

TEXAS MUNICIPAL RETIREMENT SYSTEM

REGULAR MEETING OF THE BOARD OF TRUSTEES

**TMRS Headquarters
1200 North IH 35
Austin, Texas**

March 25, 2011

On March 25, 2011, the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a special meeting at 9:00 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
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
Brad Stewart, Gabriel Roeder Smith & Company
Joe Newton, Gabriel Roeder Smith & Company
Mark Randall, Gabriel Roeder Smith & Company
Robert Klausner, Klausner & Kaufman
Susan Warren, KPMG, LLP
Tino Robledo, KPMG, LLP
Ed Schwartz, ORG Portfolio Management, LLC

Ron Lewis, Ron Lewis & Associates
Marcia Beard, R. V. Kuhns & Associates, Inc.
Jeremy Miller, R. V. Kuhns & Associates, Inc.

Guests:

Sherry Chapman, Investment Accountant
David Crow, Arlington Professional Fire Fighters
Debbie Farahmandi, Investment Operations Specialist
George Kaufman, City of Garland
Scott Kerr, Texas State Association of Fire Fighters
Randle Meadows, Arlington Police Association
Jim Moore, City of Mesquite Firefighters
Lorraine Moreno, Regional Manager, City Services
Candace Nolte, Controller
Kristin Qualls, Assistant Director of Equities
Kate Reed, Investment Analyst, Equities
David Rodriguez, Regional Manager, City Services
Bob Scott, Government Finance Officers of Texas
Sean Thompson, Regional Representative, City Services

The meeting was called to order at 9:04 a.m., and the invocation was given by Roy Rodriguez.

1. Consider and Act on Consent Agenda

Mr. Gavia briefly explained the Consent Agenda and that it includes the Minutes from the February 25, 2011 Board meeting, along with quarterly reports on service retirements, disability retirements, death benefits and financial statements. There was no discussion on this item and no revisions to the Minutes. As there were none, Mr. Parrish moved that the Consent Agenda be adopted as presented. Ms. Oakley seconded the motion, which passed unanimously.

2. 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, Applicable Federal Legislation and Possible Board Action with Regard to Specific Legislation

Mr. Gavia introduced Ron Lewis and Dan Wattles to present the Legislative update. Mr. Lewis began his presentation by discussing the character of the current legislative session. He reported that the TMRS bills are doing great. He added that TMRS has seen more bills this session that directly affect the System, as well as more bills that indirectly affect the System (i.e. bills that affect all retirement systems). Mr. Lewis anticipates that a Special Session will be needed to approve the budget.

Mr. Wattles reviewed several procedural deadlines. He indicated that the upcoming deadline is the 120th day of the Session which is the date that bills must be passed out of House Committee or else they are considered procedurally dead. Mr. Wattles discussed the fund restructuring bills. He reported that SB 350 has passed the full Senate and has been received in the House. Mr. Wattles expressed appreciation for the great support that the System

received in the hearings from the Advisory Committee members. Mr. Wattles then briefly reviewed the other bills affecting TMRS.

At 9:17 a.m., the Board entered into Executive Session, pursuant to Texas Government Code, §551.071, to consult with Legal Counsel to receive legal advice. No action was taken during the Executive Session and the meeting was opened to the public again at 10:09 a.m. All members of the Board who had been present when the Board went into Executive Session were again present.

Upon return to the public meeting, Ms. Nixon asked Mr. Gavia to present a position Resolution and read it into the Minutes of the meeting. Mr. Gavia read the following Resolution:

Whereas, the Texas Municipal Retirement System (TMRS) has provided Texas cities, municipal employees, and retirees a soundly funded, hybrid retirement program for over 60 years that provides superior retirement security when compared to defined contribution plan alternatives; and

Whereas, the design of TMRS provides local control of retirement benefits so that cities may choose the level of benefits appropriate for their employees and their communities; and

Whereas, the TMRS Board of Trustees is committed to operating under the highest ethical standards and incorporates best practices for its actuarial and investment policies; and

Whereas, the design of the TMRS program requires each city to pay the actuarially required contribution to ensure that benefits remain soundly funded over no more than a 30-year period; and

Whereas, in recent years, TMRS has worked with all constituent groups, including elected officials, employee associations, and representatives of city management, to craft important changes to the System that ensure its continued soundness; and

Whereas, some proposals before the current session of the Texas Legislature may affect all Texas public retirement systems without regard to their actuarial condition, plan design, or potential impact on the sponsoring governments; and

Whereas, the Legislature of the State of Texas has historically been supportive of TMRS, the local control it provides to cities, and the high standards of its operations; and

Whereas, the Board of Trustees believes that TMRS provides a valuable, flexible, economically run, and soundly managed hybrid retirement program for Texas cities to retain and attract employees and;

Be It Resolved by the Board of Trustees of TMRS, that the Board strongly supports the continuation of the current hybrid plan design, operational standards, local control for cities, and commitment to quality that have characterized TMRS since its inception.

