

**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM**  
**BOARD OF TRUSTEES MEETING**  
**JUNE 29, 2012**



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**MINUTES OF THE  
BOARD OF TRUSTEES MEETING  
MARCH 30, 2012**



The Board of Trustees of the Tennessee Consolidated Retirement System met on Friday, March 30, 2012 at 10:05 a.m. The meeting was held in Room 30 of the Legislative Plaza with Chairman David Lillard presiding.

Chairman Lillard asked Ms. Bachus to conduct an attendance roll call. The following members were present: Chairman David Lillard, State Treasurer; Mr. Tre Hargett, Secretary of State; Ms. Jill Bachus, Director of TCRS; Ms. Libby Sykes, Administrative Director of the Courts; Mr. Erick Huth, Mr. Greg Elliott, Mr. Michael Barker, Mr. Al Laney, Mr. Ken Wilber, Mr. Tommie Pendergrass, Ms. Patsy Moore, Mr. Bill Kemp, and Mr. David Seivers.

### **Approval of the November 18, 2011 Minutes of the Board of Trustees**

On a motion by Mr. Elliott and seconded by Mr. Huth, the minutes of the November 18, 2011 TCRS Board of Trustees meeting were unanimously approved.

### **Board of Trustees Committee Report**

Chairman Lillard recognized Mr. Barker to provide the audit committee report. Mr. Barker introduced Mr. Andy Furlong as the new Director of Internal Audit for the Treasury Department. Next Mr. Barker noted the audit committee reviewed the accounting and reporting standards. At the meeting, Ms. Teresa Hensley from the Comptroller's office discussed the June 30, 2012 State audit process and report. In addition, Ms. Suzanne Smotherman gave an update on the Concord project.

Chairman Lillard recognized Ms. Bachus to provide the administrative committee report. Ms. Bachus mentioned Mr. Fred Marshall provided the committee with an update on Concord. Mr. Jamie Wayman provided an update on the GASB Standards. Ms. Bachus updated the administrative committee on the retirement applications being processed and the proposed legislation related to new local government plan options. Ms. Bachus mentioned the cost of living adjustment (COLA) will be 3% effective July 1, 2012.

Chairman Lillard provided the investment committee update. The investment committee approved a proposed acquisition on The Avery on Southwestern, an apartment complex in Dallas, Texas. Chairman Lillard mentioned the investment committee discussed the portfolio and market review. Mr. Pete Keliuotis with Strategic Investment Solutions reviewed the asset-liability study.

### **Investment Report**

Chairman Lillard introduced Mr. Michael Brakebill, Chief Investment Officer, to review the investment report. Mr. Brakebill led the discussion with a personal disclosure of his activities with the Tennessee Valley Authority Retirement System (TVAR) as a paid, non-voting Investment Committee member. Mr. Brakebill reminded the Board that he initially disclosed this relationship to the Board in the fall of 2010 and the disclosure at this meeting was intended to keep the Board apprised on an annual basis. The Treasurer and Assistant Treasurer have reviewed the documents involved with this relationship and have expressed satisfaction that there

are no significant conflicts of interest. Mr. Brakebill discussed how this relationship had significantly improved his investment management knowledge which directly benefits the management of the TCRS pension fund.

Mr. Lamar Villere disclosed that he has been asked to join the Board of Barron Collier Companies which is a privately owned company. Mr. Villere will receive compensation for this position. The Barron Collier Company focuses primarily on real estate within Florida and Arizona. Mr. Villere discussed that the Treasurer and Assistant Treasurer have reviewed the documents involved with this relationship and have expressed satisfaction that there are no significant conflicts of interest. Additionally, Mr. Villere discussed that the time he would spend with this relationship would all be done using his personal time.

Mr. Brakebill then moved to the discussion of investment performance. The one year return as of December 31, 2011 was 5% which is exceptional in comparison with most peer pension plans that have returns in the range of 1% to 3%. Mr. Brakebill discussed the key initiatives from December 2011 and the asset allocation process underway. Next, Mr. Brakebill reviewed the market movements and investment responses since June 2011. Mr. Brakebill noted the significant positive impact the longer duration fixed income portfolio had made on the performance of the fund. Mr. Brakebill introduced, and congratulated, Mr. Pete Keliuotis for his new role at Strategic Investment Solutions, Inc. as their Chief Executive Officer.

Mr. Pete Keliuotis introduced Mr. Rich Dabrowski, Senior Consultant at Strategic Investment Solutions, Inc. Mr. Dabrowski will be working with Mr. Keliuotis and the Investment Division. Mr. Keliuotis began by reviewing the "December 2011 Executive Summary Report." Mr. Keliuotis reviewed the asset allocation and stated that the plan was slightly overweight in fixed income for the year end. TCRS finished the quarter with a return of 5.87% and the year with a return of 5.02%, which was well above the policy index return. The Domestic Equity portfolio for the quarter had a return of 12.51%. Next Mr. Keliuotis reviewed the International Equity portfolio. The portfolio outperformed the EAFE IMI by 0.23% for the quarter ending at 3.09%, but underperformed the median international manager. The portfolio outperformed the index by 1.75% for the year and beat the median manager by 1.31%. The Real Estate portfolio had good absolute performance (14.64%) for the year, and good performance relative to the median fund (12.46%).

Mr. Keliuotis reviewed the "Introduction to 2012 Asset-Liability Modeling (ALM) Study". Mr. Keliuotis provided a background of the process and discussed that the last ALM study was completed by SIS in 2007. The 2007 study led to notable portfolio changes such as an increase in Real Estate from 4% to 7%, a decrease in Fixed Income from 43% to 34%, and the addition of the Private Equity portfolio. Since September 30, 2007, core bond yields have fallen from 5.3% to 2.2%. Mr. Keliuotis reviewed the three inputs that go into a standard asset allocation model. Mr. Keliuotis concluded his remarks with a review of the Strategic Investment Solutions, Capital Market Expectations.

**Other Business**

Chairman Lillard mentioned the local government pension bill continues to move forward this session. An update will be given to the Board at the June meeting.

**Adjournment**

Chairman Lillard announced the completion of the business at hand and asked if there was any other business to come before the Board.

On a motion by Mr. Kemp and seconded by Mr. Barker, the Board unanimously approved the TCRS Board of Trustees meeting be adjourned.

With no other business, the Board of Trustees adjourned at 10:50 a.m. on March 30, 2012.

**Respectfully Submitted,**



**Jill Bachus**  
**Director, TCRS**

**Approved:**

**David H. Lillard, Jr.**  
**Chairman of the Board**



## **COMMITTEE MINUTES**



## **Minutes of the Administrative Committee**

The Administrative Committee of the Board of Trustees of the Tennessee Consolidated Retirement System met on Friday, March 30, 2012 at 9:00 a.m. The meeting was held in Room 29 of the Legislative Plaza with Director Jill Bachus presiding.

The following members were present: Jill Bachus, Director of TCRS, Mr. Bill Kemp, Mr. Alfred Laney, Ms. Patsy Moore, Mr. Tommie Pendergrass and Ms. Libby Sykes.

### **Concord Update**

Ms. Bachus introduced Mr. Fred Marshall, TCRS Assistant Director for Concord, to provide an update on the Concord project. Mr. Marshall informed the committee that the Phase 4 – Imaging, went live as of March 12, 2012. He indicated that the imaging phase contained two components – Library Manager and Work Manager. Library Manager is where all imaged documents are stored and Work Manager provides us with workflow capabilities. Mr. Marshall mentioned that as a result of this implementation, all retirement documents sent or received by TCRS are now imaged which allows employees to look at the items on their computer and work from the image instead of the paper copy. Mr. Marshall indicated that TCRS employees were trained on the use of Library Manager and Work Manager and that the imaging has been well received.

