson asked if the other pension systems have major pension bills before the legislature. Mr. Lewis responded that outside of funding for health benefits, there did not appear to be any major pension bills.

Mr. Parrish asked what the mood toward pension plans is at the legislature. Mr. Lewis mentioned TMRS' good reputation at the Legislature; Mr. Wattles commented on TMRS staff's efforts to educate the legislators about TMRS.

4. **Consider and Act on 2010 Interest Credit Allocation to the Municipality Accumulation Fund and Interest Reserve Account**

Ms. Nixon introduced this item and Mr. Gavia gave a brief overview of the item. He mentioned that this is the second year of crediting interest under House Bill 360 and also mentioned the "hard floor" of 5% guaranteed to members and retirees. He briefly described how interest is credited. Mr. Simpson asked about the total return, specifically what portion was realized income versus appreciation. Ms. Covarrubias pointed out that appreciation made up at least \$1 billion.

Mr. Randall began his part of the presentation by discussing the Board's policy of granting the 7.5% assumed rate when possible and using any remaining returns to improve the interest reserve, which has a target of 20% of total assets. He reported that the overall fund outperformed the 7.0% interest return assumption, which means TMRS can credit the guaranteed 5% interest credit to the ESF and CSARF and the 7.5% assumed interest credit to the MAF and add approximately \$550 million to reserves, bringing the reserve balance to approximately 7% of assets or \$1.2 billion.

Mr. Simpson asked what the impact would be to cities if the funds were not added to reserves but rather given to cities. Mr. Newton responded that because of 10-year smoothing, there would be minimal impact in the first year, but more impact toward the end of the smoothing period.

Mr. Rodriguez moved that the Board adopt Staff and GRS' recommendation to set the 2010 Municipality Accumulation Fund (MAF) crediting rate at 7.5% and that the remaining net investment income be transferred to the Interest Reserve Account. Mr. Parrish seconded the motion, which passed unanimously.

5. **Consider and Act on Accelerating Actuarial Experience Investigation for Possible Use in 12/31/2010 Valuation**

Mr. Gavia introduced this item and briefly explained that it is the Board's policy to do an experience study every four years. He then introduced Joe Newton and Mark Randall with Gabriel Roeder Smith & Company (GRS). Mr. Newton stated that GRS recommends the experience study be moved up so that the implementation is in conjunction with the 12/31/2010 valuation, contingent on the passage of the System's fund restructuring legislation. If the legislation is not passed, GRS recommends that changes not be implemented until the 2011 actuarial valuation.

Mr. Newton reported the preliminary indications are that the experience study results will likely cause contribution rates to increase. If this change is paired with the rate decreases associated with the fund restructuring, rates would only change once. Combining experience study rate changes with fund restructuring rate changes results in a net reduction in contribution rates in line with estimates already communicated to cities.

Mr. Newton discussed what an experience study is, and how it results in recommendations to the Board, so the Board can select its assumption set. Mr. Newton discussed the Actuarial Standards of Practice. He noted that each assumption must satisfy the standard and should be internally consistent. The assumption set as a whole must also satisfy the actuarial standards.

Mr. Newton listed the assumptions that will be reviewed. Mr. Newton pointed out that contributions and interest must equal benefits, and this formula must always balance. This study is what rebalances that equation. He discussed the general procedures in preparing the study. Mr. Newton then discussed the timeline for preparing this study and reiterated that it makes sense to do this in conjunction with fund restructuring. He pointed out the deliverables and actions needed for the next few Board meetings.

Ms. Goerdel also pointed out that R. V. Kuhns will also be doing an asset allocation study later in the year, and this will play a part in this study. Mr. Gorzell asked how this would impact the R. V. Kuhns asset allocation study. Mr. Newton gave examples of how the asset allocation study impacts the experience study.

Mr. Simpson asked about the mortality assumption review that is part of the experience study. Mr. Newton and Mr. Randall discussed the question.

Mr. Randall reiterated that the recommended schedule is the most prudent course of action for the year, and GRS is prepared to meet the schedule.

Mr. Parrish moved that the Board adopt Staff and GRS' recommendation that the Actuarial Experience Investigation be moved up so that the implementation of the results of the investigation can be made in conjunction with the December 31, 2010, actuarial valuation contingent upon passage of the Fund Restructuring legislation. If, however, Fund Restructuring is not passed, the Board adopts Staff and GRS' recommendation that the results of the Actuarial Experience Investigation be implemented with the December 31, 2011 actuarial valuation. Ms. Oakley seconded the motion, which passed unanimously.

6. **Consider and Act on Acceptance of Internal Audit Report Entitled "Fiduciary Due Diligence: The Selection and Monitoring of Investment Mangers and Consultants"**

Mr. Gavia introduced Mr. Allan and asked him to present his report on this audit. Mr. Allan began by reviewing the Objectives and Scope of the Audit. He reviewed the principal conclusion of the Audit which is that controls over the selection and monitoring of investment managers and consultant are strong. He discussed the legal framework and the requirements of the audit and noted key TMRS investment policies. He reported that the manager scoring process coincides with manager selection, and that staff does monitor manager performance. Mr. Allan then reviewed the Audit Findings, as listed in his report, and highlighted his key findings. He stated that the report contains seven recommendations to improve the Investment Policy Statement (IPS) and strengthen due diligence practices. Mr. Allan mentioned the Investment Department's response as well as the audit follow-up process. Mr. Gorzell stated that in summary, the controls are strong and most of the recommendations are currently followed, although they are not defined in the IPS.

