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

October 25, 2012 – 2:30 p.m.
October 26, 2012 – 8:30 a.m.

On October 26, 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
Ben Gorzell
April Nixon
Jim Parrish

Absent: 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, 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 Klauser, Klausner Kaufman Jensen & Levinson
Ron Lewis, Lewis & Associates
Nancy Williams, Hewitt EnnisKnupp
Mark Randall, Gabriel, Roeder, Smith & Company
Marcia Beard, R. V. Kuhns & Associates
Also in attendance:

Sherry Chapman, Investment Accountant
Debbie Farahmandi, Investment Operations Specialist
Meredyth Fowler, Speaker’s Office
Juan Garcia, Governor’s Office
Scott Kerr, Texas State Association of Fire Fighters
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 Rodriguez, Regional Manager – City Services
Ed Schwartz, ORG Portfolio Management
Melanie Thomas, Editor

Mr. Simpson called the meeting to order at 8:42 a.m. and Jim Parrish gave the invocation.

4. **Consider and Act on Adoption of Minutes from the September 20-21, 2012 Regular Meeting of the Board of Trustees**
   Mr. Simpson presented this item and asked if there were any changes or questions. There being none, Ms. Nixon moved that the minutes from the September 20-21, 2012, Meeting of the Board be adopted as presented. Mr. Parrish seconded the motion, which passed unanimously 5-0.

5. **Consider and Act on Board Resolution Regarding 2013 Legislative Session**
   Mr. Gavia introduced this item. He recapped the Advisory Committee process and reminded the Board that the Advisory Committee did not recommend any legislative proposals at their August 16, 2012 meeting. He also reminded the Board that at its September meeting, the Board voted not to endorse a proposal or a legislative agenda for the 83rd Session. He reviewed the Board’s Communications Policy between TMRS and the Legislature. He further reviewed TMRS’ legislative activities during the 2011 legislative session including discussion of bills filed. He stated that there will likely be a similar level of interest in pension issues in the 2013 session. There are a few broad areas the Board can likely reach agreement on: Maintaining the cash balance nature of TMRS, maintaining local control and resisting legislative changes that have negative financial impact on the System and its participating employers.

   Mr. Ron Lewis, TMRS Legislative Consultant, stated that the big change in the upcoming session will relate to the level of Republican control at the Legislature. The buzz at the Capitol does include pensions, so there is likely to be a large number of bills filed with regarding to pensions. There is still talk of the House Committee on Pensions, Investments and Financial Services reverting back to being split between pensions and financial services.
Mr. Simpson moved to discussion on the proposed resolution. Mr. Gavia pointed out that the resolution is more in the nature of resisting changes as opposed to supporting legislation.

The Board chose to continue discussions about the resolution at the December meeting.

Mr. Simpson asked that the draft resolution be distributed to the Advisory Committee for the review and input prior to the December Board meeting. The Board deferred action on the resolution until their December meeting.

6. **Consider and Act on Electing to Make Retirement Contributions at the Actuarially Determined Rate for TMRS as an Employer**

Mr. Gavia began the discussion with an overview of the legislative history of the Maximum Contribution Rate Limit. He also described TMRS’ contribution rate history as an employer, indicating that the System has been paying the full rate. The options regarding the maximum contribution rate limit for TMRS were discussed.

Mr. Davis reported to the Board that as of the December 31, 2011, Actuarial Valuation, TMRS’ actuarially determined phase-in contribution rate (i.e., the minimum rate required to be funded annually) has exceeded the Maximum Contribution Rate Limit of 15.50% previously adopted. The Board of Trustees adopted this increased maximum limit effective January 1, 1996.

In order for TMRS to continue to grant 100% Updated Service Credit, including Transfers and 70% CPI Annuity Increases, both on an annually repeating basis, as well as properly fund its current plan of benefits, the Maximum Contribution Rate Limit or “Stat Max” must be removed. This would not change the plan of benefits offered to TMRS employees and retirees; it allows TMRS to pay the actuarially determined contribution rate necessary to fund the existing level of benefits.

