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

October 9, 2013 – 8:00 a.m.

On October 9, 2013, the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a meeting at 8:00 a.m. at TMRS Headquarters, located at 1200 North IH 35 in Austin, Texas, with the following members present:

Board of Trustees
Roel "Roy" Rodriguez, Chair
Jim Parrish, Vice Chair
April Nixon
Bill Philibert
Julie Oakley
David Landis

Present also were:
David Gavia, Executive Director
Ian Allan, Director of Internal Audit
Rhonda Covarrubias, Director of Finance
Eric Davis, Deputy Executive Director
Kristi O'Hara, Director of Human Resources
Nancy Goerdel, Chief Investment Officer
Leslee Hardy, Director of Actuarial Services
Debbie Munoz, Director of Member Services
Christine Sweeney, General Counsel
Bill Wallace, Director of Communications
Dan Wattles, Director of Governmental Relations
Scott Willrich, Director of Information Resources
Holly Macki, Director of Real Estate
Bonnie Mitra, Director of Fixed Income
Kristin Qualls, Director of Equities
Dimitry Shishkoff, Director of Risk Management
Jesse Pittman, Senior Project Manager
Karen Jackson, Executive Assistant
Robert Klausner, Klausner, Kaufman, Jensen & Levinson
Mark Randall, Gabriel, Roeder, Smith & Company
Joe Newton, Gabriel, Roeder, Smith & Company
Marcia Beard, R. V. Kuhns & Associates

Also in attendance:
Sherry Chapman, Investment Accountant
Debbie Farahmandi, Investment Operations Specialist
Howell Hollis, Investment Analyst II
Peter Jeske, Member Service Business Process Analyst

Chris Jones, Combined Law Enforcement Associations of Texas (CLEAT)
George Kauffman, City of Garland
Scott Kerr, Texas State Association of Firefighters (TSAFF)/City of Plano
Kevin Lawrence, Texas Municipal Police Association
David Crow, Arlington Professional Fire Fighters
Bob Scott, GFOA/City of Carrollton
Carol Leung, Investment Analyst II
Colin Davidson, Regional Representative – City Services
Sean Thompson, Regional Representative – City Services
Randle Meadows, City of Arlington
Michelle Mellon-Werch, Associate General Counsel
Candace Nolte, Controller
Nick O'Keefe, Senior Staff Attorney
Cindy Morse, Investment Support Analyst
Kate Reed, Investment Risk Analyst II
David Rodriquez, Regional Manager – City Services
Eddie Schultz, Real Estate Analyst II
Meredyth Fowler, Speaker's Office
Greg Shipley, Combined Law Enforcement Associations of Texas (CLEAT)/City of Corpus Christi
Mel Thomas, Editor
Lorraine Moreno, Membership Development Specialist
Corby Alexander, City of LaPorte
Tadd Phillips, City of McKinney/Texas Municipal Human Resources Association (TMHRA)
Eddie Solis, HillCo Partners
Melinda Griffith, Combined Law Enforcement Associations of Texas (CLEAT)
Victor Hernandez, City Councilman, City of Lubbock

Mr. Rodriguez called the meeting to order at 8:00 a.m. and gave the invocation.

1. **Executive Session**

At 8:01 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 8:50 a.m. All members of the Board who had been present when the Board went into Executive Session were again present.

2. **Consider and Act on Adoption of Minutes from the September 19-20, 2013 Meeting of the Board of Trustees.**

Mr. Parrish made a motion that the Board adopt the minutes from the September 19-20, 2013 Meeting of the Board of Trustees. Bill Philibert seconded the motion; which passed unanimously by the members of the Board present, 6-0.