Mr. Marshall indicated that work is continuing on the design of Phase 5 - Retired Payroll, and have started the Gap/Fit sessions for Phase 6 - Active Members and Employer Reporting. According to Mr. Marshall, the purpose of the design documents is to let the developers know how the system should look and work. Mr. Marshall indicated this has been an effort between the TCRS business users, Concord subject matter experts (SME), and Deloitte and North Highland staff. Mr. Marshall mentioned that the design sessions will also help identify changes in responsibilities for TCRS employees as a result of implementing the system and electronic workflows. Mr. Marshall explained that the Gap/Fit sessions are intended to identify differences between how TCRS wants the system to work and how the baseline system provided by Deloitte works. He mentioned if the baseline system works as TCRS desires, the requirement will be marked as a Fit and if the baseline system does not work as TCRS desires, the requirement will be marked as a Gap.

### **FY 2011 Audit & Future Training Sessions**

Ms. Bachus mentioned that the annual financial audit performed by the Division of State Audit has been released and the report did not contain any findings.

Ms. Bachus next discussed possible training topics to be presented after future Board meetings. The topics mentioned by Ms. Bachus included Asset/Liability Study, funded status of the plan, defined contribution versus defined benefit plans, investment strategy, TCRS operations, and the

application process with Concord updates. The members of the Administrative Committee agreed with the suggested topics.

### **GASB Update**

Ms. Bachus introduced Mr. Jamie Wayman, Assistant Director of TCRS to provide an update on proposed accounting pronouncements related to pension plans issued by the Governmental Accounting Standards Board (GASB). Mr. Wayman mentioned that GASB is planning to issue two new accounting statements in the second quarter of 2012. One of the main changes being proposed relates to reporting the pension liability. Mr. Wayman indicated currently an employer does not report a liability on their balance sheet unless the employer has not been making the actuarially required contributions. The proposed standards would require an employer to report the unfunded actuarially accrued liability using the market rate of assets as a liability on its balance sheet. This change would cause the State of Tennessee to report a liability of approximately \$2.5 billion as of the July 1, 2011 actuarial valuation. In addition, Mr. Wayman indicated that since the new standards no longer link the funding of the pension plan with the accounting for the pension plan, employers will display one amount for pension expense on the financial statements and will be required to contribute a different amount based on the actuarial valuation. Mr. Wayman believes this change will cause confusion for employers and users of financial statements because the amount of expense shown will not match the amount the employer was actuarially required to contribute. Mr. Wayman also mentioned there will be increased volatility in the pension expense and pension liability reported by the plan and participating employers. This volatility is due to changes in how different components of the liability and expense are recognized under the new accounting standards.

### **Retirement Application Update**

Mr. Wayman next provided an update on the number of retirement applications TCRS has received. Mr. Wayman mentioned that last year TCRS processed approximately 7,200 retirement applications. So far this year, TCRS has received approximately 6% more retirement applications than at the same time last year. Based on the current volume of applications received, Mr. Wayman indicated that TCRS will process between 7,500 and 7,800 retirement applications this year. In response to a question by the committee, Mr. Wayman mentioned that there was approximately a 4% increase in the number of teacher retirement applications when comparing July 1, 2010 through December 31, 2010 to the same time period in 2011.

### **Local Government Plan Update**

Ms. Bachus informed the committee that the Local Government Plan legislation (Senate Bill 3216/ House Bill 3603) was currently moving its way through the General Assembly. Thus far, the bills have not had any opposition and were expected to be approved by both the House and Senate. Ms. Bachus indicated she would provide an in-depth review of enacted legislation at the next Administrative Committee meeting.

**Adjournment**

With no other business, the Administrative Committee of the Board of Trustees adjourned at 9:55 a.m. on March 30, 2012.

**Respectfully Submitted,**

A handwritten signature in cursive script that reads "James E. Wayman".

**James E. Wayman  
Assistant Director, TCRS**

**Approved:**

**Jill Bachus  
Administrative Committee Chair**



**AUDIT COMMITTEE MEETING MINUTES  
OF TENNESSEE CONSOLIDATED RETIREMENT SYSTEM (TCRS)  
March 30, 2012**

The Audit Committee of the Board of the Tennessee Consolidated Retirement System met on Friday, March 30, 2012, at 8:00 a.m. The meeting was held in Legislative Plaza, Room 30, with Chairman Michael Barker presiding.

The following members were present: Chairman Michael Barker, Mr. Ken Wilbur, Mr. Tre Hargett, Mr. Erick Huth, and Ms. Rebecca Hunter.

Others present were: Mr. David Lillard, Jr., Treasurer; Ms. Janice Cunningham, Chief of Staff; Mr. Andy Furlong, Director of Internal Audit; Ms. Jill Bachus, Director of TCRS; Ms. Kim Morrow, Director of Accounting; Ms. Suzanne Smotherman, Concord Audit Manager; Ms. Stacey Jackson, Internal Auditor; and Teresa Hensley, State Audit Manager.

**Approval of the November 18, 2011 Minutes of the Audit Committee**

Chairman Barker asked if any changes needed to be made to the minutes. No changes to the minutes were noted. Commissioner Hunter motioned to accept the minutes and Mr. Huth seconded the motion. The minutes of the November 18, 2011 Audit Committee meeting were unanimously approved.

**Introduction of Andy Furlong, Director of Internal Audit**

Chairman Barker introduced Mr. Andy Furlong as the new Internal Audit Director for the Treasury Department and informed the committee of Mr. Furlong's biography in the audit committee packet. He was previously employed with the Department of the Comptroller of Treasury in the state audit division and headed the latest TCRS audit.

**Review Significant Accounting and Reporting Standards**

Ms. Morrow explained an accounting standard newly applicable to TCRS. GASB 51 refers to any in-house built software and because of the Concord project, a capital asset is now reflected on the financial statements for the first time. The amount of \$1,897,000 consists of the salaries and benefits paid to Concord staff and costs paid to the vendor. Once the Concord project is fully active, the cost will be depreciated over the life of the asset, which is estimated to be ten years.

Ms. Morrow further explained the financial statements and fielded questions from the committee.

**Review TCRS Audit Report Issued by Comptroller's Office of year ended June 30, 2011**

Mr. Furlong informed the committee that TCRS received an unqualified opinion with no findings.

**Independent Discussion with State Auditors**

All Treasury employees left the room and the committee held a private discussion with Ms. Hensley regarding the TCRS audit.

### **Concord Update**

Ms. Smotherman gave a detailed overview of the Concord project and Internal Audit's role in the development. Internal audit's position is to monitor internal controls within the system, to ensure security protocols are sufficient, and to development a continuous monitoring program. Ms. Smotherman and Ms. Bachus also answered several questions from the committee.

### **Other Business**

Chairman Barker asked Treasurer Lillard to elaborate on the legislation regarding new retirement program options for local governments. The Treasurer stated the bill is now in the Counter Committee in the Senate and will be progressing in the next couple weeks. Only good feedback has been received from the local governments.

Chairman Barker asked about the proposed GASB statement related to pension fund accounting and Treasurer Lillard informed everyone that the GASB has not come to a final decision. As stated in the last two audit committee meetings, several states and pension fund based organizations have written letters to the GASB stating their opinions on the matter. The Treasurer explained that the proposed statement will require pension funds to report the net pension liability in the financial statements and that scenario would have a negative impact on the appearance of the pension plan's financial condition.

### **Adjournment**

Chairman Barker indicated that if there were no additional items, the meeting could be adjourned. Mr. Huth motioned to adjourn the meeting and Secretary Hargett seconded the motion. Chairman Barker thanked the members of the Audit Committee and adjourned the meeting.

**Respectfully Submitted,**



**Andy Furlong,  
Director of Internal Audit**

**Approved:**

**Michael Barker  
Audit Committee Chairman**

**Minutes of the Meeting of the Investment Committee of the TCRS Board of Trustees  
March 30, 2012**

The Investment Committee of the TCRS Board of Trustees ("Investment Committee") met at 9:00 a.m. on March 30, 2012 in Hearing Room 31 of Tennessee Legislative Plaza. Members of the Investment Committee participating were the Honorable David H. Lillard, Jr., State Treasurer; the Honorable Tre Hargett, Secretary of State; Mr. Greg Elliott and Mr. David Seivers. Also in attendance were Mr. Bill Abney, Assistant Treasurer, Mr. Michael Brakebill, Chief Investment Officer, Mr. Andy Palmer, Deputy Chief Investment Officer, Mr. Peter Katseff, Director of Real Estate, Mr. Tim McClure, Director of Cash Management, Mr. Lamar Villere, Director of Private Equity, Mr. Michael Keeler, Director of Equities, and Mr. Matthew Haitas, Real Estate Analyst. Mr. Peter Keliotis and Mr. Rich Dabrowski of Strategic Investment Solutions, as well as Mr. Matthew Haitas, Real Estate Analyst were also present.

