

**MINUTES OF THE
TEXAS MUNICIPAL RETIREMENT SYSTEM
Joint Meeting of the Board of Trustees and
Advisory Committee on Benefit Design**

May 31, 2019 - 8:00 a.m.

On May 31, 2019, the Board of Trustees of the Texas Municipal Retirement System (TMRS) and the Advisory Committee on Benefit Design (Committee) convened for a joint 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

Jim Parrish, Chair
Bill Philibert, Vice Chair
David Landis
Jim Jeffers

Absent: Jesus Garza
Julie Oakley

Advisory Committee Members

Bonita Hall, Texas Municipal Human Resources Association (TMHRA)
Paulette Hartman, Texas City Management Association (TCMA)
George Kauffman, Retired Member
Julie Masters, Mayor, City of Dickinson, Elected Member
David Riggs, Texas State Association of Fire Fighters (TSAFF)
Scott Leeton, Combined Law Enforcement Associations of Texas (CLEAT)
Casey Srader, Government Finance Officers Association of Texas (GFOAT)

Present also were:

David Gavia, Executive Director
Eric Davis, Deputy Executive Director
TJ Carlson, Chief Investment Officer
Christine Sweeney, General Counsel
Bill Wallace, Director of Communications
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
Leslie Ritter, Director of Human Resources
Jesse Pittman, Senior Project Manager
Kristin Qualls, Director of Public Equity
Jason Weiner, Director of Fixed Income

Chris Schelling, Director of Private Equity
Tom Masthay, Director of Real Estate and Real Return
Karen Jackson, Executive Assistant
Robert Klausner, Klausner, Kaufman, Jensen & Levinson
Marcia Beard, RVK
Amy McDuffee, Mosaic Governance Advisors
Mark Randall, Gabriel, Roeder, Smith & Company
Joe Newton, Gabriel, Roeder, Smith & Company
Keith Brainard, National Association of State Retirement Administrators
Ron Baker, Colorado Public Employees Retirement Association
Michelle Kranes, Pension Review Board
Ben Warden, Pension Review Board
Kathleen Depweg, City of Arlington

Also in attendance:

Michelle Mellon-Werch, Assistant General Counsel
Nick O'Keefe, Lead Investment Attorney
Madison Jechow, Assistant General Counsel
Candace Nolte, Assistant Finance Director
Andi Focht-Williams, Senior Auditor
David Rodriguez, Senior Regional Manager– City Services
Sean Thompson, Regional Manager – City Services
Peter Jeske, Operations Analyst
Trisha Solis, Project Specialist
Melanie Thomas, Process and Content Management Specialist
Eddie Schultz, Assistant Director of Real Assets
Cindy Morse, Investment Support Analyst
Debbie Farahmandi, Investment Operations Specialist
Geldon Vllahu, Operations Analyst
Celise Cobos, Real Assets Analyst
Ryan Conner, Risk Management Analyst
Jacob Bowland, Fixed Income Analyst
Melissa Jerkins, Quantitative Analyst
Kurt Cressotti, Compliance Officer
German Gaymer, Fixed Income Analyst
Kevin Notaro, Absolute Return Analyst
Peter Teneriello, Private Equity Analyst
Yvonne Huang, Real Assets Analyst
Kenneth Oliver, Actuarial Analyst
Tish Root, Legal Assistant
Greg Shipley, Combined Law Enforcement Associations of Texas

Mr. Philibert called the meeting to order at 8:00 a.m.

1. Consider and Act on Adoption of Minutes from the November 15, 2018 Meeting of the Advisory Committee on Benefit Design

Committee member Mayor Masters moved that the Advisory Committee on Benefit Design adopt the minutes from the November 15, 2018 meeting. Committee member David Riggs seconded the motion, which passed by a unanimous vote of the Committee.

