

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

June 19, 2009

On June 19, 2009, 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

Carolyn Linér, Chair
Ben Gorzell, Jr., Vice Chair
Pat Hernandez
April Nixon
Roel ("Roy") Rodriguez
H. Frank Simpson

Advisory Committee on Retirement Matters

David Crow, President, Arlington Professional Fire Fighters
Scott Kerr, Texas State Association of Fire Fighters
Debbie Maynor, Texas Municipal Human Resources Association
Randle Meadows, City of Arlington Police Department
Jim Moore, Assistant Fire Chief, City of Mesquite
Bob Scott, Director of Finance, City of Carrollton

Present also were:

Eric Henry, Executive Director and CIO
Ian Allan, Director of Internal Audit
Rhonda Covarrubias, Director of Finance
Eric Davis, Deputy Executive Director
Bernie Eldridge, Director of Human Resources
David Gavia, General Counsel
Nancy Goerdel, Director of Public Investments and Asset Allocation
Leslee Hardy, Staff Actuary
Russ Kuhns, R. V. Kuhns & Associates, Inc.
Ron Lewis, Ron Lewis & Associates
Holly Macki, Director of Fixed Income
Pete Madsen, R. V. Kuhns & Associates, Inc.
Michelle Mellon-Werch, Associate General Counsel
Cindy Morse, Executive Assistant
Debbie Munoz, Director of Member Services
Mark Randall, Gabriel, Roeder, Smith and Company
Juventino Robledo, KPMG
Eddie Solis, Director of Government Relations
Brad Stewart, Gabriel, Roeder, Smith & Company
Bill Wallace, Director of Communications

Susan Warren, KPMG
Nancy Williams, Ennis Knupp + Associates, Inc.
Scott Willrich, Director of Information Resources

Guests:

Sherry Chapman, Investment Analyst
Lorraine Moreno, Regional Manager, City Services
Candace Nolte, Controller
Kristin Qualls, Assistant Investment Officer
Kate Reed, Investment Analyst
Kate Reissman, Investment Intern
Melanie Thomas, Communication/Editor
Sean Thompson, Membership Analyst

The meeting was called to order by Ms. Linér at 8:37 a.m., and Mr. Rodriguez gave the invocation.

1. Executive Session

At 8:40 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 9:37 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 Performance and Compensation of General Counsel and Internal Auditor

Mr. Henry introduced this item and discussed that both individuals have exceeded expectations in almost every area evaluated. Mr. Henry proposed that both individuals receive a 4% increase in salary.

Mr. Rodriguez moved that both individuals be awarded a 4% merit increase. Ms. Hernandez seconded the motion, which passed unanimously.

3. Consider and Act on Consent Agenda

Mr. Henry introduced this item and gave a brief overview of what is contained in the Consent Agenda. There were no questions and no revisions to the proposed Minutes from the April 24, 2009 meeting of the Board.

Mr. Simpson moved that the Consent Agenda be adopted. Mr. Gorzell seconded the motion, which passed unanimously.

4. Legislative Update and Overview of 81st Legislative Session

Mr. Solis and Mr. Lewis generally noted that there will likely be a special session to wrap up a few items regarding sunset issues, but indicated that there will be no pension issues addressed in the special session. Mr. Solis and Mr. Lewis provided a brief update on Representative Kuempel's health.

Mr. Solis reported that House Bill 360 was passed and signed by the Governor. He commented that the Legislative Stakeholders Group and TMRS staff did a great job laying the groundwork for this bill and getting it in and out of the session early. Mr. Solis reported that no other bills affecting TMRS, such as the Advisory Committee bill, the Pension Review Board (PRB) bill and the Cost of Living Adjustment (COLA) bill passed the Legislature.

On another note, Mr. Solis reported that all Board members who were awaiting confirmation have in fact been confirmed. Mr. Lewis added that TMRS should keep the current legislative process the same for next session.

Mr. Linér and Mr. Rodriguez thanked the Legislative Stakeholder Group, the Advisory Committee and TMRS staff for their efforts prior to and during the Legislative Session.