Treasurer Lillard chaired the meeting and called the meeting to order. The minutes of the November 18, 2011 and February 15, 2012 meetings were presented for discussion. Secretary Hargett made a motion for approval of the minutes and Mr. Seivers seconded a motion to approve the minutes. The motion was approved by voice vote.

Mr. Katseff was asked to introduce the proposed investment by TCRS in The Avery on Southwestern, an apartment community in Dallas, Texas. The transaction had been proposed by TA Associates, a Real Estate Investment Advisor engaged by TCRS.

Mr. Katseff stated that the primary attribute of the proposed investment was the high end urban finishes, which will appeal to the primary renter demographic, at a relatively low price per unit. In addition, the property is located in a good location surrounded by some of the most prestigious neighborhoods in Dallas, a city whose economy has performed extremely well since the end of the great recession. Mr. Katseff further noted that the property is situated in close proximity to strong retail centers and many large employers. He also stated that the greatest risk to this investment is the impact of new development. However, this risk is mitigated by the price to be paid by TCRS which is estimated to be below the cost to build a comparable property.

Treasurer Hargett made a motion to approve this investment by TCRS. The motion was seconded by Mr. Elliott and unanimously approved.

Mr. Brakebill provided an update to a previous disclosure he had made to the Investment Committee in the fall of 2010. He stated that he has continued to serve on the Investment Committee of the Tennessee Valley Authority Retirement System (TVAR) as a paid, non-voting member and noted that he had found it to be a valuable experience. He thanked the Investment Committee for their continued support in that endeavor. Treasurer Lillard stated his support for Mr. Brakebill's continued presence on the TVAR Committee, but noted that the continuation in this role was at the will of the Treasurer.

Mr. Villere disclosed to the Investment Committee that he was asked to join the Board of Baron Collier Company, a real estate company located in Florida. He noted that it was a compensated position, but all duties surrounding this position would be fulfilled after normal business hours, on weekends, and during vacation time. Treasurer Lillard stated his support for Mr. Villere's role as a board member, but noted that the continuation in this role was at the will of the Treasurer.

Mr. Brakebill provided a review of the portfolio and financial markets. He stated that staff continues to discuss and plan for the implementation of the Key Initiatives, which includes a strategic lending program, investment in emerging market equities and investment in non-core real estate. He stated that TCRS had returned 5% for the 2011 calendar year. He noted that this return placed TCRS in the 96<sup>th</sup> percentile of its peers. Further, he noted that most pension funds had seen a return of between 0% and 3% during the same period. Mr. Brakebill stated that the fiscal year to date return is currently slightly above 6% and the current value of the total portfolio is \$35.3 billion.

A question was asked about the feedback from the legislature about the new initiatives. Treasurer Lillard noted that of the three new initiatives, only strategic lending required legislative approval. He stated that the legislation to authorize this initiative was currently being discussed in committees. The Treasurer further noted that the legislature was willing to implement these new initiatives because they had been given assurances that any new initiatives would be closely monitored. It was also noted that the new real estate initiative did not need legislative approval but the international equities strategy required and received approval from the Council on Pensions and Insurance.

Mr. Pete Keliuotis of Strategic Investment Solutions ("SIS") was asked to provide a review of TCRS's recent performance as well as an introduction to the Asset-Liability study that SIS is currently performing for TCRS. Before doing so, Mr. Keliuotis introduced Mr. Rich Dabrowski, who recently joined SIS. Mr. Keliuotis noted that Mr. Dabrowski, who is based in Chicago, would be heavily involved in servicing the TCRS account. Mr. Dabrowski has 25 years of investment management experience and had worked with Mr. Keliuotis for several years before Mr. Keliuotis joined SIS twelve years ago.

Mr. Keliuotis stated that TCRS asset allocation was close to target at the close of the quarter ending December 31, 2011. Fixed income remains slightly above target, but this allocation will decrease with continued investment in Real Estate and Private Equity. Mr. Keliuotis noted that performance had been strong across all asset classes with fixed income producing particularly strong returns.

Mr. Keliuotis moved on to the introduction of the Asset-Liability study being performed by SIS. He noted that it had last been performed in 2007 and the 2007 study resulted in an allocation of 3% to Private Equity, increasing the allocation to Real Estate from 4% to 7%, and decreasing the allocation to Fixed Income from 43% to 34%. Since the last

study, expected returns have declined, which is best illustrated by the drop in the core bond yields from 5.3% to 2.2% during this period. Therefore, SIS now has a 7.0% expected return for the TCRS portfolio, a decline of 50 basis points from September 2007.

Mr. Keliuotis explained that asset allocation is the single largest driver of long-term performance, highlighting the importance of the asset-liability study. In the study, SIS will attempt to determine the appropriate asset allocation for TCRS that maximizes its returns for a certain level of risk. He noted that the new initiatives discussed by Mr. Brakebill are expected to add an additional 20 basis points to the expected return of the portfolio while adding a small amount of additional risks.

Treasurer Lillard asked Mr. Dabrowski of SIS to introduce himself. Mr. Dabrowski introduced himself and stated that he was excited to work with TCRS.

The members of the Investment Committee had no additional questions and the meeting of the Investment Committee was adjourned.

Respectfully Submitted,



Michael Brakebill  
Chief Investment Officer

APPROVED:

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David H. Lillard, Jr., Chairman  
TCRS Board of Trustees



**Minutes of the Meeting of the Investment Committee of the TCRS Board of Trustees  
May 11, 2012**

The Investment Committee of the TCRS Board of Trustees ("Investment Committee") met at 8:30 a.m. on May 11, 2012 in the office of The Honorable David H. Lillard, Jr., State Treasurer. The Honorable David H. Lillard, Jr., State Treasurer; and Mr. Greg Elliott were present in person. The Honorable Tre Hargett, Secretary of State, and Mr. David Seivers participated in the meeting by telephone. The Honorable Mark Emkes, Commissioner of Finance and Administration was unable to attend the meeting. Also in attendance were Mr. Bill Abney, Assistant Treasurer, Justin Wilson, State Comptroller, Mr. Rick Newton, Mr. Michael Brakebill, Chief Investment Officer, Mr. Andy Palmer, Deputy Chief Investment Officer, Mr. Peter Katseff, Director of Real Estate, and Mr. Matthew Haitas, Real Estate Analyst. Mrs. Sheila Ryan of Cambridge Associates, TCRS's Private Equity Consultant, participated by telephone.

The Treasurer began the meeting by reading the Resolution for a Conference Call Meeting. He noted that the purpose of this meeting is to consider action on several real estate transactions and several private equity transactions. The law allows the Investment Committee to meet by telephone conference call upon a determination by the Committee that the matters to be considered at this meeting require timely action by the body, that physical presence by all members is not possible within the period of time requiring actions and the participation by some members by telephone is, therefore, necessary. If the Committee makes such a determination, any member participating in a meeting by telephone is deemed present in person at the meeting for purposes of quorum requirement and voting.

Due to the importance and need for timely action of the matter to be considered at this meeting, Treasurer Lillard moved that the Committee find that the telephone participation in this meeting by some Committee members is necessary. Mr. Seivers seconded the motion and the motion was unanimously approved by the committee.

