

**MINUTES OF THE
TEXAS MUNICIPAL RETIREMENT SYSTEM**

Meeting of the Board of Trustees

August 22, 2019 – 1:00 p.m.

On August 22, 2019, the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a meeting at 1:00 p.m. at TMRS Headquarters, located at 1200 North IH 35 in Austin, Texas, with the following members present:

Board of Trustees

Bill Philibert, Chair
David Landis, Vice Chair
Julie Oakley
Jim Jeffers
Jesús Garza

Absent: Jim Parrish

Present also were:

David Gavia, Executive Director
Eric Davis, Deputy Executive Director
TJ Carlson, Chief Investment Officer
Christine Sweeney, General Counsel
Dan Wattles, Director of Governmental Relations
Leslee Hardy, Director of Actuarial Services
Debbie Munoz, Director Member Services
Scott Willrich, Director of Information Resources
Rhonda Covarrubias, Director of Finance
Sandra Vice, Director of Internal Audit
Bill Wallace, Director of Communications
Kristin Qualls, Director of Public Equity
Marc Leavitt, Director of Absolute Return Strategies
Tom Masthay, Director of Real Assets
Jason Weiner, Director of Fixed Income
Dimitry Shishkoff, Director of Risk Management
Karen Jackson, Executive Assistant
Robert Klausner, Klausner, Kaufman, Jensen & Levinson
Marcia Beard, RVK
Amy McDuffee, Mosaic Governance Advisors
Mark Randall, GRS Retirement Consulting
Joe Newton, GRS Retirement Consulting
James Maina, StepStone Group, LP

John Claisse, Albourne America
Chris Slavin, Albourne America

Also in attendance:

Michelle Mellon-Werch, Assistant General Counsel
Madison Jechow, Assistant General Counsel
Nick O'Keefe, Lead Investment Attorney
Kelsey Baldwin, Investment Attorney
Tish Root, Legal Assistant
Eric Obermier, Assistant Director Information Resources
Trisha Solis, Business Process Analyst
David Rodriguez, Senior Regional Manager – City Services
Melanie Thomas, Process and Content Management Specialist
Natalie Garza, Communications Analyst
Eddie Schultz, Investment Manager
Yvonne Huang, Real Assets Analyst
Cindy Morse, Investment Support Analyst
Debbie West, Investment Operations Specialist
Geldon Vllahu, Investment Operations Analyst
Ryan Conner, Risk Management Analyst
Melissa Jerkins, Quantitative Analyst
Kurt Cressotti, Compliance Officer
German Gaymer, Fixed Income Analyst
Jacob Bowland, Fixed Income Analyst
Kevin Notaro, Absolute Return Analyst
Celise Cobos, Real Assets Analyst
Andi Focht-Williams, Senior Auditor
Peter Jeske, Operations Analyst
Paula Nguyen, Investment Accountant
Kenneth Oliver, Actuarial Analyst
Pete Krnavek, Information Systems Manager
David Riggs, Texas State Association of Fire Fighters
Bob Scott, City of Carrollton
George Kauffman, City of Garland Retiree
Casey Srader, Government Finance Officers Association of Texas
Scott Leeton, Combined Law Enforcement Association of Texas
Greg Shipley, Combined Law Enforcement Association of Texas
Kathleen Depweg, City of Arlington
Ron Lewis, Ron Lewis and Associates
Bryan Burnham, Pension Review Board
Ben Warden, Pension Review Board
Gary Anderson, Retiree

Mr. Philibert called the meeting to order at 1:00 p.m. and Mr. Landis gave the invocation.

Mr. Philibert made an announcement that due to the loss of a quorum, the Friday, August 23, 2019, Meeting of the Board of Trustees was cancelled.

1. Consider and Act on Adoption of Minutes from the June 20-21, 2019 and July 18, 2019 Meetings of the Board of Trustees

Staff had nothing to add to the minutes as presented. There were no changes suggested by the Board.

Mr. Jeffers moved that the Board adopt the minutes from the June 20-21, 2019 and July 18, 2019 meetings of the Board of Trustees. Mr. Landis seconded the motion, which passed 5-0.