Mr. Simpson asked if there were any further questions. There being none, Mr. Parrish moved that the Board adopt the Resolution to move the Stat Max effective January 1, 2013 to allow TMRS to pay the actuarially determined contribution rate necessary to fund the existing level of benefits. Ms. Nixon seconded the motion, which passed unanimously 5-0.

7. **Northern Trust Global Investments (NTGI) and Colchester Global Investors Annual Managers Review**

Mr. Gavia introduced Kristin Qualls and Bonnie Mitra to present the annual manager reviews of Northern Trust Global Investments (NTGI) and Colchester Global Investors. Ms. Qualls began her presentation by reviewing TMRS’ relationship with Northern Trust Global Investments (NTGI) that began in 2008, and covers the passive management of TMRS domestic and international equity allocations. The most recent change in the equity allocation was the Board’s approval of an equity core-satellite structure approved in March 2012. TMRS is currently in the process of implementing the new rules-based strategies. She summarized the investment process at NTGI highlighting that index management is one of NTGI’s core business processes and the Firm’s assets under management have increased from $684 billion as of June 30, 2011 to $704 billion as of June 30, 2012. She added that NTGI’s new risk system has been fully implemented, utilizing four different risk models with
daily updates. Ms. Qualls next reviewed the current mandates on both the domestic and international equity allocations, along with the rebalancing activities under each mandate.

Ms. Qualls reviewed performance through August 31, 2012 and provided updated YTD performance numbers through October 24, 2012.

Next Ms. Qualls reviewed risk management and compliance stating that both are robust with strong controls. She stated that NTGI is adding resources and staff with a continued global presence.

Ms. Qualls reviewed the client service relationship with TMRS, highlighting the quarterly service calls and 1-2 in-person meetings per year. She touched on the service description document detailing the deliverables required by NTGI, which is updated and executed quarterly.

Ms. Qualls next reviewed the positives and negatives of the 2011 annual due diligence visit compared to the 2012 visit. Turnover was still present in 2012 but the replacement for TMRS’ former client service representative was someone who had previously worked on the TMRS relationship. Additional turnover took place in the risk management group and the replacement for the former Chief Risk Officer was someone who has been with Northern Trust since 1988. Board member, Ben Gorzell, asked if TMRS was concerned with Northern’s turnover and did TMRS feel Northern had enough coverage. Ms. Qualls discussed Northern’s corporate culture of wanting to assist in the professional development of employees who excel. This leads to turnover but Northern ensures all employees are aware of the expectations for client service. Marcia Beard of R.V. Kuhns & Associates added that this is not uncommon for large banks or large investment management firms.

Next, Ms. Qualls reported that NTGI’s annual report card reflects “green light” scoring in all categories. She concluded by reviewing the investment staff recommendation that NTGI be retained as manager for the current equity core (passive) mandates.

Mr. Mitra then began the review of TMRS’ Real Return Global Inflation-Linked Bond portfolio manager, Colchester Global Investors. He gave an overview of the real return portfolio objectives: (1) to enhance total return, (2) to provide diversification; and (3) to hedge against inflation. Colchester was selected for their Investment Philosophy which includes value orientation; quality bias and increased diversification through small and unique markets. He reviewed the objectives and general restrictions of Colchester’s TMRS mandate.

Mr. Mitra then reviewed Colchester’s historical performance and reported that their YTD performance is 6.70% against the benchmark of 4.59%. He reviewed the performance enhancers and detractors against the benchmark and explained that the reasons for the TMRS’ portfolio’s underperformance relative to Colchester’s own composite are TMRS’ inability to trade currency pairs apart from hedging an underlying bond position, and the TMRS IPS guidelines as it applies to investment grade status. He noted that due to the downgrading of Irish bonds by one rating agency, the Manager quickly sold the position to comply with TMRS’ investment grade guideline which prevents a manager from holding
non-investment grade debt. He reviewed the current market snapshot for this allocation both in regards to real yields and currency exposure.