Mr. Brakebill was asked to introduce the proposed investment by TCRS in four new private equity funds. He began by presenting the proposed investment in Oaktree Opportunities Fund IX, a \$4 billion distressed debt fund. TCRS has commitments to Oaktree VIII (A&B) and Oaktree PPIP Private Fund. TCRS staff recommended making a \$50 million commitment to this fund. Mr. Brakebill noted that TCRS has been pleased with its partnership with Oaktree and the performance of the investments in its earlier funds. He noted that Oaktree had recently taken itself public, which does create certain additional risks. However, Mr. Brakebill noted that both TCRS and Cambridge Associates, TCRS's private equity consultant, believe this risk is mitigated by the expertise and strength of Oaktree as a general partner. Treasurer Lillard shared similar concerns about the potential conflict of interest between the limited partners of the funds and the shareholders of the publicly traded general partner.

David Seivers made a motion to approve the investment in Oaktree Opportunities Fund IX by TCRS. The motion was seconded by Treasurer Lillard and unanimously approved.

Mr. Brakebill next presented the proposed investment in Khosla Seed B, a \$300 million early stage venture capital fund. TCRS has commitments to Khosla Ventures III and Khosla Ventures IV. TCRS staff recommended making a \$10 million commitment to this fund. Mr. Brakebill stated that TCRS knows the managers of these funds very well and are very comfortable in investing in their new funds. He further noted that while TCRS will target a \$10 million commitment, it is likely that the final commitment will be lower as the demand to invest in this fund is very strong. Secretary Hargett asked if the fund would allocate commitments on a pro-rata basis. Mr. Brakebill stated that TCRS would not be allocated its investment on a pro-rata basis.

Secretary Hargett made a motion to approve the investment in Khosla Seed B by TCRS. The motion was seconded by David Seivers and unanimously approved.

Mr. Brakebill presented the proposed investment in Institutional Venture Partners XIV, a \$1 billion late stage venture capital fund. TCRS staff recommended making a \$25 million commitment to this fund. Mr. Brakebill stated that this fund invests in companies that are still unprofitable but growing rapidly. Many of these companies are internet companies that are currently attracting significant attention from the media. Treasurer Lillard raised concerns about the rising valuations in this sector and asked how TCRS would remain comfortable that its general partner is keeping its discipline. Sheila Ryan of Cambridge Associates agreed that valuations in this space may be getting stretched. She noted that Institutional Venture Partners has demonstrated discipline by avoiding investments in companies valued over \$1 billion, which are the companies that are most at risk of overvaluation. Institutional Venture Partners tends to focus on companies valued in the range of \$300 to \$500 million.

David Seivers made a motion to approve this investment in Institutional Venture Partners XIV by TCRS. The motion was seconded by Secretary Hargett and unanimously approved.

Mr. Brakebill presented the proposed investment in Advent Global Private Equity Fund VII, a \$9 billion diversified global buyout fund. TCRS staff recommended making a \$100 million commitment to this fund. Mr. Brakebill noted that this investment was critical to increasing diversification in the private equity portfolio by adding additional exposure to buyout strategies. Further, this fund would increase the international exposure in the portfolio. He further noted that the commitment was larger than most commitments because the value of the fund is much larger than typical funds. Treasurer Lillard asked if a moderate amount of leverage would be implemented by the fund. Shelia Ryan of Cambridge Associates stated that Advent Partners does use leverage to gain access to cheap financing; however, it focuses on creating value through operational improvements and not through high levels of leverage.

Treasurer Lillard made a motion to approve the investment in Advent Global Private Equity Fund VII by TCRS. The motion was seconded by Secretary Hargett and unanimously approved.

Before moving the meeting to discussions of the proposed real estate transactions, Comptroller Wilson asked about the role of private equity in the overall TCRS portfolio considering several large institutional funds experienced trouble in meeting cash

obligations to private equity during the recent financial crises. Treasurer Lillard noted that the private equity target was recently increased to a maximum allocation of 10% with a target of 8%. However, strategic lending will consist of 5% leaving a 3% allocation to traditional private equity. Mr. Brakebill added that the majority of funds who experienced liquidity crunches were significantly less liquid than TCRS is today. Those funds would have had 15% to 30% allocation to private equity in addition to larger annual required distributions. Sheila Ryan added that Cambridge Associates works closely with TCRS to analyze the effects on commitments from different economic scenarios.

Peter Katseff was asked to introduce the three proposed real estate investments by TCRS. He began by introducing the proposed investment by TCRS in an Apartment Community in Houston, Texas built in 2007. The transaction had been proposed by UBS, a Real Estate Investment Advisor engaged by TCRS. The proposed investment has been reviewed and approved by Mr. Katseff.

Mr. Katseff and Mr. Haitas visited the property and the competition. Mr. Katseff noted that the property is located in an excellent location surrounded by some of the most prestigious neighborhoods in Houston, a city whose economy has performed extremely well since the end of the great recession. It is located near several large employers and within walking distance to strong national retailers. While construction of new apartments is a potential long-term threat to this property, that risk is mitigated by the purchase price being significantly less than the estimated cost to build new apartments in a comparable location.

David Seivers made a motion to approve the investment by TCRS. The motion was seconded by Secretary Hargett and unanimously approved.

Mr. Katseff introduced the proposed investment by TCRS in two Student Housing Communities. The transaction has been proposed by Clarion, a Real Estate Investment Advisor engaged by TCRS. The proposed investment has been reviewed and approved by Mr. Katseff.

Mr. Katseff and Mr. Haitas visited both properties, met with the operator and performed a significant level of due diligence with the operator. Mr. Katseff noted that this was a new type of investment for TCRS. However, he noted that several large institutional investors are investing in this space including the University of California, CalPERS, CalSTRS, and the State of Wisconsin Investment Board (SWIB). Mr. Katseff has a long standing relationship with senior management at Heitman and reached out to the firm to discuss investing in student housing. Heitman, a separate account real estate advisor to institutional investors with over \$21.9 billion in private real estate under management, has been investing in student housing for its institutional clients since 2002 with great success. Further, there are two publicly traded REITS with a market cap in excess of \$1 Billion dedicated solely to the investment in private student housing.

Mr. Katseff stated that one community is under construction and being built with high end finishes including granite countertops and stainless steel appliances. The community will offer several amenities including a fitness room, a resort style pool, a

tanning salon and public study rooms. The location allows students to walk to campus and a popular retail strip.

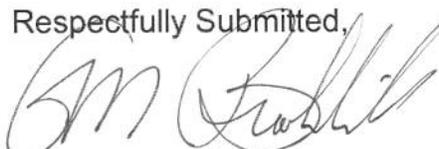
The other community was built in 2005 and is located one mile from nearest section of the campus and two miles from the main downtown campus. Shuttle buses provide transportation for students to and from campus. As part of this investment, TCRS plans to renovate some of the units to provide an additional return through increased rents and to better position the property to compete with new communities.

Mr. Katseff noted that TCRS would be utilizing a specialized third-party property manager focused on student housing as the property manager of both these properties. This manager is one of the largest student housing companies in the country. TCRS has developed a relationship with high level executives at the company and is confident that they are highly competent operators of this product. Mr. Katseff noted that despite the confidence TCRS has in this manager, there are other companies that specialize in student housing who could replace this manager should it ever be necessary.

Greg Elliott asked about the planned renovations and the likelihood of achieving the projected returns on those plans. Mr. Katseff stated that the renovation was based on the strategy of providing a similar quality unit at a lower price point to new communities that are leasing at higher rents. He also noted that the renovation plan was still under review and could easily be scaled back if necessary. Further, he noted that TCRS would be relying heavily on the specialized manager's experience to deliver the appropriate level of upgrades to the units.

Treasurer Lillard made a motion to approve this investment by TCRS. The motion was seconded by Greg Elliott and unanimously approved.

The members of the Investment Committee had no additional questions and the meeting of the Investment Committee was adjourned.

Respectfully Submitted,  
  
Michael Brakebill  
Chief Investment Officer

APPROVED:

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David H. Lillard, Jr., Chairman  
TCRS Board of Trustees

## **2012 LEGISLATION HIGHLIGHTS**



## 2012 Legislation Highlights

### **SB 3216/HB 3603 (Public Chapter 939) – New Local Government Plan Options**

This bill adds two new plan options for local governments and modifies the existing TCRS plan provision.