5. Consider and Act on Resolution Honoring Representative Edmund Kuempel

Mr. Henry introduced this item and explained that this Resolution serves as a token of TMRS' appreciation for Representative Kuempel's assistance over the years and especially during the 81st Legislative Session.

Mr. Simpson moved that the Resolution honoring Representative Edmund Kuempel be adopted. Ms. Nixon seconded the motion, which passed unanimously.

6. Consider and Act on Resolution Honoring Senator Tommy Williams

Mr. Henry introduced this item and explained that this Resolution serves as a token of TMRS' appreciation for Senator Williams' assistance during the 81st Legislative Session.

Ms. Nixon moved that the Resolution honoring Senator Tommy Williams be adopted. Ms. Hernandez seconded the motion, which passed unanimously.

7. Consider and Act on the 2008 External Audit Results and Auditor Report to the Board of Trustees

Susan Warren and Juventino Robledo, both with KPMG, presented the Responsibilities of Management, as well as the results of the Audit. Ms. Warren said that TMRS received an unqualified audit opinion and that no material weaknesses or significant deficiencies were found, and there were no corrected or uncorrected adjustments identified. Ms. Warren reported that market conditions led to unrealized losses on securities lending; however, she stated that most pension systems experienced similar losses this year. There were no other deficiencies noted.

Mr. Simpson asked if the shift from realized income to total return will change the audit function. Ms. Warren replied that from an accounting point of view, the audit already deals with realized and unrealized gains or losses. Mr. Gorzell then asked whether KPMG will conduct additional tests as TMRS moves into new asset classes. Ms. Warren replied yes and that KPMG would work with management on this.

Mr. Rodriguez moved to accept the 2008 External Audit Results and adopt the Auditor Report. Mr. Simpson seconded the motion, which carried unanimously.

8. Consider and Act on 2008 Comprehensive Annual Financial Report

Mr. Henry asked Ms. Covarrubias to walk the Board through the Comprehensive Annual Financial Report (CAFR). Ms. Covarrubias began her presentation by noting that the CAFR will not be printed this year, but will be distributed to cities via CD Rom. The Popular Annual Financial Report (PAFR) will be distributed to members and retirees through the TMRS newsletter as opposed to a separate mailing. Ms. Covarrubias then walked the Board through the different sections of the CAFR. She highlighted the auditors' role in reviewing and auditing the CAFR, the investment consultant's letter, and the Actuary's Certification letter. Mr. Henry noted that TMRS did receive GFOA's Certificate of Achievement for the year ending 12/31/2007.

Mr. Gorzell thanked Ms. Covarrubias and her staff for a very clean audit and CAFR process. Mr. Gorzell moved that the 2008 Comprehensive Annual Financial Report be accepted and approved its distribution. Ms. Nixon seconded the motion, which carried unanimously.

9. Consider and Act on Ad Hoc Updated Service Credit and Annuity Increase Amortization Policy

Mr. Randall and Mr. Stewart (Gabriel, Roeder, Smith and Company) introduced this item. This item was tabled from a previous Board meeting until after the legislative session. This policy is directed at ad hoc adoptions of Updated Service Credit (USC) and Cost of Living Adjustments (COLA). Since these are in theory one-time adoptions, they are not prefunded. The cost is reflected in the city's plan liabilities and is amortized over a 25 or 30 year period. Actuarial Standard Of Practice (ASOP) #4 recommends that these benefits be funded such that the payments going out do not exceed the payments coming in. Thus, they should be funded as a stand-alone arrangement. Mr. Randall showed graphically the current policy versus the recommended policy, which would use 15 year, level dollar amortization.

Mr. Simpson asked about the significance of the cost impact of the policy. His concern was that cities would turn off the repeating features and do regular ad hoc adoptions. Staff replied that we had increased communications to cities explaining the risk of regular ad hoc options and would continue to monitor the situation.

Mr. Randall indicated that GRS is recommending the 15 year, level dollar amortization policy.

Mr. Simpson moved that the Board adopt the 15 year, level dollar amortization policy for future ad hoc benefit enhancements, including USC and annuity increases, beginning with the 12/31/2009 actuarial valuation (2011 rates). Mr. Rodriguez seconded the motion, which carried unanimously.