3. **Review Impact of GASB Changes on TMRS and Sample TMRS Cities**

Mr. Gavia introduced Mark Randall and Joe Newton of Gabriel, Roeder, Smith and Company to discuss the forthcoming Governmental Accounting Standards Board (GASB) statements 67 and 68. Mr. Randall began by discussing what GASB has done by adding these new standards. GASB has changed the current pension accounting and financial reporting standards for state and local governments. The GASB's goal was to try to bring more transparency and consistency to reporting pension liabilities. Under the new accounting rules, there is a clear disconnect between pension accounting and pension funding. The funding numbers will no longer tie to the accounting numbers and the nomenclature for reporting has completely changed. The Net Pension Liability (NPL) will show up directly on the balance sheet and is similar to the previous Unfunded Actuarial Accrued Liability (UAAL), but calculated differently. GASB will also require employers to recognize a new measure of the Pension Expense (PE) on their income statements, which will be different from their actuarially determined contribution (ARC). The new statements will replace most of the current financial statement note disclosures and require supplementary information based on the new measures. Mr. Randall discussed the timing of the implementation of these new standards. GASB 67 (plan reporting) is effective for fiscal years beginning after June 15, 2013. For TMRS, it is effective for December 31, 2014 financial statements. GASB 68 (employer reporting) is effective in fiscal years beginning after June 15, 2014. For TMRS member cities, it is effective for fiscal years ending in June 30, 2015 through May 31, 2016. Many employers will report a pension liability that is considerably larger than what has been previously reported. Employers will also report a pension expense that in many cases will be higher than previously reported. Pension expense will also be a more volatile number. The GASB changes affect reporting, but does not change funding.

Mr. Randall discussed what is currently being reported and what will be reported including liability, assets, expense and Long Term Return Assumption, also known as the discount rate (LTeROR). The "new" Pension Expense (PE) immediately recognizes items such as service cost, interest on Total Pension Liability (TPL), projected investment earning, actual member contributions, administration costs and changes in TPL due to changes in benefits. TPL is the accounting counterpart to the funding Actuarial Accrued Liability (AAL). Certain other changes are treated as "deferred outflows of resources" and "deferred inflows of resources" which is basically amortization of certain changes in the TPL over different periods of time.

Mr. Newton discussed how the discount rate is to be calculated under the new GASB statement. He gave an example of when a blended discount rate would have to be used. The expectation is that most, if not all TMRS cities will still be able to use the current 7% discount rate instead of a blended rate. The Entry Age Normal (EAN) cost method must be used in GASB reporting. The TPL will always be higher under EAN than PUC. Any benefit that is determined to be substantially part of the expected benefit package must be valued as if it will continue in perpetuity. For cities with ad hoc COLAs, the guidance is to use a five year look back. Some cities with certain patterns of ad hoc COLA adoptions may have to report higher liabilities. EAN accrues higher liability early in a member's career; therefore most cities will disclose a higher NPL (UAAL) under EAN than under PUC. Mr. Newton reviewed examples of the effect on cities based on six categories of TMRS cities and discussed the impact of deferred gains and deferred losses on the reporting numbers.

If TMRS continues to fund on PUC, but discloses under EAN, cities with an NPL today are never expected to fully amortize the NPL, because the current funding policy (PUC) is not targeting this higher amount. Mr. Newton discussed "communication challenges" relating to these changes. Some of those challenges are the new large liability on the balance sheet, all of the new nomenclature and why accounting numbers do not equal funding numbers. The GASB changes will result in increased administrative expenses for TMRS and its member cities.

Before discussion of the next agenda item, Mr. Rodriquez introduced TMRS' newest Board member, David Landis, from the City of Perryton.

4. **Consider and Act on Retiree Mortality Assumptions and Change in Actuarial Cost Method**

Mr. Randall and Mr. Newton were available for questions.

Mr. Jim Parrish moved that the Board approve the following recommendations: 1) Annuity Purchase Rate factors used in determining retirement and disability annuities as of January 1, 2015 be calculated on the basis of 70%/30% male/female blend of the RP-2000 Blue Collar Table with a 107.5% load, and with fully generational Scale BB projection; 2) The updated Annuity Purchase Rate factors be phased in over a 13 year period beginning January 1, 2015 with the Annuity Purchase Rate tables for the 13 year phase-in period (2015-2027, inclusive) to be provided by GRS in electronic format for final Board approval at its December 2013 meeting; 3) For valuation purposes, in determining actuarial liabilities and contribution requirements, retiree and beneficiary mortality rates based on the RP-2000 Blue Collar Table loaded 109% for males and 103% for females, and with fully generational Scale BB projection; 4) Utilization of the Entry Age Normal cost method for funding purposes in preparing the annual actuarial valuations; 5) Amortization periods be decreased or increased in accordance with current TMRS statutes and Board rules to the extent necessary to minimize the impact of the actuarial changes on contribution rates; 6) Any contribution rate increases resulting from the net impact of the actuarial changes and amortization period adjustments, be phased in at a maximum of 0.50% per year until the actuarially determined Annual Required Contribution (ARC) is attained; and 7) All of the above recommendations be adopted as a "package" and first reflected in the December 31, 2013 actuarial valuation used in determining 2015 contribution rates.