- Plan 1 – In general, the original TCRS plan remains the same. However, a local government has an additional choice of a 2.5% employee contribution and an option for a local government to reserve the right to freeze or make changes to the plan for new hires in the future.
- Plan 2 provides a reduced benefit formula (1.4%) with higher retirement eligibility (age 65 or Rule of 90 - combination of age and service equaling 90).
- Plan 3 is a hybrid plan offering a low benefit formula (1.0%) and higher retirement eligibility, but requires the local government to additionally offer a defined contribution (DC) plan. The local government can utilize the state's DC plan or utilize a 3<sup>rd</sup> party DC plan to satisfy the requirement.

New features applicable to plans 1, 2, and 3 include an additional 2.5% employee contribution option and an option for a local government to reserve the right to freeze or make changes to the plan for new hires in the future.

These plans are optional to local governments and are intended to give local governments lower cost pension options through increased retirement eligibility, lower accrual factor, and/or employee contributions. The changes will only affect employees hired after the effective date of the local government resolution. State employees, higher education employees, and teachers are not impacted by these plan changes.

### **SB 3262/HB 3601 (PC 941) – Private Equity Investments**

This bill modified the current law to expand private equity investments to include strategic lending and other fixed income instruments. The authority for the new investments will expire on December 31, 2017. In addition the bill increased the maximum investment in private equity from 5% to 10% of the market value of the total TCRS assets.



## **STATISTICAL REPORTS**



## ANALYSIS OF MEMBERS ACTIVELY CONTRIBUTING

	6/30/2008	6/30/2009	6/30/2010	6/30/2011	9/30/2011	12/31/2011	3/31/2012
<b>Group I Members:</b>							
(State & Higher Ed.)	62,987	58,940	58,601	57,592	56,536	56,656	56,466
Teachers	76,926	78,550	78,593	79,583	78,940	78,865	78,814
General Employees of Polisubs	80,079	80,376	81,601	81,751	80,239	80,167	80,761
General Assembly	124	122	126	127	128	129	129
County Officials	3	3	3	2	2	2	2
PSC							
County Judges	1	1	1	1	1	1	1
Attorneys General	634	635	639	635	640	644	644
<b>Total Group I</b>	<b>220,936</b>	<b>218,809</b>	<b>219,564</b>	<b>219,691</b>	<b>216,486</b>	<b>216,464</b>	<b>216,817</b>
<b>Group II &amp; Prior Class:</b>							
Wildlife Officers	10	9	6	3	3	2	2
Highway Patrol	25	11	8	6	3	3	3
Firemen & Policemen- Political Subdivisions	45	36	34	21	18	17	17
<b>Total Group II &amp; Prior Class</b>	<b>80</b>	<b>56</b>	<b>48</b>	<b>30</b>	<b>24</b>	<b>22</b>	<b>22</b>
<b>Group III and Prior Class:</b>							
State Judges	2	2	2	2	2	2	2
County Judges	-	-					
Attorneys General	5	6	5	5	5	5	5
County Officials	12	10	9	5	5	5	5
<b>Total Group III &amp; Prior Class</b>	<b>19</b>	<b>18</b>	<b>16</b>	<b>12</b>	<b>12</b>	<b>12</b>	<b>12</b>
<b>Group IV</b>							
State Judges	182	182	182	181	182	181	181
<b>Total Membership</b>							
<b>Contributing to TCRS</b>	<b>221,035</b>	<b>218,883</b>	<b>219,810</b>	<b>219,914</b>	<b>216,704</b>	<b>216,679</b>	<b>217,032</b>
Teachers Contributing to ORP	11,501	11,388	11,506	11,562	11,575	11,570	11,601
<b>Grand Totals</b>	<b>232,536</b>	<b>230,271</b>	<b>231,316</b>	<b>231,476</b>	<b>228,279</b>	<b>228,249</b>	<b>228,633</b>

**RETIRED PAYROLL  
STATISTICS  
March 31, 2012**

	<u>AMOUNT</u>	<u># OF RETIREES</u>
STATE EMPLOYEES	43,275,016.30	39540
STATE PAID JUDGES	825,761.15	164
COUNTY PAID JUDGES	366,529.62	120
ATTORNEY GENERALS	779,658.22	288
COUNTY OFFICIALS	410,093.30	235
PUBLIC SERVICE COMMISSIONERS	8,325.18	5
POLITICAL SUBDIVISIONS	21,377,351.57	32955
TEACHERS	76,173,432.29	41008
LOCAL TEACHERS	3,655,546.70	2178
GOVERNORS AND WIDOWS	28,830.00	5
AGED STATE EMPLOYEES	129.26	1
AGED TEACHERS	<u>2,878.51</u>	<u>22</u>
<b>TOTAL</b>	<b>\$146,903,552.10</b>	<b>116,521</b>

**RETIRED PAYROLL**  
**July 1, 2011**  
**THROUGH**  
**March 31, 2012**

	<u>AMOUNT</u>	<u># OF RETIREES</u>
STATE EMPLOYEES	385,144,526.18	39540
STATE PAID JUDGES	7,534,202.79	164
COUNTY PAID JUDGES	3,350,548.70	120
ATTORNEY GENERALS	6,985,551.06	288
COUNTY OFFICIALS	3,775,006.40	235
PUBLIC SERVICE COMMISSIONERS	74,926.62	5
POLITICAL SUBDIVISIONS	189,208,192.46	32955
TEACHERS	688,174,661.81	41008
LOCAL TEACHERS	33,517,816.27	2178
GOVERNORS AND WIDOWS	259,485.03	5
AGED STATE EMPLOYEES	1,166.34	1
AGED TEACHERS	<u>27,935.41</u>	<u>22</u>
<b>TOTAL</b>	<b>\$1,318,054,019.07</b>	<b>116,521</b>

**NOTE: NINETY-FIVE PERCENT (95%) OF THE RETIREES ARE ON DIRECT DEPOSIT.**

## NUMBER OF MEMBERS REFUNDED

<u>Month</u>	<u>2005-06</u>	<u>2006-07</u>	<u>2007-08</u>	<u>2008-09</u>	<u>2009-10</u>	<u>2010-11</u>	<u>2011-12</u>
July	829	507	1,149	450	894	499	496
August	544	481	675	308	612	406	466
September	515	546	566	316	494	431	447
October	424	454	609	411	369	379	383
November	316	440	492	353	320	293	364
December	320	318	234	257	256	276	257
January	305	408	450	332	257	307	348
February	389	333	308	310	242	265	312
March	329	342	316	291	278	299	231
April	823	365	308	311	687	277	
May	694	323	619	217	385	662	
June	428	313	843	340	360	406	
TOTAL	<u>5,916</u>	<u>4,830</u>	<u>6,569</u>	<u>3,896</u>	<u>5,154</u>	<u>4,500</u>	<u>3,304</u>

**REFUND EXPENDITURES  
2011-12 FISCAL YEAR**

<b>MONTH</b>	<b>MEMBER'S CONTRIBUTIONS</b>	<b>414(H) CONTRIBUTIONS</b>	<b>MEMBER'S INTEREST</b>	<b>EMPLOYER CONTRIBUTIONS</b>	<b>DEATH PAYMENTS</b>	<b>TOTAL</b>
July	200,835.21	2,533,305.90	764,576.14	91,237.94	223,114.97	\$3,813,070.16
August	122,857.54	2,965,717.47	887,671.53	69,132.41	592,205.39	\$4,637,584.34
September	98,169.01	2,717,030.83	740,314.59	15,574.01	356,481.85	\$3,927,570.29
October	60,190.24	2,650,819.23	972,726.16	164,521.62	758,624.20	\$4,606,881.45
November	62,236.58	1,886,049.31	614,070.78	61,549.03	164,580.09	\$2,788,485.79
December	65,069.32	1,514,728.33	686,845.76	168,963.26	598,590.57	\$3,034,197.24
January	96,160.54	2,119,064.92	715,730.27	88,530.92	277,140.17	\$3,296,626.82
February	73,932.42	1,940,322.67	721,120.95	53,169.81	446,289.58	\$3,234,835.43
March	67,618.17	1,611,407.03	730,301.07	158,896.14	649,032.01	\$3,217,254.42
April						
May						
June						
<b>TOTAL</b>	<b>847,069.03</b>	<b>19,938,445.69</b>	<b>6,833,357.25</b>	<b>871,575.14</b>	<b>4,066,058.83</b>	<b>\$32,556,505.94</b>