Mr. Simpson asked what the size of public institutional money was in comparison to private money in Colchester’s composite and Mr. Mitra will follow up with this information.

He concluded by recommending that TMRS consider allowing Colchester to utilize a currency forward strategy to exploit dislocations in the currency forwards markets caused by the global convergence of interest rates driven by quantitative easing programs. While interest rate differentials have collapsed, inflation differentials persist, rendering forward markets in many currency pairs to trade rich/cheap to inflation fundamentals. Mr. Mitra identified a number of parameters that would need to be considered, and added that a legal review of a potential fund structure would need to be done. Mr. Mitra advised that TMRS should also consider a reasonable cure process for downgrades to non-investment grade status. This recommendation would be consistent with TMRS’ other portfolios.

TMRS staff’s recommendation is to retain Colchester Global Investors as its real return manager.

Mr. Gorzell asked for further clarification on the second recommendation regarding the downgrading of debt relative to compliance with TMRS’ investment grade guideline, and it was noted that such a recommendation was already being addressed in the annual IPS review, also on the agenda.

8. Annual Investment Policy Statement Review and Discussion on Proposed Revisions
Ms. Goerdel presented the proposed Investment Statement Policy (IPS) revisions for discussion purposes. She explained to the Board that the revisions fall into three broad categories: (1) clarification (clean-up) changes, (2) changes made in order to document current practice and (3) new policies. The new policies are further broken down into general investment policy revisions versus portfolio guideline revisions, along with an indication of whether each revision is effectively neutral or whether it restricts or expands authority. Ms. Goerdel stated that she will focus her comments on the new policy issues.

She began by reviewing the five “general investment policy revisions” that achieve the following: address exceptions to the IPS; broaden Conflict of Interest language; add ranges to asset allocation targets; clarify delegation of authority within rebalancing policy; and allow for exemption to registered investment advisor status.

She next reviewed the “portfolio guideline revisions”. The first adds language to clearly lay expectation on the manager for curing policy violations in all portfolios. Items 19 and 21 relate to tracking error guidelines for the equity allocations while items 24 and 28 do so for fixed income. Item 33 relates to the global inflation linked bonds and changes in credit ratings, giving staff a better ability to react in the event of a ratings change as discussed in the Colchester manager review discussion. Items 40, 42 and 43 relate to objectives and valuation issues in the real estate allocation. Items 46, 47 and 48 relate to the cash equivalent vehicles held in certain funds, and concentration limits. Finally, item 51 relates to the cash collateral guidelines relating to securities lending.
Ms. Goerdel stated that these changes are presented for review and will be brought back to the Board in December 2012 for adoption.

Mr. Simpson reiterated the need for historically tracking changes that are made to the IPS. Ms. Goerdel responded that the historical summary of IPS revisions is usually presented to the Board at the time revisions are adopted, so the Board will receive the updated summary with the December Board materials.

9. Investment Report: Performance Update
Ms. Beard presented the monthly performance update as of September 30, 2012, and reported that across the board TMRS has outperformed or matched its benchmarks. The total fund composite, year to date, has returned 8.42%. Mr. Simpson asked about the Real Estate Composite numbers. Mr. Schwartz indicated that the portfolio earned money via mostly rental income and distributions. Ms. Goerdel commented that the methodology for calculating real estate performance has required significant research and concurrence among TMRS staff, consultants, and our custodian State Street, and explained to the Board that, in accordance with industry standards, there is a quarter lag in the Real Estate Composite performance due to valuations.

10. Call for Future Agenda Items
Mr. Simpson asked the Board if there were any future agenda items to be discussed. Mr. Gorzell asked for more information on how the Stat Max is applied. Ms. Oakley asked for more information on cities that are paying above the Stat Max, but whose rate is below the Stat Max. As there was no further business, the meeting adjourned at 11:20 a.m.

David Gavia
Executive Director

Frank Simpson
Chair, Board of Trustees