2. Consider and Act on Board Committee(s) Creation, Appointment(s) and Reappointment(s) for 2019

Mr. Gavia noted that due to Trustee Parrish's resignation, there are openings on the Legislative and Technology Committees. Mr. Landis agreed to serve on the Legislative Committee. Mr. Garza indicated he would continue to serve on the Technology Committee; Mr. Jeffers also volunteered to serve.

Ms. Oakley moved that the Board approve the appointments to fill the vacancies for the following Committees for 2019:

- Technology Committee
 - Chair: Jesus Garza
 - Vice Chair: Jim Jeffers

- Legislative Committee
 - Vice Chair: David Landis

Mr. Landis seconded the motion, which passed 5-0.

3. Discuss Asset Liability Modeling Results

Ms. Hardy introduced the first of three studies to be presented to the Board over the remainder of 2019. The results of the Asset Liability Modeling (ALM) study, along with the Asset Allocation and Experience studies to follow, will equip the Board with the knowledge to consider and act on a new set of actuarial assumptions to be effective with the December 31, 2019 actuarial valuation.

A primary goal of TMRS is to ensure that all long-term pension obligations are covered by plan assets within a reasonable period of time. Because plan assets are a combination of contributions and earnings on investments, the funding and investment policies are linked. While the ALM study is not making any recommendations on portfolio choice, it does provide input to the Asset Allocation study regarding liquidity concerns, potential shock risks and the sensitivity of the liabilities to price and/or wage inflation. The upcoming Asset Allocation study will delve into the risk/return/correlation expectations for the individual asset classes and produce alternative portfolios for the Board's consideration in selecting a strategic target asset allocation. The ALM study is simply attempting to provide the Board

with a broader quantitative framework for assessing the risks and rewards of the various portfolios to be presented in the Asset Allocation study.

Lower investment returns lead to higher required contributions and vice versa. Population development and cash flow needs will be reviewed. Mr. Newton noted, that based on this study, there are very little cash flow needs of the System; in fact we have one of the best cash flow profiles in the nation. Mr. Randall noted that the System's active to retiree ratio works in its favor. Mr. Newton discussed percentile rankings and reliability of the modeling techniques. A different set of assumptions, or even a different modeling procedure, will produce different results for a specific option. Therefore, don't over emphasize the specific result for a given choice. The relationship between choices will be more reliable across different models.

Mr. Newton began reviewing the baseline results. Over time, the current portfolio has an expected return of 6.3%, but this does not include alpha and other options. This leads to a bias toward under performance compared to a 6.75% assumption, which would cause unfunded liabilities to increase over time. He noted that if the amortization period was reduced to 20-years, the bias could be mitigated to keep the Unfunded Actuarial Accrued Liability (UAAL) holding level; not making progress on paying down liability, but it doesn't grow either. The point here is that decisions are not made in an assumption vacuum. The question needs to be where is the Board willing to take risk and is the additional risk worth the additional reward.

Mr. Newton focused the attention on specific questions to ask with regard to reward and risk. These are specific questions that matter to stakeholders.

Mr. Newton next moved to an efficient frontier graph. How much risk is acceptable to try and get more reward? He showed how three sample portfolios could result in higher standard deviations, but result in lower future rates, under the "very poor" outcome, than the current portfolio. He also reviewed potential portfolios from a contribution rate volatility and funded status perspective.

The current funding policy was discussed in regard to the asset smoothing and current industry best practice. With ten year asset smoothing and a twenty-five year amortization strategy, the current process could take thirty-five years to fully recognize a significant event. This combination would not fall under current industry best practice and it is recommended one of the two parameters be decreased by five years.

Several different strategies of potential alternative funding strategies were highlighted. The layered approach, disciplined approach and the floating approach were discussed and Mr. Newton showed the outcomes of these different approaches graphically.

Mr. Newton concluded with a discussion of combination of options. Eventually there will be a combination of investment and funding strategies to be implemented. The true comparison is the combined package before to the combined package after. Combining multiples of these options, all of these individual decisions, work together and can present varied results.

This study is not making any recommendations on portfolio choice. The upcoming asset allocation study will dive into the details of individual asset classes and produce recommendations. This analysis attempts to provide a broader quantitative framework for the Board to assess the risks and rewards of the portfolios recommended in the asset allocation study.