**PRIOR SERVICE ACTIVITY**  
**January 1, 2012 through March 31, 2012**

<b>State:</b>	<u>Type of Service</u>	<u>No of Members</u>	<u>Years of Service</u>	<u>Amount</u>
	Backpayment	26	36	\$ 86,837
	Military	32	63	9,038
	Redeposit	9	35	105,308
	Totals	67	134	\$ 201,183

<b>Teachers:</b>	<u>Type of Service</u>	<u>No of Members</u>	<u>Years of Service</u>	<u>Amount</u>
	Backpayment	10	2	\$ 121,140
	Military	8	17	-
	Redeposit	21	89	294,507
	Totals	39	108	\$ 415,647

<b>Higher Education:</b>	<u>Type of Service</u>	<u>No of Members</u>	<u>Years of Service</u>	<u>Amount</u>
	Backpayment	44	32	\$ 19,426
	Military	6	13	-
	Redeposit	2	12	24,675
	Totals	52	57	\$ 44,101

<b>Political Subdivisions:</b>	<u>Type of Service</u>	<u>No of Members</u>	<u>Years of Service</u>	<u>Amount</u>
	Backpayment	224	226	\$ 97,513
	Military	29	64	-
	Redeposit	6	20	49,577
	Totals	259	310	\$ 147,090

<b>Grand Totals:</b>	<u>Type of Service</u>	<u>No of Members</u>	<u>Years of Service</u>	<u>Amount</u>
	Backpayment	304	296	\$ 324,915
	Military	75	157	9,038
	Redeposit	38	156	474,068
	Totals	417	609	\$ 808,021

## **DISABILITY RETIREMENT REPORT**



## Disability Statistical Report

### Third Quarter 11-12

Disability Applications Received	January	29
	February	35
	March	<u>29</u>
	TOTAL	93
Initial Claims Approved	January	18
	February	33
	March	<u>16</u>
	TOTAL	67
Initial Claims Disapproved	January	08
	February	08
	March	<u>06</u>
	TOTAL	22
Initial Claims Approved after Reconsideration		10
Initial Claims Disapproved after Reconsideration		09
Re-Evaluation Claims Approved		59
Re-Evaluation claims Disapproved		0



**APPROVED FOR DISABILITY  
THIRD QUARTER  
2011-2012**

Type	Re-E	Re-C	Age	Employer	Position	Svc	AFC	Opt.	Mo. Ben.	Disability Summary
ORD.	YES	NO	48	POL SUB	TEACHER'S ASSISTANT	14	\$13,967	A	\$330	DJD BILATERAL KNEES, S/P MULTIPLE SURGERIES, CTS
ORD.	NO	NO	58	POL SUB	BUS DRIVER	11	\$24,800	A	\$381	RA W/JOINT PAIN, DECREASED ROM
ORD.	NO	NO	59	POL SUB	PROGRAM ASSISTANT	21	\$30,612	A	\$774	LEGALLY BLIND
SS-ORD.	NO	NO	54	POL SUB	JANITOR	15	\$21,677	B	\$445	CLUB FOOT W/ULCERATION, CHARCOT-MARIE TOOTH W/ANKLE EQUINUS
SS-ORD.	NO	NO	53	TEACHER	TEACHER	15	\$43,546	A	\$1,029	BIPOLAR D/O, MS
SS-ORD.	NO	NO	57	POL SUB	FIRE CAPTAIN	8	\$28,425	A	\$400	CAD, COPD, EMPHYSEMA, NOCTURNAL RA HYPOXEMIA, GLOBAL HA'S
SS-ORD.	NO	YES	57	POL SUB	LAB TECH	11	\$39,595	B	\$559	MEMORY LOSS, DEMENTIA, RENAL INSUFFICIENCY, SEIZURE D/O
SS-ORD.	YES	NO	48	POL SUB	POLICE SERGEANT	17	\$56,140	A	\$1,326	DM, RENAL FAILURE
SS-ORD.	NO	NO	52	POL SUB	MAINTENANCE	14	\$35,582	A	\$841	CAD, CTS, DDD, RA
ORD.	NO	NO	55	STATE	CORRECTIONAL OFFICER	27	\$37,564	A	\$1,217	CARDIOMYOPATHY, HTN, DM, OBESITY
ORD.	NO	NO	55	STATE	LABORER	6	\$24,451	A	\$318	S/P CVA, SEVERE PVD, CAROTID STENOSIS, MODERATELY SEVERE COPD
ORD.	YES	YES	46	STATE	PSYCH TECH	12	\$22,917	A	\$293	NECK AND BACK PAIN
SS-ORD.	YES	NO	45	POL SUB	DIETARY CLERK	14	\$27,447	A	\$648	PARANOID SCHIZOPHRENIA
ORD.	YES	NO	42	STATE	ELECTRICIAN	6	\$34,716	A	\$820	MULTIPLE FRACTURES, S/P ORIF, SPLEEN LACERATION, OBESITY, DECREASED ROM
SS-ORD.	NO	NO	60	POL SUB	LPN	6	\$38,880	A	\$510	S/P CVA, PSYCHOSIS, DM, HTN

**APPROVED FOR DISABILITY  
THIRD QUARTER  
2011-2012**

Type	Re-E	Re-C	Age	Employer	Position	Svc	AFC	Opt.	Mo. Ben.	Disability Summary
ORD.	NO	NO	58	POL SUB	CUSTODIAN	7	\$24,294	A	\$287	CAD
ORD.	NO	NO	54	STATE	CUSTODIAN	12	\$24,029	A	\$525	RA, RENAL FAILURE, DM, HTN, OBESITY
ORD.	YES	NO	50	POL SUB	MAINTENANCE	6	\$25,547	A	\$475	S/P MULTIPLE NECK AND BACK SURGERIES
ORD.	YES	NO	39	POL SUB	DEPUTY	7	\$31,160	A	\$736	BI-POLAR D/O, MIGRAINE HA'S
ORD.	YES	NO	51	STATE	PROCESSING OPERATOR III	16	\$22,584	A	\$534	SEVERE DEPRESSION, BI-POLAR D/O
ORD.	YES	YES	49	STATE	PROGRAM MANAGER	25	\$46,840	A	\$1,383	FIBROMYALGIA, S/P CERVICAL FUSION, DEPRESSION
SS-ORD.	NO	NO	58	STATE	ELIGIBILITY COUNSELOR	12	\$34,926	A	\$584	PERIPHERAL NEUROPATHY, CHARCOT-MARIE TOOTH DISEASE, MEMORY LOSS
ORD.	NO	NO	56	POL SUB	TEACHER'S ASSISTANT	14	\$17,367	A	\$385	DEPRESSION, SLEEP APNEA, BACK PAIN, S/P ROTATOR CUFF SURGERY
SS-ORD.	NO	NO	53	POL SUB	BUS DRIVER	13	\$13,527	A	\$320	CHRONIC RESPIRATORY FAILURE, EMPHYSEMA, HTN, DYSLIPIDEMIA
ORD.	YES	NO	49	POL SUB	TRUCK DRIVER	24	\$35,306	A	\$1,032	L-SHOULDER ADHESIVE CAPSALITIS, SEVERE DDD, PULMONARY EMPHASEMA
SS-ORD.	YES	YES	44	TEACHER	TEACHER	14	\$34,085	D	\$731	DEPRESSION, L-SPINE DDD, INTERSTITIAL CYSTITIS, FIBROMYALGIA, CHRONIC PAIN
ORD.	YES	NO	34	TEACHER	TEACHER	5	\$40,433	A	\$955	S/P CVA, DVT, CARDIOMYOPATHY
ACC.	NO	YES	59	STATE	CORRECTIONAL OFFICER	19	\$32,747	A	\$842	KNEE INJURY, OA, OBESITY
ORD.	NO	NO	58	POL SUB	HVY EQUIP OPERATOR	11	\$32,975	A	\$523	COPD, ENCEPHALOPATHY, HTN
ORD.	NO	NO	58	TEACHER	TEACHER	23	\$45,094	A	\$1,274	BILATERAL PROFOUND SENSORINEURAL HEARING LOSS

