

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

**December 1, 2011 – 3:30 p.m.**

**December 2, 2011 – 9:00 a.m.**

On December 2, 2011, the Board of Trustees of the Texas Municipal Retirement System (TMRS) reconvened for a regular meeting at 9:00 a.m. at TMRS Headquarters, located at 1200 North IH 35 in Austin, Texas, with the following members present:

**Board of Trustees**

April Nixon, Chair

Frank Simpson, Vice Chair

Ben Gorzell

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

Cindy Morse, Executive Assistant

Christine Sweeney, General Counsel

Holly Macki, Director of Real Estate

Michelle Mellon-Werch, Associate General Counsel

Debbie Munoz, Director of Member Services

Dev Outlaw, Director of Fixed Income

Dimitry Shishkoff, Director of Risk Management

Bill Wallace, Director of Communications

Dan Wattles, Director of Governmental Relations

Scott Willrich, Director of Information Resources

Jim Voytko, R. V. Kuhns & Associates

Ed Schwartz, ORG Portfolio Management LLC

Lynn Schultz Kehoe, ORG Portfolio Management LLC

Robert Klausner, Klausner & Kaufman, P. A.

**Also in attendance:**

David Crow, Arlington Fire Fighters  
Debbie Farahmandi, Investment Operations Specialist  
Jerry Gonzalez, SEIU San Antonio  
Glenn Johnson, Garland Fire Fighters  
George Kauffman, City of Garland  
Scott Kerr, Texas Association of Fire Fighters  
Randall Meadows, Arlington Police Association  
Rick Menchaca, BOSCO, Inc.  
Jim Moore, Mesquite Fire Fighters  
Candace Nolte, Controller  
Kristin Qualls, Assistant Investment Officer for Equities  
Katie Reissman, Investment Analyst – Fixed Income  
Kate Reed, Investment Risk Analyst  
David Rodriguez, Regional Manager – City Services  
Bob Scott, GFOA/City of Carrollton  
Mel Thomas, Editor

Ms. Nixon called the meeting to order at 9:01 a.m. and gave the invocation.

3. **Consider and Act on Consent Agenda**

Mr. Gavia introduced this item and explained the Consent Agenda includes the quarterly service retirements, disability retirements, death benefits, financial statements. He added that in December of each year, the Consent Agenda also includes the Seven Year Inactive Report/Transfer of Inactive Accounts, Seven Year Inactive Report/Transfer of Unclaimed Refunds and the Updated Service Credit and Annuity Increase Ordinances Adopted Report. There were no questions or amendments to the Minutes. Mr. Simpson moved that the Board adopt the Consent Agenda as presented. Mr. Parrish seconded the motion, which passed unanimously with Mr. Parrish abstaining from the vote.

4. **Investment Report: September Quarterly Report and October Performance Update**

Mr. Gavia introduced Mr. Jim Voytko, COO and Senior Consultant with R.V. Kuhns to present the Quarterly Investment Performance Report. Mr. Voytko said that the 3rd quarter was very difficult, as macroeconomic concerns, both domestically and internationally, contributed to increased volatility and significant downward pressure for almost every major equity market during the quarter. The two key points to remember for this time period are (1) performance is hostage to macro factors, which are extremely difficult to predict, and the System is well positioned to weather this storm; and (2) equity is the main driver of volatility risk, so risk monitoring is time well spent. Moving on, he reported that in the U.S., fiscal issues led to a credit rating downgrade from Standard & Poor's. In Europe, significant fiscal issues resulted in widening spreads for multiple countries. Emerging markets, especially in Eastern Europe and Asia, experienced widespread sell-offs amid rising fears of financial contagion and slowing growth.

With regard to economic factors impacting the markets, Mr. Voytko reported that unemployment remains well above its 50-year average; inflation ticked slightly higher; real GDP increased at an annual rate of 2.5%; and the Federal Reserve announced plans to continue to maintain historically low interest rates through mid-2013. In response to questions regarding the debt crisis and European problems, Mr. Voytko stated that maintaining the current transition policy appears to be the proper strategy and the asset allocation transition should be continued on its slow and methodical pace. He reported that the System is also in a good position in that it is not facing liquidity issues compared to its peers. TMRS has just over a two-year history of managing to a total return objective, and so five-year performance did not exceed the actuarial return assumption of 7% on a total return basis, but exceeded the benchmark and the policy index. He said the System has been taking less risk and getting higher returns than its peers.

Mr. Voytko then reported that the System's fixed income composite return was 5.98% over the trailing five-year period. The real return composite was positive, but underperformed the benchmark; however, this allocation is in its infancy. He said domestic equity is matching the index, as it should due to the passive mandate, and the Non-U.S. equity performance was slightly better than the index, but well within norms. He concluded his presentation by looking at a series of benchmarks relevant to the TMRS asset allocation policy, over different market periods, and concluded that things are going well given the fact that the 3rd quarter was historically one of the worst quarters in investment markets.