4. Discuss Summary of Board Governance Workshop

Ms. McDuffee presented a summary of the July 18th Governance Workshop. The timeline was reviewed and it was noted that the Board has taken a very methodical and holistic approach to governance. She reviewed the three primary areas of discussion at the Governance Workshop: governance structure and responsibilities, Investment Beliefs, and Governance Policy manual.

The nine key areas of consensus were reviewed and Ms. McDuffee discussed the development of the Governance Policy manual. The current policies will be reviewed and potential new policies developed. These were set into three groups based on the time period in which they will be reviewed.

Ms. McDuffee concluded with next steps, which included developing a Board/Committee work plan as well as continue to develop the Investment Beliefs and Governance Policy manual.

5. Consider and Act on Board Officer Positions, including Roles, Terms and Other Matters

This discussion regarding Board Officer positions was initiated to put some structure around what has been a loose structure historically. Ms. McDuffee reviewed common peer practices with regard to board officer selection processes and procedures. The different drivers include: 1) statutory structures and responsibilities; 2) board size and terms; 3) board composition – elected, appointed, ex-officio, plan members; 4) balance of power; 5) governing styles; 6) differences in involvement and leadership; 7) frequency of legislative sessions, vacancies and turnover; and 8) informal practices and preferences. She reviewed the evolving role of the Board and possible Board Chair responsibilities. Ms. McDuffee discussed the current model for Board Chair and highlighted possible alternative options for consideration. A question was asked as to what should be the role of the Vice-Chair. Ms. Oakley stated that she preferred the Vice-Chair role to be “in sync” with the Chair so they would have the ability to step in seamlessly, if needed. She prefers the one-year term and the flexibility that it provides and the progression from Vice-Chair to Chair, but it is not a requirement. Mr. Philibert agreed. Mr. Landis agreed, but did not want to force someone into the role of Chair. Ms. Oakley reiterated the Board should think about it and decide each year. There was discussion on should there be a cap on how long a Chair could serve. Ms. Oakley noted that based on the legislative cycle, having the Vice-Chair serve as the Chair of the Advisory Committee helps give them the needed background to be prepared, while not over burdening the Chair. Mr. Jeffers agreed with Ms. Oakley, except with regard to any term limit. He believes the Board should select the best person to be the Chair.

Ms. McDuffee summarized the discussion regarding the Board Chair: have a one-year term, no term limits, no preference for rotation, and no automatic presumption of the Vice Chair becoming Chair, but it is a good idea to groom a Vice Chair for the possibility. A Board Chair and Vice-Chair position description will be developed.

Filling the committee roles was also discussed and Ms. McDuffee noted that the committee charters will be reviewed by Trustees. For example, should the Board Chair be the Chair of the Legislative Committee or should the Board Chair just be a member?

6. Discuss Investment Beliefs and Consider and Act on Possible Alternative Board Processes for Approval and/or Delegation of Investment Manager Selections and Terminations

Ms. McDuffee, Mr. Klausner and Ms. Beard continued the discussion of the Investment Beliefs. The objective is to recap the results of the Investment Beliefs survey and the current processes, explore the decision making processes, and get direction on next steps.

Ms. Beard noted that the beliefs provide the basis for a good investment program and the Board owns these beliefs. She reviewed the areas where the Board felt their time could best spent and what activities were least productive.

- The Board has responsibility for managing and monitoring the investment program
- The Investment Policy Statement (IPS) provides for delegation of responsibilities;
- The standards for prudence (prudent person for Board and Staff, prudent expert for consultants, etc.) were reviewed

Mr. Klausner reviewed the Prudent Person Rule in the TMRS Act, as well as the Prudent Investor Standard in the Texas Trust Code. Ultimately it is unsettled in Texas case law, but based on General Counsel's review of applicable Texas Law, the Prudent Person Standard applies to the Board and Staff. The TMRS IPS imposes the Prudent Expert Standard on the external hired experts.

Questions asked included: Should a prudent Trustee delegate? What can never be delegated? In general, the answers depend on the topic at hand and the parties' knowledge and expertise on the topic. In some circumstances, delegation can raise the level of care. The Board is the ultimate fiduciary and it is responsible for setting policy, including the IPS. The Executive Director should then implement the policy. However, the Board must also monitor the implementation. The Board must use reasonable care, skill, and diligence in: 1) selecting an agent; 2) establishing the scope and terms of the delegation; and 3) periodically reviewing the agent's actions and compliance.