2. TMRS Trustee Education: Governance Discussion

Ms. McDuffee explained the connection of this item to the TMRS Strategic Plan. She reviewed the agenda for the Governance Discussion and gave a preview of the objectives for the July workshop. A question to be asked, "Looking ten years into the future, if TMRS becomes a \$40 or \$50 billion fund, how does a system of that size operate?" Although there are many different examples to consider, the purpose of the Governance Discussion was to hear about how one specific \$50 billion fund operates. Ms. McDuffee then introduced the guest speaker, Mr. Baker, Executive Director of the Colorado Public Employee Retirement Association (PERA).

To set the stage for discussion, Ms. McDuffee reviewed the Mission and Vision statements from the TMRS Strategic Plan. She cited a study demonstrating the importance of well-run and properly managed public sector retirement systems in delivering the benefits that attract and retain public sector employees. Ms. McDuffee summarized the path of growth and expansion that TMRS has been on over the past decade, including asset size, staff size, benefits payouts, cities covered and more. During this time, TMRS has been recognized as being well-run and properly managed. It is timely for the Board to consider the future of TMRS and how it can best continue to grow while also continuing to be well-run, properly managed, and deliver on the mission to members and beneficiaries.

Mr. Baker provided an overview of Colorado PERA, its membership, plan design, and interrelation with Social Security. He noted PERA's five divisions covering over 600,000 members and retirees and 500+ employers. The plan design is a hybrid with both defined benefit and cash balance aspects for their main benefit. There is a "choice" defined contribution component for state employees, with slow expansion and adoption of the "choice" plan. The benefit structure is the same across the divisions. The differences are based on date of hire, not employer. Questions from the Board centered on how the benefit structure works. Mr. Baker noted that the voluntary defined contribution savings plans and choice plan all have the same investment options menu.

Mr. Baker then discussed PERA's governance framework. PERA is an instrumentality of the State, and Board's authority is well defined in the statute. The Board administers benefits, invests assets, and sets assumptions. The Board cannot set contribution rates or establish benefits. PERA has fixed, statutory contribution rates with a limited ability to increase rates when needed. Employer rates are consistent within a division, but there are some differences between divisions. Ms. McDuffee pointed out that Colorado PERA and TMRS have similar statutory authority regarding budget, personnel, compensation, and contracts. That is not necessarily the norm for large public retirement systems across the country. Upon a question from the Board, Mr. Baker discussed what PERA does well in its relationship with the legislature and what aspects could use further development.

Mr. Baker next discussed PERA's Board composition and other aspects of Board governance, noting a 16-member Board with 1 non-voting member, five regular meetings per year with one planning meeting, and applicability of open meetings laws. The Board has eight standing committees and highlighted that the audit committee utilizes non-trustee outside experts, appointed by the Trustees. It has a similar structure to TMRS' audit committee in that the director of internal audit reports to it; however, its scope includes both internal and external audit matters. Mr. Baker then discussed the purpose of each committee and commented on the strategic value they provide. The PERA Investment Committee engages in higher level asset allocation discussions and makes recommendations to the full Board for action, but does not select investment managers. This is to maintain the policy focus on strategic allocations and benchmarks. Mr. Baker described the meeting format, noting that the committees meet the day before Board meeting and run all day. The committees are staffed by executive staff liaisons and the Executive Director attends these meetings. PERA has a fairly rigorous trustee training program, but no statutory Board training. Committees need to provide direct focus and make strategic decisions. It is always challenging to strike the right balance in how many committees are needed to accomplish the work of the board. Mr. Baker suggested to the TMRS Board that in light of its upcoming governance workshop, the board ought to consider the strategic value of each of its committees.

Ms. McDuffee noted that the strategic plan has been an important driver for Colorado PERA, as it has been for TMRS. PERA also has a very effective Board Policy Manual that encapsulates charters and policies of the Board in one centralized location.

Mr. Baker next discussed budget, staffing and compensation matters at PERA. He highlighted that the majority of investing of the \$50B portfolio is done in-house. The internal asset management framework has been built slowly and methodically over the past two decades. Having internal staff do the lion's share of the work on investments and technology has been a huge benefit to Colorado PERA. The challenge has been continually bringing in talent and maintaining the knowledge base to support systems. PERA has over 50 investment staff and approximately 40 technology staff. All of PERA's new hires in these two areas come from the private sector.