Ms. Goerdel then presented the staff report, and provided an update on the fixed income equity, and global linkers markets. She presented manager comments related to their specific strategies and reported that income from securities lending is down about 20% compared to last year due to market conditions and the difficulty in making profitable loans.

Ms. Goerdel then reviewed performance as of October 2011 by asset class, reporting that October was a strong month for equities bringing the year-to-date total portfolio return to 2.97%. She reviewed the asset allocation and portfolio diversification, reporting that the equity targets had been met. She updated the Board on the watch list criteria set for BlackRock, the actions needed to be removed from the watch list, and that progress was being made. She concluded with brief comments on next steps with regard to diversification.

5. **Consider and Act on 2012 Real Estate Implementation Plan and Authorization for Related Manager Searches**

Ms. Macki of TMRS and Mr. Schwartz and Ms. Kehoe of ORG Portfolio Management (ORG) began the discussion on the Real Estate Implementation Plan for 2011/2012. Ms. Macki reviewed 2011 activity and the status of 2011 Investments, including two examples of recent investments.

Ms. Kehoe explained the manager selection process and reported that the process worked very effectively this year and will be used again next year. She also outlined the ongoing manager monitoring process performed by staff and ORG for recently engaged managers.

Mr. Schwartz reviewed the 2012 recommendation, which is for the System to commit up to \$600 million in Core, Value-Added and/or Opportunistic real estate investments with attractive risk-adjusted returns and consistent with TMRS Investment Guidelines.

Mr. Schwartz discussed co-investment opportunities, stating that they can complement an existing portfolio and provide access to preferred assets at reduced fees. He stated that this concept is simply being introduced and the Board is not being asked to take action at this time. Mr. Schwartz reported that a number of other funds are doing this; however, he said a method for pre-approving co-investment authority would have to be developed in order for the System to position itself to provide capital for co-investment opportunities as they arise. The Board agreed that more discussion was needed on this topic.

Ms. Kehoe then reviewed the pacing plan and the cash flow forecast. Ms. Macki concluded the presentation by briefly reviewing the 2012 implementation plan and pointed out that ORG met their commitments in 2011.

Mr. Simpson moved that the Board approve the 2012 Real Estate Implementation Plan as presented and authorize TMRS staff and ORG to conduct manager searches as needed for real estate managers/investment offerings to fulfill the 2012 real estate allocation of \$600 million. Mr. Gorzell seconded the motion, which passed unanimously.

*At this time, the Board took a break from 10:46 a.m. until 11:05 a.m.*

6. **Annual Investment Policy Review and Discussion on Proposed Revisions**

Ms. Goerdel presented the proposed policy revisions. Ms. Goerdel reviewed the three categories of changes: (1) clarifying (clean up) changes; (2) changes made in order to document current practice; and (3) substantive changes. She explained that more than half of the proposed changes are clarifying changes. Ms. Goerdel reviewed the substantive changes, including one change that clarifies the Board's delegation of authority to the Executive Director in order to ensure flexibility in managing the assets of the System, and other changes that revise the credit rating requirement for U.S. Government securities in response to their recent downgrades by Standard & Poor's. Mr. Rodriguez asked about the change that eliminates the AAA-rating requirement for U.S. Government securities, and adds an overall minimum average quality rating of A+. Ms. Goerdel stated that the addition of an overall average quality rating provides additional control and combined with the minimum quality ratings is a conservative quality standard. Ms. Goerdel stated that these changes are presented for review at this time and will be brought back to the Board in February 2012 for adoption.

7. **PIMCO Annual Manager Review**

Mr. Gavia introduced Dev Outlaw to present this review. He summarized the mandate for Fixed Income Core Plus portfolio and then reviewed the manager monitoring/assessment process, as well as the conclusions of the review. Mr. Outlaw then reviewed the key insights from the review process, and highlighted the depth of the investment team within PIMCO's organization as well as PIMCO's work ethic.

Mr. Outlaw concluded that based on the quantitative and qualitative assessment of the firm, staff recommends that the Board retain PIMCO as the Core Plus Manager and he reported that R. V. Kuhns supports this recommendation. He mentioned that a fixed income strategy analysis is in progress, which may impact the PIMCO mandate.

8. **Consider and Act on Proposed 2012 Operating Budget**

Mr. Gavia reported that the proposed 2012 Operating Budget was presented to the Board for review at the October meeting, and mentioned that a few minor revisions have been made since that meeting. He introduced Ms. Covarrubias to present the final proposed budget. Ms. Covarrubias began her presentation by reviewing the changes to the October preliminary budget that Mr. Gavia mentioned. She pointed out an increase in legal fees related to investment needs and the need to acquire software in order to resolve a computer security issue. She mentioned increased capital costs relating to hard drive pricing due to flooding in Thailand where the hard drives/components are manufactured.