**APPROVED FOR DISABILITY  
THIRD QUARTER  
2011-2012**

Type	Re-E	Re-C	Age	Employer	Position	Svc	AFC	Opt.	Mo. Ben.	Disability Summary
ORD.	NO	NO	58	STATE	LAB AID	28	\$22,289	D	\$641	STAGE IV CANCER OF THE NASOPHARYNX
ORD.	NO	NO	55	POL SUB	ADMINISTRATIVE ASSISTANT	28	\$26,954	D	\$768	S/P CVA
SS-ORD.	YES	NO	49	STATE	LABORER	16	\$19,847	A	\$469	MS
ACC.	YES	YES	44	STATE	DEV TECH	22	\$33,915	A	\$905	OJA, S/P SPINAL FUSION W/CONTINUED PAIN
ORD.	YES	NO	36	STATE	MANAGED CARE SPECIALIST	11	\$36,537	B	\$840	BI-POLAR D/O, OBESITY
SS-ORD.	NO	NO	56	POL SUB	STS-TECH	11	\$47,001	A	\$856	PERICARDIAL EFFUSION, S/P PERICARDIAL WINDOW, MILD CAD, HTN
SS-ORD.	NO	NO	54	STATE	FOOD SERVICE	9	\$23,614	A	\$421	PANCREATIC CANCER, DM, HIV, HTN, HEART DISEASE
SS-ORD.	NO	NO	55	TEACHER	TEACHER	13	\$36,524	A	\$823	CVA
SS-ORD.	NO	NO	53	TEACHER	TEACHER	24	\$50,550	A	\$1,468	S/P CVA W/MUSCLE WEAKNESS
SS-ORD.	NO	NO	52	TEACHER	TEACHER	29	\$56,749	B	\$1,856	PANCREATIC CANCER
INACT.	NO	NO	51	STATE	MAINTENANCE	11	\$22,008	B	\$144	BI-POLAR D/O, PANIC D/O, PTSD
ORD.	YES	YES	47	POL SUB	PUBLIC SAFETY OFFICER	16	\$38,281	C	\$846	BACK INJURY
ACC.	YES	NO	48	STATE	RN	13	\$37,893	B	\$1,493	CERVICAL SPONDYLOSIS, CARPAL TUNNEL SYNDROME
ORD.	NO	NO	57	STATE	CORRECTIONAL OFFICER	25	\$45,926	A	\$1,383	DM, HTN, CHF
SS-ORD.	NO	YES	57	POL SUB	CORRECTIONAL OFFICER	7	\$37,190	A	\$439	S/P EPIDURAL ABCESSSES, I&D TRAPEZIUS

**APPROVED FOR DISABILITY  
THIRD QUARTER  
2011-2012**

Type	Re-E	Re-C	Age	Employer	Position	Svc	AFC	Opt.	Mo. Ben.	Disability Summary
SS-ORD.	NO	NO	57	STATE	DEV TECH	9	\$24,106	A	\$363	COPD, RA, LUPUS
INACT.	NO	NO	40	STATE	DISTRICT ATTORNEY	9	\$57,326	D	\$108	MULTI-VISCERAL TRANSPLANT
SS-ORD.	NO	NO	56	POL SUB	EMT	16	\$44,256	B	\$928	ALS
SS-ORD.	NO	NO	59	STATE	EXAMINER	13	\$24,870	A	\$446	CHF, ATRIAL FIBRILATION
ORD.	NO	NO	53	TEACHER	TEACHER	8	\$43,492	B	\$702	CIRRHOSIS, ESOPHAGEAL VARICES, HEMOCHROMATOSIS
ORD.	NO	YES	53	STATE	CARDIOVASCULAR TECH	24	\$48,647	A	\$1,398	DM, HEART DISEASE, S/P MI
ORD.	NO	NO	54	STATE	REGIONAL MONITOR	8	\$48,256	B	\$672	ISCHEMIC CARDIOMYOPATHY
ORD.	NO	NO	53	POL SUB	TEACHER'S ASSISTANT	15	\$14,394	A	\$324	OBESITY, BILATERAL FOOT PAIN
ORD.	NO	NO	53	POL SUB	FOREMAN	11	\$35,106	A	\$791	MORBID OBESITY, DM, SLEEP APNEA, CHF, CROHN'S DISEASE
ORD.	YES	NO	49	STATE	ELIGIBILITY COUNSELOR II	13	\$32,605	A	\$770	S/P BREAST CA W/BILATERAL MASTECTOMIES, CHEMO INDUCED NEUROPATHY
ORD.	NO	NO	51	POL SUB	MAINTENANCE MANAGER	6	\$28,772	A	\$513	PSORIATIC ARTHRITIS, COPD, PULMONARY HTN, OBESITY, CARDIOMEGALY
ORD.	YES	NO	48	STATE	CUSTODIAN	22	\$21,921	A	\$589	S/P CVA, R-SIDED HEMIPARESIS
SS-ORD.	NO	NO	58	POL SUB	FIELD TECH	13	\$35,198	B	\$558	GOUT, POLYARTHRALGIAS, OA
ORD.	NO	NO	56	TEACHER	TEACHER	29	\$46,817	A	\$1,553	METASTATIC DUODENAL CANCER
ORD.	NO	NO	56	POL SUB	INTERPRETER FOR DEAF	22	\$24,367	A	\$643	RA, COPD, ASTHMA



**DISAPPROVED FOR DISABILITY  
THIRD QUARTER  
2011-2012**

Type	Re-C	Age	Employer	Position	SVC	Disability Summary	Reason Denied
ORD.	YES	58	TEACHER	TEACHER	16	MENIERE'S DISEASE, DM II W/NEUROPATHY, HTN, OA, AND LOW BACK PAIN	CAP OF LGT WRA
ORD.	YES	59	TEACHER	TEACHER	9	MYESTHENIA GRAVIS, DIPLOPIA, TREMORS, FATIGUE, MUSCLE WEAKNESS	INSUFFICIENT MEDICAL RECORDS
ORD.	YES	48	STATE	CHILD SUPPORT SPECIALIST	10	SMALL CELL LYMPHOCYTIC LYMPHOMA, CHRONIC LEUKEMIA, DEPRESSION	RELEASED TO RETURN TO WORK
ORD.	YES	45	TEACHER	TEACHER	15	SYSTEMIC LUPUS ERYTHEMATOSUS, DM, CHRONIC MIGRAINE HA'S	CAP OF SED TO LGT WRA
ORD.	NO	51	STATE	CUSTODIAL SUPERVISOR	25	ANXIETY, DEPRESSION, RECURRENT OTIS MEDIA-HEARING LOSS	CAP LGT WRA
ORD.	YES	40	STATE	CASE MANAGER	15	SINUSITIS, CHRONIC FATIGUE SYNDROME, FIBROMYALGIA, OSA, ASTHMA, MIGRAINE HA'S	CAP OF SED TO LGT WRA
ORD.	YES	40	STATE	CASE MANAGER IV	15	SINUSITIS, CHRONIC FATIGUE SYNDROME, FIBROMYALGIA, OSA, ASTHMA, MIGRAINE HA'S	CAP SED TO LGT WRA
ORD.	NO	44	TEACHER	TEACHER	14	DEPRESSION, L-SPINE DDD, INTERSTITIAL CYSTITIS, FIBROMYALGIA, CHRONIC PAIN	CAP SED TO MED WRA/INSUFFICIENT MEDICAL RECORDS
ORD.	NO	58	TEACHER	TEACHER	13	RA, OA	CAP SED WRA
ACC.	NO	40	POL SUB	FIRE FIGHTER	19	MAJOR DEPRESSION, CHRONIC NECK AND BACK STRAIN	CAP SED WRA
ACC.	YES	48	STATE	HWY MAINT WKR	7	S/P REPAIR TORN MENISCUS, TRIGEMINAL NEURALGIA	RELEASED TO SED WRA
ORD.	NO	58	POL SUB	HEAD COOK	18	GENERAL ANXIETY D/O AND DEPRESSION	INSUFFICIENT MED RECORDS/CAP SED WRA