Although PERA uses CEM benchmarking, Mr. Baker and the PERA Board are adding benchmarking comparisons that provide different insights, with a specific focus on comparisons to the private businesses that members use. He noted members' expectations that PERA offer online features and services that are similar to those they receive through other areas in their life - their bank, credit union, retail shopping experiences, and more. Much of the experience is mobile phone based. This requires PERA to not only measure if they are performing effectively, but also to consider if PERA is providing the right features and services that members want.

Mr. Baker then discussed compensation structure for internal staff, noting a mix of base salary and incentives. He noted the recent changes to the incentive program to ensure that performance is synchronized to a baseline as well as being tied to longer-term goals.

Philosophically, the incentives need to be hard for staff to get, but worthwhile. Mr. Baker noted that PERA's internal management of assets saves approximately \$45 million per year. Mr. Baker concluded his comments by summarizing the focus of PERA's strategic plan: "What do we think about who we are and what we do, and how do we get there?"

After a short break, the Advisory Committee members introduced themselves and, where applicable, the organizations they represented.

Ms. McDuffee was next joined by Ms. Beard to update the Board regarding the activities for the Investment Beliefs project. Ms. Beard provided an initial overview of the results of the recent survey of the Board and select staff, noting that the information is still fresh and therefore further analysis will be needed to finalize insights. The initial results have been shared with the Board. She thanked those participating in the survey for their responses, noting the information will remain anonymous. Next steps will be to see how the items with strong similarities in views are being implemented in the portfolio. Education will be provided to the Board on those items where dispersion in responses was noted. Ms. Beard reiterated that there is no expectation that the investment beliefs will be completed in July. Rather, this will be an ongoing process for the System to achieve where it would like to be in the future.

3. Consider and Act on Results of 2018 Actuarial Valuation and Approval of 2020 Retirement Contribution Rates and Supplemental Death Benefit Contribution Rates

Mr. Gavia introduced Mr. Newton and Mr. Randall from Gabriel, Roeder, Smith & Company (GRS) to present the results of the December 31, 2018 actuarial valuation. Mr. Randall and Mr. Newton presented the actuarial valuation report. Even given the negative investment return for 2018, rates remained fairly stable and cities continued to improve benefits. The System is in great shape and is in an enviable position nationwide. Mr. Newton began by showing that there was a very nice bell curve around the distribution of contribution rate changes due to actuarial experience, thanks in part to COLAs being less than expected.

The Summary of System-wide results was reviewed. The Aggregate BAF valuation was reviewed, noting the impact of benefit changes on the funded ratio and contribution rate. From an actuarial perspective, COLA was the biggest area of actuarial gain: expected 2.50% inflation while the actual inflation rate was lower. Salary experience in aggregate was higher than expected which can have a more pronounced impact on cities with USC. Average age and service remained stable. A summary of benefit changes was highlighted. Sixty-four (64) cities made plan benefit changes that impacted the total retirement rate.

Yields based on market value of assets was reviewed as well as the market versus actuarial value of assets. The growth in assets compared to liabilities was also reviewed, showing the AAL and AVA. Mr. Newton stated that we should start to see is these lines converging since we are in positive amortization. The relative size of the UAAL to AAL was also discussed. The funded ratio is one of the few in the nation that is expected to continue to show improvement. Based on the 2018 NASRA survey of our peers, TMRS' funded ratio continues to be better than the average of our peers. Mr. Newton next reviewed projections of the funded ratio under historical stress tested investment return scenarios. He noted that

the funding policy keeps funded ratios up during extended down markets. The stochastic projection was reviewed, as was the distribution of funded ratios. All in all, the position of employers has been improved. An example of the amortization layering was discussed as was the distribution of single equivalent amortization periods.

Mr. Newton next discussed the historical dollar weighted contribution rates and distribution of changes in contribution rates by city. The contribution rates have remained very stable. Mr. Newton also reviewed projections of the dollar weighted contribution rates under historical stress tested investment return scenarios.

The sustainability checklist was reviewed. He reviewed the "star" scoring system. TMRS scored very well on most of the items that it has control over, and is reviewing the areas where we didn't rate as well and there is room for improvement.