Mr. Rodriguez moved that the Board accept the Internal Audit Report Entitled "Fiduciary Due Diligence: The Selection and Monitoring of Investment Managers and Consultants". Mr. Gorzell seconded the motion, which passed unanimously.

7. **2010 Annual Investment Review and January 2011 Update**

Mr. Gavia introduced Marcia Beard and Jeremy Miller with R. V. Kuhns & Associates. Ms. Beard stated that Mr. Miller has been a part of the consulting team supporting TMRS since the inception of the relationship and has now been named Co-Consultant to TMRS as a result of the departure of Peter Madsen,

Mr. Miller began his presentation by reviewing the capital markets for the year ended December 31, 2010, indicating that there were good equity returns, overshadowing fixed income returns as investors became concerned about the strength of the economic recovery and potential for increased inflation. He reported that TMRS still has significant fixed income holdings, and the pessimism in the Bond market is keeping returns down on the bond portfolio. Ms. Beard stated that depending on how stocks perform versus bonds, because TMRS is transitioning the portfolio and not yet fully diversified, it will more likely appear at the top or the bottom of the peer universe which is more heavily weighted to stocks. She said that the portfolio is very liquid, and has slices for both capital appreciation and preservation. Ms. Beard ran through Comparative Performance for the total portfolio

reporting that the one-year return of 9.02% exceeded the actual allocation benchmark, and reviewed performance by asset class and by managers. Ms. Beard then moved to the January update, reporting that TMRS had a good month in January led by equities. She said there has been a lot of uncertainty in the markets in February, although no ground was lost.

8. **Investment Policy Review and Discussion on Revisions**

Ms. Goerdel presented this item and stated that this is the annual review of the Investment Policy for discussion by the Board. The recommended revisions are grouped into four categories. The first category is clarifying changes which do not change the substance of the policy. She indicated that about half of the changes fall into this category. The second category of changes does not reflect a change in the application of the policy, but documents current practice. The third category includes changes that are based on the audit recommendations that were discussed earlier in Mr. Allan's presentation to the Board. The fourth category identifies revisions to the policy document. These last two categories represent about one-third of the changes.

Ms. Goerdel briefly discussed the changes resulting from the audit recommendations. Mr. Simpson suggested that the policy guideline addressing consultant searches should also provide the Board flexibility in directing the process. Ms. Goerdel then moved to the fourth category of revisions which deal with manager qualifications, retention and termination, custodian bank standards, risk policies, and quality rating guidelines. She explained that the guideline for delegation to the Executive Director for manager terminations relates to terminations in situations outside the norm, where it would not be prudent to wait until the next Board meeting to take action. She also outlined what the current Board process is for these situations. Mr. Klausner stated that implementation of the action in these revision requires flexibility in real time, primarily for asset preservation reasons, and that the policy should also address the transfer of assets in the event of such a manager termination. Ms. Beard added that it would only be in rare instances when this process would be utilized.

Ms. Goerdel then stated that the balance of the revisions were relatively specific and relate to manager experience and expertise criteria; watch-listing a firm for performance issues; the expansion of custody to include foreign custody, consistent with the standards negotiated; filling risk management gaps; and finally quality guidelines.

9. **Consider and Act on Proposed Amendments to TMRS Rule §127.4 to Address Compliance with the Uniformed Service Employment and Reemployment Rights Act (USERRA)**

Mr. Gavia presented this item and indicated that this amendment is the result of an internal audit finding concerning an inconsistency between the TMRS rule and the federal statute. Mr. Gavia explained the difference between the federal requirements and the TMRS rule and stated that the amendments will bring the rule into compliance with federal statute and shorten the period of time the member has to pay in contributions. Mr. Simpson moved that the Board authorize the Executive Director to file the amendments to TMRS Rule §127.4 with the *Texas Register* in proposed form with permanent adoption of the amended

rule to take place at a later Board meeting. Mr. Gorzell seconded the motion, which passed unanimously.

10. Consider and Act on Proposed Amendments to TMRS Rule §127.3 to Address Compliance with Internal Revenue Code Section 415

Mr. Gavia advised that this rule amendment will bring TMRS into compliance with current federal regulations regarding Section 415. Mr. Gorzell moved that the Board authorize the Executive Director to file the amendments to TMRS Rule §127.3 with the *Texas Register* in proposed form with permanent adoption of the amended rule to take place at a later Board meeting. Mr. Parrish seconded the motion, which passed unanimously.

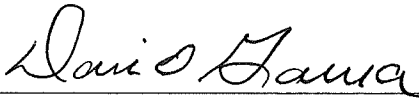
11. Consider and Act on Ratification of Ordinances Adopting Updated Service Credit and/or Annuity Increases Effective January 1, 2011

Mr. Gavia explained that this agenda item is a follow up to the Board's action at the December 3, 2010 meeting where the Board adopted ordinances regarding Updated Service Credit (USC) and annuity increases. This group of ordinances adopting additional USC and annuity increases was received after the December meeting. Ms. Oakley moved that the Board ratify the ordinances adopting USC and/or annuity increases that were received after the December 3, 2010 Board meeting, in accordance with the advice of Fiduciary Counsel. Mr. Simpson seconded the motion, which passed unanimously.

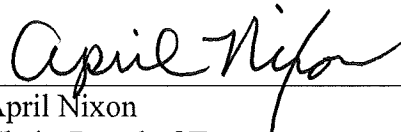
12. Call for Future Agenda Items

Mr. Simpson asked that the Board consider a Thursday and Friday format for future Board meetings when the agenda is lengthy.

There being no further items to discuss, the meeting adjourned at 12:11 p.m.



David Gavia
Executive Director



April Nixon
Chair, Board of Trustees