Ms. April Nixon seconded the motion and Mr. Landis abstained; which passed unanimously by the members of the Board present, 5-0.

Mr. Rodriguez asked that Mr. Newton discuss the 0.50% maximum per year increase until the ARC is attained. Mr. Newton explained that this will phase-in any rate increases associated with these changes. The majority of TMRS cities will not experience rate increases greater than 0.5% and therefore will not be subject to the phase in. Any rate phase-in greater than 0.5% is separate from the 13 year phase-in period for the APRs.

5. **Consider and Act on Actuarial Services Contract Renewal**
Mr. Gavia gave a general overview of GRS' service to the System and the Board over the past five years, touching on highlights and accomplishments. Staff has been pleased with their service and the relationship.

Mr. Gavia discussed that two fee schedules were presented, one based on two funding methods and the other based on the all EAN methodology. The fee schedule for the all EAN method would be used based on agenda item 4 being passed by the Board of Trustees.

Mr. Philibert moved that the Board authorize the Executive Director to negotiate and execute a contract with GRS satisfactory to the System for actuarial consulting services for the period of five years, January 2014 through December 2018 for fees substantially consistent with the all EAN fee schedule presented. Ms. Nixon seconded the motion, which passed unanimously by the members of the Board present, 6-0.

6. **Review and Discuss 2014 Preliminary Operating Budget**
Ms. Covarrubias began the discussion on the 2014 preliminary budget and how the budget aligns with the Strategic Plan. For Goal 1, she highlighted "new" items that include the change in the actuary retainer and an actuarial audit or peer review being completed in 2014. Under Goal 2, TMRS anticipates new investment data services for both real estate and risk analysis; additionally, an investment consultant search will be conducted in 2014 (no external resources needed, so no budget impact). New items in regard to Goal 3 include consulting services for improvements to TMRS' online and self-service capabilities for both members and cities, utilizing Straight-Through Processing (STP).

Section II of the budget provides a comparison of the 2013 budget to the 2014 proposed budget. Ms. Covarrubias highlighted new personnel requests, consulting services for Straight-Through Processing (STP), actuarial audit, SOC-1 audit and the new investment online services. She next gave a breakdown of the five main categories of the operating budget. On Personnel and Professional Services, she discussed the items within the category. For Professional Services, highlights included consulting services, actuarial audit, banking services, legal services, medical service and SOC-1 audit. Communications includes funds for increased postage and travel. Miscellaneous items include funds for the Investment department, including risk analysis electronic data services, real estate online services, and additional Bloomberg access for three new employees. Ms. Covarrubia discussed capital expenditures and Mr. Gavia noted that this did not include funds to finish the fourth floor. Mr. Gavia noted that information and more detailed cost estimates for the fourth-floor build-out will be provided at a later date.

Ms. Covarrubias highlighted the new personnel requests. Two of the three investment position requests are critical for Investments to implement the Absolute Return Strategy. Ms. Covarrubias then noted the need for an additional investment accountant, and stated that no additional accounting positions have been added since investment diversification began almost six years ago. Mr. Gavia discussed the need for an additional attorney and the need for an additional network administrator. The cost for each of these positions was detailed in the document.

Jesse Pittman, Debbie Munoz and Scott Willrich provided information regarding the TMRS Online Transformation program. A business case was presented and it is included in the information provided to the Board. This program aligns with the Mission and Vision of the System and is in accordance with the Strategic Plan. The goal is to transform many of our member and retiree related processes from a paper- based process to an online, self-service process. Staff refers to this as Straight Through Processing (STP). Ms. Munoz showed a flow chart of the retirement application process, showing the complexity of the process that will be transformed into the STP. Automating the existing process should free up time for the Member Services analysts to perform higher level work to better serve our members.