Mr. Rodriguez moved that the Board adopt this Resolution. Mr. Parrish seconded the motion, which passed unanimously.

3. Review and Discussion of 2010 External Audit (SAS-114)

Mr. Gavia introduced Susan Warren and Tino Robledo from KPMG to review and discuss the 2010 Audit Plan. Ms. Warren began her presentation by introducing the team that will perform the audit. She explained that the objective of the audit is for the auditor to express an opinion about whether the financial statements prepared by management, with oversight of the Board, have been presented fairly in all material respects and in conformity with generally accepted accounting principles (GAAP). She indicated that KPMG will perform the audit to provide 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 the audit. Ms. Warren then discussed the responsibilities of management and the Board, as individual groups and both 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.

Ms. Warren discussed the deliverables and the timeline of the audit plan. She discussed fraud risks and pointed out that KPMG has performance risk assessment procedures to identify fraud risks at the financial statement level and at the assertion level. She also briefly discussed KPMG's response to identified fraud risks.

Ms. Warren then explained the difference between material weakness and significant deficiency. She reviewed significant audit areas, significant estimates, significant unusual transactions as well as information technology matters. She explained that a "possibility that something could happen" could be considered a material weakness.

Ms. Warren then asked the Board a series of questions. She first asked what the protocol should be if an item needs to come to the Board. Ms. Nixon responded that the auditor and the Executive Director should bring the issue to the Board Chair. Ms. Warren asked if there had been a reallocation of responsibilities between management and the Board of Trustees and whether there had been any changes to the System's objectives, strategies and related business risks. The Board asked that an invitation to speak with the auditor be extended to all Board members. Ms. Warren asked how to handle items that may not rise to the level of

significant deficiency. After a brief discussion, Ms. Nixon said that a letter should be presented to the Board if there are findings. Ms. Warren asked if there had been significant communications with regulators about fraud or any other matters that KPMG is not aware of. There were none. Ms. Warren then discussed the involvement of other outside entities in the audit process (i.e., State Street and Northern Trust).

Ms. Warren concluded with information regarding the audit committee institute and educational opportunities for the Board members.

4. Investment Report

Ms. Goerdel introduced Marcia Beard and Jeremy Miller with R. V. Kuhns & Associates. Ms. Beard began her presentation by briefly reviewing the current asset allocation versus the target allocation, indicating that we have almost reached the target for equities and have initiated the real return allocation. She reviewed the asset class market performance commenting that there is not a lot of confidence in the markets right now.

Mr. Miller commented on the exposure resulting from the events affecting Japan which led to further discussion. He stated that the impact was only about 3 to 3.5% of the portfolio. He mentioned the impact of Libya, Saudi Arabia and oil prices on the portfolio and stated that he believes the System is well positioned to handle the current issues in the market.

Ms. Beard reported that at the end of February, the System was at \$18.356 billion. She also reviewed the comparative performance charts, first by asset class, then by manager.

Ms. Goerdel then reviewed market headlines touching on anticipated slow economic growth, events in the Middle East and Europe, and inflationary fears. She reviewed each manager and their strategy, benchmark and performance objectives, and highlighted the differences in the managers' focus and outlooks for the month of February. She concluded with a portfolio diversification status update.

5. Consider and Act on Adoption of Revised Investment Policy Statement

Ms. Goerdel discussed the changes previously brought before the Board for discussion. She mentioned three additional changes, two of which were recommended by the Board at the previous meeting. The first change dealt with allowing flexibility for the Board to direct a different selection process for consultant selection. The second change added language to the delegation of manager terminations section, and the final change modified a revision to the cash equivalents guideline. Mr. Simpson asked that a history of changes to the investment policy be kept for future reference.

Mr. Simpson moved that the Board adopt the revisions to the Investment Policy Statement as proposed. Mr. Gorzell seconded the motion, which passed unanimously.

6. Review and Discussion of Preliminary Experience Study Results

Mr. Gavia introduced Mark Randall and Joe Newton with GRS to review the preliminary Experience Study results. Mr. Randall began the discussion on the general preliminary findings of the Actuarial Experience Investigation Study. He discussed the makeup of the

report and outlined the six separate sections. He reviewed the proposed timeline and discussed the purpose of the experience study, explaining that the assumptions should not be static, but rather should be reviewed periodically.

Mr. Newton explained how the assumptions tie together and that the assumption set should lean more to the conservative side – it should not be overly conservative or aggressive. He reviewed the current assumption set on the existing fund structure and detailed individual assumptions. He indicated that the current total assumption set lean somewhat to the aggressive side, although not overly so.

Mr. Randall then discussed the current assumption set with the new fund structure. The total assumption set leans to conservative side on the whole. He said that after restructuring, the assumption set should show slightly aggressive without the reserve policy. He indicated that GRS has a few recommendations that would improve the model, but would slightly increase the liabilities and costs when the Reserve Policy is not considered. Mr. Simpson asked about the life expectancy factors used in calculating the benefit and suggested that the Board needs to develop a plan to begin looking at this issue so that the potential impact can be smoothed out over time.