Ms. Covarrubias explained how the budget aligns with the Strategic Plan, and she highlighted the costs associated with specific strategic plan goals. She compared the 2011 budget to the 2012 budget and reported that with new items included, the 2012 budget exceeds the 2011 budget by 11.9%. She said the increase is approximately 1.1% excluding those new items. Ms. Covarrubias presented a breakdown of the new items. She then moved to the five major budget categories and highlighted the key points within each category.

Mr. Willrich gave a brief overview of the three major Information Technology projects included in the proposed budget and provided the business cases for these projects. Ms. Covarrubias briefly discussed the new personnel requests, highlighting proposed pay groups and hiring dates.

Mr. Parrish moved that the board adopt the *2012 Proposed Operating and Capital Expenditures Budget* as presented. Ms. Oakley seconded the motion, which passed unanimously.

9. **Consider and Act on Resolution Transferring Monies from Interest Reserve Account to Expense Fund**

Mr. Gavia reported that the Board's policy on transferring monies from the Interest Reserve Account to the Expense Fund is to maintain reserves in the Expense Fund of approximately 15% of the following budget year expenses. The Board had no questions or comments.

Mr. Rodriguez moved that the Board adopt a resolution to transfer \$15,515,000 from the Interest Reserve Account to the Expense Fund to cover budgeted expenses for 2012 of \$16,487,000. Mr. Simpson seconded the motion which passed unanimously.

10. **Consider and Act on Adoption of 2012 Risk-Based Audit Plan**

Mr. Gavia introduced Mr. Allan to present the Audit Plan. Mr. Allan briefly updated the Board on 2011 audit activities. He reported that the 2012 audits will focus on an update of the departmental risk assessments and CobiT reviews, as well as a review of the fixed income portfolio, including fees and charges, risk management, back office operations and due diligence.

Mr. Rodriguez moved that the board adopt the 2012 Risk-Based Audit Plan as presented. Mr. Gorzell seconded the motion, which passed unanimously.

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

Mr. Gavia reported that two members of the Individual Class of the Advisory Committee -- Allan Bogard and Michelle Leftwich -- have terms expiring this month. Mr. Bogard is seeking reappointment, but Ms. Leftwich has decided not to seek reappointment. Mr. Gavia said the appointment subcommittee will review applications for appointment to replace Ms. Leftwich. Mr. Simpson pointed out the benefit of appointing another elected official.

Mr. Rodriguez moved that the Board accept the recommendation of the Subcommittee of the Board and reappoint Allen Bogard to serve a second three-year term on the TMRS Advisory Committee as part of the Individual Class. Ms. Oakley seconded the motion, which passed unanimously.

12. **Consider and Act on Election of Board Officers**

Mr. Gavia reviewed the Board's past practices in rotating the positions of Board Chair and Vice-Chair among Board trustees. Following this practice, Mr. Simpson would become the Chair and Mr. Parrish would become Vice Chair. Mr. Parrish said that because he is the newest member of the Board, he believed that Ms. Oakley would be a better Vice Chair at this time.

Mr. Parrish moved that Mr. Simpson be appointed the Chair and Ms. Oakley be appointed the Vice Chair for 2012. Mr. Rodriguez seconded the motion, which passed unanimously.

13. **Consider and Act on Changes to TMRS Rule Section 127.7 to be Adopted on an Emergency Basis and Proposed for Later Permanent Adoption to Address Compliance with the Pension Protection Act of 2006 (PPA)**

Mr. Gavia introduced Ms. Sweeney to present the emergency proposed rules. Ms. Sweeney explained the proposed changes to this rule and the reason these rules need to be adopted on an emergency basis. She reported that the System's current operations are in line with the current Internal Revenue Service (IRS) guidelines, but the rules also need to reflect the current guidelines. Ms. Sweeney stated that this is a routine formalization of the rules in order to comply with the IRS guidelines.

Mr. Gorzell moved that the Board authorize the Executive Director (i) to file the proposed amendments to TMRS Rule §127.7, in substantially the form presented, with the *Texas Register* on an emergency basis to be effective immediately on filing; (ii) to also file such

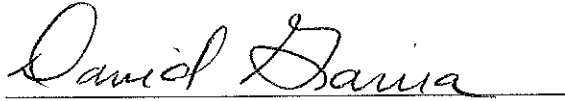
amendments to TMRS Rule §127.7 with the *Texas Register* in proposed form with permanent adoption of the amended rule to take place at a later Board meeting; and (iii) to make non-substantive changes to the attached rule amendments as necessary or desirable to conform the rule amendments to *Texas Register* requirements. Mr. Parrish seconded the motion, which passed unanimously.

14. **Executive Director and Staff Reports**

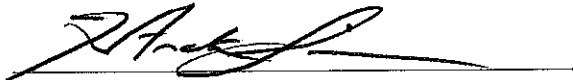
Mr. Gavia presented the staff reports and the Board had no questions or comments.

15. **Call For Future Agenda Items**

Ms. Nixon asked the Board if they had any future agenda items. As the Board had none at this time, the meeting was adjourned at 12:29 p.m.



David Gavia  
Executive Director



Frank Simpson  
Chair, Board of Trustees