Mr. Pittman discussed the decision to treat the online transformation effort as one overall program instead of a series of individual, stand-alone projects. The steps that have been accomplished to date include analysis of current business processes in a paper environment and an analysis of TMRS' current software development tools vs. alternatives. The projects that are currently underway are the redesign of MyTMRS and City Portal screens. Mr. Pittman explained that the 2014 tasks and the experience gained from them will allow for an incremental, cumulative program upon which 2015 and future year tasks will be planned and developed.

Mr. Willrich discussed that internal resources will be used to implement the program and external resources will only be used where internal expertise is lacking and to accelerate completion. External resources will initially be used for usability analysis, business process analysis, and identity and access management. Additional software developers will be used to augment TMRS staff to accelerate program completion. He next discussed the funds requested in the 2014 budget. Mr. Gavia asked how cost estimates for these requests were derived and Mr. Willrich explained the process. The initial estimate for completion of the program is 2017, but, depending on other priorities or other unforeseen projects, it may stretch into 2018. The Board will be updated on a quarterly basis on the progress of the program.

Mr. Gavia discussed that it may not be an exact comparison, but noted that many other systems are looking at costs for similar redesign projects and those are in excess of $20 million. At present, our estimated costs are closer to $5 million. Mr. Rodriguez asked what expertise the consultants bring. Mr. Pittman and Mr. Willrich discussed the specific roles of the consultants.

Ms. Covarrubias noted that Management would continue to refine and complete any missing items in the draft budget, and would be bringing the final budget to the Board in December, for their approval.

7. **<u>Annual Investment Policy Statement Review and Discussion on Proposed Revisions</u>**
In keeping with the annual process of reviewing and revising policies to reflect changes in assets and investment programs, benefit changes and economic conditions, Ms. Goerdel discussed proposed revisions to the Investment Policy Statement (IPS) dated February 2013.

The revisions are categorized according to their purpose: clarification, to document current practice, and new policy. New policy revisions are further broken down by those that expand authority, restrict authority, or are considered to have a neutral impact.

Ms. Goerdel highlighted the substantive "new policy" changes to the main body of the Investment Policy Statement. The first change relates to the Executive Director' s authority to take action, on the advice of the Investment Consultant and the Chief Investment Officer, in the exercise of his fiduciary responsibilities to protect the assets of the system. The change allows him discretion about whether to ask Fiduciary Counsel, General Counsel and/or the Chairman of the Board to review such action. The second change makes the review of commingled fund proxy voting guidelines optional given that managers are obligated as Registered Investment Advisors to vote all proxies in the best interest of the fund and that commingled fund investors do not have the ability to direct a change to the proxy voting guidelines. Another revision incorporates the new Risk Budget Policy framework into the monitoring process and reporting requirements.

Regarding Portfolio Guideline Revisions, Ms. Goerdel discussed the more significant changes, including the revision of the list of permissible investments in the Core and Core Plus Fixed Income for consistency with the mandate benchmark. She highlighted the addition Fof U.S. Treasury futures to the Core and Core Plus Fixed Income list of permissible investments, on an unlevered basis, to obtain market exposure and manage duration more efficiently. Further, Ms. Goerdel noted that new sections were added for the Non-Core Fixed Income Asset Class, the Bank Loan/CLO mandate, and the Absolute Return Strategies allocation, consistent with previous Board presentations on those topics. The proposed revisions will be presented to the Board at the December meeting for adoption.

8. **<u>Investment Report: Performance Update</u>**

Marcia Beard, from R. V. Kuhns, began by discussing that August was a very difficult month resulting in a negative return due to the concern over Syria and expectations of impending exit from Quantitative Easing (QE3). Ms. Beard discussed that returns for the year were still positive at 2.93% even though the quarter ended August 31 was negative. She then reviewed returns by asset class, noting that fixed income and real return allocations have been negative year to date while equities and real estate have been positive. September was a much better month and year-to-date, the system saw significant improvement.

9. **<u>Call for Future Agenda Items</u>**

Mr. Gavia mentioned that the administrative rules regarding APRs and the electronic tables will be brought to the Board for final approval.
The meeting was adjourned at 12:00 p.m.

David Gavia
Executive Director

Roel "Roy" Rodriguez
Chair, Board of Trustees