10. Consider and Act on Closed Plan Amortization Policy

Mr. Randall introduced this policy which had been tabled from a previous Board meeting until after the legislative session. This policy is a significant change for plans that close access to new entrants. ASOP #4 provides the standards for the recommended policy. Mr. Randall also indicated that the recommended policy incorporates GASB requirements for amortizing unfunded liabilities of a closed plan. He showed the decline of active members in a closed plan

and how it impacts the payroll base used to fund benefits. He discussed three methods that could be used to fund the liabilities: (1) level percent; (2) level dollar; and (3) decreasing payroll.

Mr. Randall indicated that GRS recommends the level dollar approach. He said it maintains adequate funding compared to the current policy. He also recommended a standard 20 year period, but giving the Board the flexibility to allow cities to request a longer period. If further review by the actuary suggests a different period is feasible, the Board may set a different period, not to exceed 30 years, subject to annual review by the actuary. Mr. Randall said that GRS is also recommending that any remaining phase-in be eliminated in the event a plan is closed. He added that any future benefit enhancements to a closed plan must be carefully scrutinized.

Ms. Nixon moved that the Closed Plan Amortization Policy be adopted, effective immediately. Ms. Hernandez seconded the motion, which passed unanimously.

At this time, the Board took a short break from 10:50 – 11: 04 a.m.

11. Discuss Reserve Policy and MAF Fund Analysis

Mr. Randall presented this item for information purposes only. He indicated that the goal of the reserve fund is to reduce volatility in city contribution rates. TMRS is unique in that TMRS has guaranteed asset reserve pools, i.e. the Employee Savings Fund (ESF) and the Current Service Annuity Reserve Fund (CSARF). A typical plan does not carve up funds into legally distinct pools, rather it has just one large pool of assets. Because the TMRS Act has created these legally distinct pools, it needs to build a large enough reserve in good times to help protect against negative investment returns in down times. With a reserve, the volatility to the Municipality Accumulation Fund (MAF) can be managed and city rates should come down over time. The appropriate level must be determined: not too high or too low. The goal is to recognize TMRS' unique structure, but keep the standard deviation closer to a typical public sector plan.

Mr. Gorzell asked about the normal smoothing period used by public sector plans. Mr. Randall discussed different smoothing periods and the use of "corridors" around the market value of assets. The corridor is used to keep the Actuarial Value of Assets in line with the market value of assets.

Mr. Randall indicated that what GRS wants to develop is a reserve policy that is flexible enough to allow the Board to set the MAF crediting rate (target 7.5%), and the level of reserves. The size of 2008 investment losses in other plans and the experience that Texas County and District Retirement System experienced with regard to the loss of its own reserves is causing GRS to revise its thinking about a reserve policy. There are a number of alternatives that GRS will be looking at. It's possible that TMRS could go with a smaller reserve if the structure of the asset pools is revised.

Mr. Simpson asked if the reserve could be "immunized" with regard to how it is invested. Mr. Randall responded that there are no public plans that anyone is aware of that immunizes their reserves.

Mr. Randall then discussed TMRS current fund structure versus a typical, co-mingled pension fund. In a typical fund, when a person retires, nothing happens on a “settlement” basis. In TMRS, there is a “settlement;” in other words, money is transferred to the CSARF from the ESF and the MAF. He showed the “settlement’ flows (or cash flows) in TMRS versus a more typical pension plan. These extra cash flows end up costing the System more. If the funds were comingled, they could earn more, thereby requiring less at the time of settlement.

Mr. Bob Scott, City of Carrollton, addressing the Board, discussed the impact the transfer of assets to the CSARF has on the MAF for an individual city.

Mr. Randall discussed that GRS, in conjunction with the staff actuary, has done additional cash flow analysis on each city’s MAF balance. This analysis was both historical and prospective. The results were within expected norms.