When asked how does all of this apply, Mr. Carlson answered, if the investment staff does not live up to all of their due diligence activities, they would be held to the higher standard. Mr. Klausner stated that the Board does not have the same level of investment expertise which is why they should delegate. Ms. Beard next discussed that Investment staff currently follows many "best in class" activities relating to due diligence.

Ms. Oakley stated that the Board should be concerned with the process. Specifically, should the staff's internal investment committee process be memorialized in the IPS and require reports on compliance? Mr. Carlson stated that the IPS could reference this with all the "procedures" of the committee noted in the staff Investment Committee Charter and reference manual.

Ms. McDuffee reviewed different possible alternative models for retaining, maintaining and terminating investment managers. There were four levels of Board involvement that were modeled: 1) Consent Agenda – Board approval in advance of deal being entered into; 2) Consent Agenda – Board ratification/confirmation after a deal has been entered into; 3) Delegated Authority – approved list of Investment Funds (TCDRS model); 4) Delegated Authority – percentage limit by asset class (allow staff to implement fully-vetted average sized deals that the Board had previously approved, and still require prior Board approval for deals outside of the limits). A description of how each model would work and specific considerations for each model were discussed.

Ms. Oakley stated there were parts of models (2) and (4) that she liked. She liked model (2) with regard to alternative investments and she would like to see a hybrid of (2) and (4) in this regard. The Board saw the benefits of model (4), Mr. Jeffers was intrigued by the hybrid approach. Ms. Oakley noted that the confirmation aspect of model (2) would keep the flow of information from the Board's consultants flowing. Mr. Carlson noted that the same information is currently being provided and would continue to be provided in the future.

Ms. McDuffee will follow up at the next Board meeting with proposed recommendations regarding how to optimize the consultant relationship with the Board and bring back models (2) and (4).

7. Status Update of Executive Director Search Firm Request for Information (RFI)

Ms. McDuffee updated the Board on the responses to the RFI that was issued for an Executive Recruitment Firm for the Executive Director search. The due date for proposals has passed and three firms have responded to the RFI. The review team will evaluate the proposals and will bring the results of the evaluation to the September Board meeting.

Once the Board decides on a firm, the following tasks will need to be discussed: 1) position description; 2) other recruitment materials and 3) an advertising plan.

8. RVK Quarterly Report/Asset Class Updates (formerly #9 on the Friday, August 23, 2019 agenda)

Ms. Beard presented the second quarter report for 2019. Global risk assets add to the gain realized during the first quarter. The strong equity returns realized in April were erased in May as confidence in the steady pace of global economic expansion waned. The economic data released during the quarter was largely consistent with a slowing economy. An inverted yield curve has been a concern as it is seen as a predictor of future recession.

Target versus Actual Asset Allocations were reviewed and Ms. Beard noted that most asset classes are approaching their target allocations. Portfolio performance was highlighted and

each time frame has shown the benchmarks has been outperformed and alpha has been returned by the managers. As of August 21st, the System was over \$30 billion with a return of 9.1% net of fees. The three policy objectives were discussed. Since allocations are not at their full targets, it is difficult to meet these objectives.

Ms. Beard discussed the Total Fund Performance versus Peers. The difference in our portfolio and our peers was noted, but this is expected due to higher holdings in fixed income and less in equities. TMRS falls below median volatility, but we also have below median returns. In up markets, we have returned more than actual allocation benchmark and in the down markets, we have lost less than our peers.

Asset Class Performance was reviewed and Ms. Beard highlighted the reasons for under or over performance compared to the respective benchmarks. Composite objectives and performance were also discussed as well as each asset class. Currently, no changes are being recommended and it is a good time to be preparing for the Asset Allocation Study.

9. Executive Session (formerly #8 on the Thursday, August 22, 2019, agenda)

At 5:18 p.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 all members of the Board except for Mr. Jeffers that were present before the Executive Session were still present. The meeting was opened to the public again at 5:45 p.m.

At 5:45 p.m. the meeting was adjourned.



David Gavia
Executive Director



Bill Philibert
Chair, Board of Trustees