Mr. Newton stated that many of the demographic assumptions have been reworked to be more flexible based on member characteristics, classifications (i.e. general, police and fire) and benefit provisions. He indicated there were no recommended changes to the economic assumptions; however, GRS is recommending the discount rate change with fund restructuring from the current 7.5% to the investment return assumption of 7.00%. Mr. Newton mentioned that with restructuring, the asset smoothing corridor should also be tightened from 25% to 15% with a low reserve target.

With regard to small cities, Mr. Newton said the current policies are very volatile for 1 and 2 employee cities. The recommendation is to extend the small city group out to 20 employees, and then gradually tighten certain assumptions as the employee count decreases. He indicated that this may cause rates to be slightly higher, but they will be much more stable over time.

Mr. Newton returned to the discussion of the level of conservation for the assumption set as a whole. He said that the new set with restructuring now leans (as desired) to the conservative side. He showed a distribution of plan savings across all cities with greater than 4 active employees. He also reviewed projected actuarial results in the aggregate, showing improvement in funding, without taking into account the current reserves.

Mr. Randall then moved to a discussion of the actuarial funding method, stating that a review of the funding method is required as part of the Experience Study. Mr. Randall briefly described the Projected Unit Credit (PUC) funding method and contrasted that with the Entry Age Normal (EAN) cost method. He showed the impact of a change to the EAN on the sample of 28 cities. He stated that there are cities that will cost a bit more in the short term; approximately 40% of the cities would see small to moderate rate increases. Mr. Randall said that GASB's proposed changes are leaning toward requiring reporting on an EAN basis;

however, he noted that GASB has not worked through all of the issues yet. He stated that GRS is not recommending a change to the method at this time.

7. Consider and Act on Resolution Honoring Patricia Hernandez

Mr. Gavia presented this agenda item and presented a brief history of Ms. Hernandez's work history in Plainview as well as her history as a TMRS Board member. He stated that he will miss Ms. Hernandez's participation and the leadership she provided while she was a member of the Board of Trustees. Mr. Simpson stated that he believed the Resolution stated well Ms. Hernandez's role on the board.

Mr. Simpson moved that the Board adopt the Resolution for Pat Hernandez and prepare it for presentation to her at a later date. Mr. Gorzell seconded the motion, which passed unanimously.

8. Consider and Act on New Appointments and/or Reappointments to the Advisory Committee on Retirement Matters

Mr. Gavia presented this agenda item and provided a brief background on the Advisory Committee and changes to both the Individual and Group Classes. Regarding the Group Class, Mr. Gavia explained that the terms of Randle Meadows, John Lewis and Jim Moore expired in December 2010. He reported that Randle Meadows is eligible for and has indicated an interest in reappointment, while John Lewis and Jim Moore have served two terms and are term-limited under the provisions of the Advisory Committee charter. Mr. Gavia said that the Board has received information on all interested Advisory Committee applicants for their consideration.

Regarding the Group Class membership of the Advisory Committee, Mr. Gavia mentioned that the Texas Municipal Police Association has named Kevin Lawrence, Deputy Executive Director, to replace Chris Heaton. Also, the Texas Municipal Human Resources Association has name Don Byrne, Director of Human Resources for the City of Odessa, to replace Jim Parrish, who was recently appointed by Governor Perry to the TMRS Board of Trustees. Mr. Gavia mentioned that these recommendations for the Group Class are subject to Board approval.

Mr. Simpson moved that Randle Meadows be reappointed for another term on the Advisory Committee. Mr. Parrish seconded the motion, which passed unanimously. Mr. Simpson then moved that the Board accept the Group Class nominations for the Advisory Committee as outlined by Mr. Gavia. Ms. Oakley seconded the motion, which passed unanimously.

Mr. Rodriguez requested that the Chair appoint a committee to review and vet the Advisory Committee applications received from interested individuals. There was consensus by the Board to proceed in this manner. Chair Nixon indicated that the committee would be made up of Ms. Oakley and Mr. Parrish.

9. Executive Director and Staff Reports

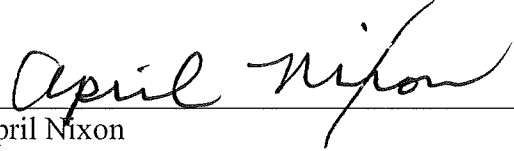
Mr. Gavia introduced this item and asked if there were any comments or questions concerning the Staff Reports. As there were none, the Board moved on to the next agenda item.

10. Call for Future Agenda Items

As there was no further business of the Board, Mr. Gorzell moved that the Board meeting be adjourned. Ms. Oakley seconded the motion, which passed unanimously. The meeting was adjourned at 12:36 p.m.



David Gavia
Executive Director



April Nixon
Chair, Board of Trustees