12. Discuss Board’s Role in Investment Process

Mr. Henry introduced Nancy Williams with Ennis Knupp + Associates, Inc. Ms. Williams discussed several areas of best practices regarding money manager searches. Ms. Williams discussed the use of an RFP process versus an “open search” process conducted by the investment consultant using its own database of qualified managers. Ms. Williams stated that the open search process currently used by TMRS is used by more Boards than the older RFP process. Ms. Williams stated that most Boards prudently delegate manager search responsibilities to staff and the investment consultant. Staff and the investment consultant should disclose the due diligence procedures and policies used in the search process to the Board. The investment consultant and staff are best positioned to establish the search criteria for searches. Staff should develop interim reporting of the manager search process for the Board. It is not uncommon for some Boards to interview more than one finalist. The investment consultant and staff should affirmatively confirm that the due diligence procedures have been followed and that any exceptions were noted.

At this time, the Board took a lunch break from 12:10 p.m. until 1:00 p.m.

13. Consider and Act on Proposed Revisions to Investment Policy Concerning Asset Allocation

Mr. Kuhns stated that he is proud of the work TMRS and R. V. Kuhns staff have done on this policy. He also stated that although returns to date have been very strong relative to TMRS’ peers, in an ideal planning world, things could not play out any better than they have for TMRS given where the different markets are valued today.

Ms. Goerdel began reviewing the proposed investment policy. She noted differences from previous versions the Board has seen previously. She highlighted the asset allocation and performance benchmarks. She also focused on how investment managers would be selected and how the policy conforms to the governance questions discussed by Ms. Williams previously in this Board meeting.

Mr. Simpson asked if the manager search process would reflect current trends in the investment markets. Ms. Goerdel replied that supplemental questionnaires used in the search process will

enable staff to evaluate those characteristics of particular money managers. Mr. Gorzell requested interim updates during the search process, and also asked that benchmarks for fees and other points be communicated as part of the recommendation. In addition, he asked that a “termination at will” clause be included in all contracts. Ms. Goerdel replied that benchmarks for fees would be included in staff recommendations to the Board. Appropriate terminations clauses and incorporation of the investment policy would be part of the contract. Ms. Goerdel discussed the Investment Manager Retention Policy. Mr. Gorzell asked about this policy and asked about the process for putting managers on a watch list. He also stated that he liked having the positive affirmation that every step of the managers selection policy has been completed.

Mr. Simpson noted his concern on the differences between the benchmark for Municipal Bonds at AA versus a lower rating for corporate bonds of BBB. Staff discussed the difference between these as a separate asset class versus within a core or core plus strategy. Mr. Kuhns suggested having one of their staff members put together a study on this question.

Mr. Rodriguez moved that the Board adopt the proposed TMRS Investment Policy Statement, effective July 1, 2009, with the understanding that more information on bonds will be provided. Ms. Nixon seconded the motion, which carried unanimously.

14. Consider and Act on Interim Asset Allocation

Ms. Goerdel introduced the revised motion regarding the interim asset allocation through 12/31/2010. She stated that at this time the request is just to increase the allocation to equities into non-lending index funds. A separate action will be brought to the Board for the Real Estate & Real Return classes.

Mr. Madsen pointed out that these interim targets are guidelines, not rigid goals. Progress reports will be provided to the Board.

Mr. Rodriguez moved that the Board adopt the following interim asset allocation targets

<u>Asset Class</u>	<u>Current</u>	<u>By 12-31-09</u>	<u>By 12-31-10</u>
Domestic Equities	6%	12%	20%
International Equities	6%	12%	20%
Fixed Income	88%	76%	55%
Real Estate	0%	0%	3%
Real Return	0%	0%	2%

and authorize staff to fund the 12-31-10 interim target allocation through a systematic rebalancing with the increased allocation to equities to be invested in the Northern Trust Global Investments commingled Russell 3000 and EAFE non-lending index funds. Ms. Hernandez seconded the motion, which passed unanimously.

15. Consider and Act on Fixed Income Structure Allocation and Authorization to Conduct Core Plus Fixed Income Investment Manager Search

Ms. Goerdel stated that the goal is to achieve manager diversification as well as investment diversification. Mr. Simpson asked for a brief explanation of core and core plus. Ms. Goerdel said that "core" is defined by investment grade while core plus is a part core and a portion allocated to non-investment grade or international securities.

Mr. Madsen worked through the efficient frontier analysis for this portion of the portfolio. Ms. Goerdel pointed out the Investment Policy Statement Appendix Addendum.