In an agent multiple employer type plan, not every employer looks like the system average. Mr. Newton pointed out that there are adjustments made to account for these differences between individual employers. Payroll growth was discussed with regard to this. All in all, TMRS grades out very well on the checklist, but there are a few areas to which attention should be paid: amortization periods, capital market expectations, and longer term liability (or asset) to payroll ratios.

In summary, overall System health continues to improve. Expectation is for a slowly increasing funded ratio and continued stability in contribution rates. The 2019 Experience Study will be presented in the summer.

Jim Jeffers moved that the Board accept the December 31, 2018 actuarial valuation prepared by its consulting actuary and certify retirement contribution rates and Supplemental Death Benefit contribution rates for municipalities for 2020. Jim Parrish seconded the motion, which passed 4-0.

4. TMRS Trustee Education: Public Pension Trends Presentation

Mr. Gavia introduced Mr. Brainard, Research Director of the National Association of State Retirement Administrators, and provided a highlight of his career and his credentials.

Mr. Brainard began by reviewing public pension plans in Texas. Nationwide, the public/employee funding is approximately 60%/40%. In Texas, that ratio is closer to 50%/50% with employees paying a higher percentage. The changes in aggregate public pension funding levels was reviewed; this has shown a fairly marked decline. TMRS has contrasted the nationwide trend and has shown continued improvement. The distribution of public pension funding levels for 2017 was highlighted.

The public pension community is facing headwinds with declining investment return assumptions leading the way. Slower payroll growth and longer life expectancies are also creating challenges. Compared to the national average, historically TMRS' investment return assumption has been trending to the more conservative. Differences in private versus

public employment trends were reviewed as well as the ratio of active members per annuitant. TMRS is relatively stronger than most systems in this area. Slower than expected payroll growth is becoming a trend. TMRS' cash flow is stronger than most systems even though we recently had negative returns.

Tailwinds supporting public pension systems include: stabilizing investment returns, stronger efforts to pay contributions, more aggressive amortization strategies, lower benefit levels, and stronger hiring and salary growth.

Many plans continue to struggle with key actuarial challenges and the size of these challenges varies widely. We have seen unprecedented numbers of pension reforms and the major theme has been the establishment of risk sharing plan design features.

Mr. Brainard discussed some of the risk sharing plan designs that have been created. These include hybrid retirement plans, contingent or limited Cost of Living Adjustments (COLAs), flexible employee contribution rates and adjustable benefit levels.

Another public pension trend is risk assessment. ASOP 51 requires all actuarial valuations to include risk assessment. Stress testing of public pension plans and sensitivity testing activities were discussed.

Mr. Brainard concluded by discussing recent Texas legislative changes regarding investment performance evaluation (SB 322) and funding policy (SB 2224).

Mr. Gavia asked Mr. Brainard's opinion on nationwide aggregate funding levels. Mr. Brainard doesn't feel the funding level has bottomed out. In the short term, he feels more systems will go sideways; not necessarily declining, but not improving either. Paying required contributions will go a long way to serving many of the pension funding issues.

David Riggs, Texas State Association of Fire Fighters, thanked the Board for excellent work during the past Legislative Session. Mr. Riggs asked since we have operated under the current 5% interest credit to members for a decade, he feels that gain-sharing should again be considered as an option for discussion.

Scott Leeton, Combined Law Enforcement Associations of Texas, asked that gain sharing again be reviewed and studied. He also asked that mortality assumptions for first responders be reviewed to see if there is something that stands out.

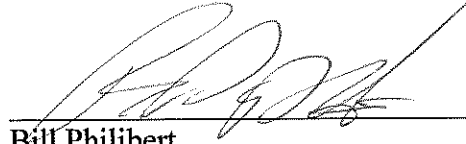
5. Call for Future Agenda Items

No items were requested by the Board.

There being no further business, Mr. Parrish moved to adjourn the meeting. Mr. Jeffers seconded the motion. The meeting was adjourned at 11:37 a.m.



David Gavia
Executive Director



Bill Philibert
Chair, Board of Trustees