Mr. Simpson moved that the Board (a) adopt a fixed income structure allocation of 87% Active Core and 13% Core Plus; (b) adopt the Core Plus Fixed Income Guidelines as an addendum to the Investment Policy Statement Appendix; and (c) authorize the search for a Core Plus Fixed Income manager for selection at the September 2009 Board of Trustees meeting. Mr. Gorzell seconded the motion, which passed unanimously.

16. Investment Report as of May 31, 2009

Mr. Madsen reiterated that TMRS is in the top 1% and 5% among all public funds for several time periods. He then reported on the May returns. He pointed out that there are a lot of theories out right now on how the recovery is going to proceed. This speaks to the need to continue to dollar cost average into the market going forward. TMRS' fixed income allocation protected TMRS from significant investment losses in 2008, but has been a performance drag in 2009.

In closing, Mr. Kuhns pointed out that on 01/01/09, Mr. Madsen became a principle of R. V. Kuhns.

17. Consider and Act on State Street Contract Renewal

Eric Henry introduced this item and requested that staff be given approval to renew the contract with State Street.

Mr. Rodriguez moved that the Board approve an extension of the Custody and Securities Lending Agreement with State Street Bank & Trust Company for an additional three (3) years with the same fee structure through 12/31/2012 and authorized the Executive Director to negotiate a contract extension satisfactory to the System. Mr. Simpson seconded the motion, which carried unanimously.

18. Discuss Possible Changes to Communication Policy

Ms. Williams pointed out that many other clients do not have communication policies, so she is very pleased to see TMRS take this action. She indicated that the document presented to the Board was for discussion purposes only; it was intended to simply get the Board thinking along these lines. Mr. Simpson stated that he liked the guidelines, but would like to change all references to "must" to "should."

This agenda item will be brought back to the Board for review at the September Board meeting.

19. Consider and Act on Nominations for Advisory Committee Group Class Membership

Mr. Henry introduced this item and explained that Jim Parrish resigned his position on the Advisory Committee due to a change in employment. The Texas Municipal Human Resources Association has nominated Debbie Maynor, Human Resources Director with the City of Killeen as the primary appointee to replace Jim Parrish, and nominates Bonita Hall, Human Resources Director for the City of Cleburne as the alternate.

Ms. Nixon moved that the Board accept the nominations of Debbie Maynor (primary) and Bonita Hall (alternate) to the Advisory Committee on Retirement Matters. Ms. Hernandez seconded the motion. Mr. Rodriguez was not present at the time of the vote, but the motion carried with no opposition.

20. Consider and Act on Amendment to Advisory Committee Charter to Add an Additional Group Class to the Membership

Mr. Henry introduced this item and reported that representatives from the Texas Police Chiefs Association (TPCA) have approached TMRS about serving as a Group Class member on the Advisory Committee. Mr. Simpson stated that he was not in favor of expanding the group at this time. Ms. Hernandez asked if applications are being accepted for the three positions that will come open in December. Mr. Henry answered affirmatively.

No action was taken on this agenda item.

21. Discuss Potential Board of Trustee Meeting Dates and Location for 2010

Mr. Henry briefly introduced this item and mentioned to the Board that this is just for their information in order to get them thinking about possible meeting dates and locations for board meetings in 2010. The dates and locations will be discussed again at the August meeting and finalized at the September meeting.

22. Executive Director and Staff Reports

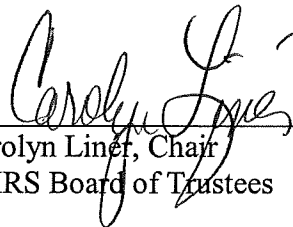
Mr. Henry directed the Board to the Executive Director and Staff Reports and asked if there were any questions. As there were not any, the Board moved on to the next agenda item.

23. Call for Future Agenda Items

As there was no further business, Mr. Gorzell moved to adjourn the meeting. Mr. Simpson seconded the motion, which carried unanimously. The meeting adjourned at 2:34 p.m.



Eric Henry
Executive Director and CIO



Carolyn Liner, Chair
TMRS Board of Trustees