**DISAPPROVED FOR DISABILITY  
THIRD QUARTER  
2011-2012**

Type	Re-C	Age	Employer	Position	SVC	Disability Summary	Reason Denied
ORD.	NO	57	POL SUB	CORRECTIONAL OFFICER II	7	S/P EPIDURAL ABCESES, I&D TRAPEZIUS	CAP SED WRK. FULL RECOVERY EXPECTED < 12 MONTHS
ORD.	YES	50	POL SUB	TEACHING ASST	18	FIBROMYALGIA, OBESITY, DEPRESSION, GERD, IBS	MBR'S DOCTOR RECOMMENDS SED WRA
ORD.	YES	50	POL SUB	TEACHING ASST	18	FIBROMYALGIA, OBESITY, DEPRESSION, GERD, IBS	MBR'S DOCTOR RECOMMENDS SED WRA
ORD.	NO	46	STATE	P & P OFFICER	5	S/P BILATERAL HIP REPLACEMENT, SPINAL STENOSIS, CHRONIC ANEMIA	INCOMPLETE MEDICAL RECORDS
ORD.	NO	50	STATE	HWY MAINT WKR	9	NECK AND LOWER BACK PAIN	INCONCLUSIVE TEST RESULTS
ORD.	NO	53	STATE	CLERK	25	CHRONIC BACK PAIN, SPONDYLOSIS, MILD COGNITIVE IMPAIRMENT	INCOMPLETE MEDICAL RECORDS
ORD.	YES	35	TEACHER	TEACHER	6	SPASMOTIC DYSPHONIA	CAP OF OTHER WORK
ORD.	NO	48	TEACHER	TEACHER	10	FIBROMYALGIA, CHRONIC PAIN, DDD, MIGRAINE HAS, DEPRESSION	CAP OF SED TO LGT WORK
ACC.	NO	55	STATE	SERGEANT	17	L-SHOULDER ROTATOR CUFF REPAIR, T11 DISC HERNIATION W/PAIN, AND OBESITY	CAP SED TO MED WRA
ORD.	NO	49	STATE	COMPUTER LAB TECH	10	NIDDM W/DIABETIC NEUROPATHY AND ULCERS OF BLE'S	CAP SED WRA



## **FINANCIAL STATEMENTS**



**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM**  
**STATEMENT OF PLAN NET ASSETS**  
**AS OF MARCH 31, 2012**

ASSETS

Cash and cash equivalents	\$738,802,861.84
<hr/>	
Receivables	
Member receivable	628,705.53
Employer receivable	620,818.32
Accrued interest receivable	92,079,627.07
Accrued dividends receivable	61,874,268.42
Real estate income receivable	833,403.26
Investments sold	630,653,660.08
<hr/>	
Total receivables	786,690,482.68
<hr/>	
Investments, at fair value	
Government securities	8,360,210,250.69
Corporate securities	5,595,411,540.34
Corporate stocks	19,529,926,382.45
Private Equities	143,059,186.00
Real estate	1,244,172,670.14
<hr/>	
Total investments	34,872,780,029.62
<hr/>	
Capital Assets, at cost	
Intangible Asset	1,896,671.07
<hr/>	
TOTAL ASSETS	36,400,170,045.21
<hr/>	
LIABILITIES	
Retired payroll payable	5,721,575.88
Retiree insurance premium payable	7,019,533.71
Accounts payable	91,161.70
Investments purchased	1,151,922,628.02
Other investment payables	1,725,500.00
<hr/>	
TOTAL LIABILITIES	1,166,480,399.31
<hr/>	
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS	\$ 35,233,689,645.90
<hr/> <hr/>	

*See Accompanying Notes to the Financial Statements*

**UNAUDITED**

**TENNESSEE CONSOLIDATED RETIREMENT SYSTEM**  
**STATEMENT OF CHANGES IN PLAN NET ASSETS**  
**JULY 1, 2011 THROUGH MARCH 31, 2012**

ADDITIONS

Contributions	
Member contributions	\$168,271,545.76
Employer contributions	666,412,089.91
Total contributions	<u>834,683,635.67</u>

Investment income	
Net Appreciation in fair value of investments	1,370,001,910.26
Interest	382,972,067.09
Dividends	301,818,281.63
Real Estate income, net of operating expenses	50,642,216.77
Total investment income	<u>2,105,434,475.75</u>
Less: Investment expense	(12,593,853.06)
Net investment income	<u>2,092,840,622.69</u>
TOTAL ADDITIONS	<u>2,927,524,258.36</u>

DEDUCTIONS

Annuity benefits	
Retirement benefits	1,089,371,343.84
Cost of living	228,052,101.69
Death benefits	3,777,678.36
Refunds	27,511,557.66
Administrative expenses	8,414,843.63
TOTAL DEDUCTIONS	<u>1,357,127,525.18</u>

NET INCREASE	1,570,396,733.18
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS	
JULY 1, 2011	33,663,292,912.72
MARCH 31, 2012	<u>\$35,233,689,645.90</u>

*See Accompanying Notes to the Financial Statements*

**UNAUDITED**

**Tennessee Consolidated Retirement System**  
**Notes to the Financial Statements**  
**March 31, 2012**

The Tennessee Consolidated Retirement System (TCRS) administers two defined benefit pension plans - State Employees, Teachers and Higher Education Employees Pension Plan (SETHEEPP) and Political Subdivisions Pension Plan (PSPP). Although the assets of the plans are commingled for investment purposes, each plan's assets may be used only for the payment of benefits to members of that plan, in accordance with the terms of the plan.

**A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

1. **Reporting Entity** - The TCRS is included in the State of Tennessee Financial Reporting Entity. Because of the state's fiduciary responsibility, the TCRS has been included as pension trust funds in the *Tennessee Comprehensive Annual Financial Report*.
2. **Measurement Focus and Basis of Accounting** - The accompanying financial statements have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The financial statements have been prepared using the flow of economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Plan member contributions are recognized in the period of time for which the contributions are assessed. Plan employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan.

3. **Cash and Cash Equivalents** - Cash and cash equivalents by definition, includes cash and short-term investments with a maturity date within three months of the acquisition date. The state's accounting policy regarding the definition of cash and cash equivalents includes cash management pools as cash. Cash received by the TCRS that cannot be invested immediately in securities, or that is needed for operations, is invested in the State Pooled Investment Fund sponsored by the State of Tennessee and administered by the State Treasurer. The classification of cash and cash equivalents also includes cash invested in a short-term, open-end mutual fund under the contractual arrangement for master custody services.
4. **Method Used to Value Assets and Investments** - Investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. The fair value of real estate investments is determined at least every three years by qualified independent appraisers who are members of the Appraisal Institute and internally by real estate advisors for those years when independent appraisals are not performed. The fair value of investments in private equities is determined quarterly by the independent private equity managers with a more intensive review being performed at the end of each calendar year end. Investment income consists of realized and unrealized appreciation (depreciation) in the fair value of investments. Interest income is recognized when earned. Securities and securities transactions are recorded in the financial statements on trade-date basis. Real estate transactions are recorded in the financial statements at the time of closing. Software in development has been reported at historical cost as a capitalized asset in accordance with GASB 51.

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**Tennessee Consolidated Retirement System**  
**Notes to the Financial Statements**  
**March 31, 2012**

**B. PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION**

At July 1, 2009, the date of the latest actuarial valuation, the membership of each plan consisted of the following:

	<b>SETHEEPP</b>	<b>PSPP</b>
Retirees and beneficiaries currently receiving benefits	76,955	30,920
Terminated members entitled to but not receiving benefits	21,577	8,823
Current active members	<u>136,147</u>	<u>78,803</u>
Total	234,679	118,546
Number of participating employers	140	482

**State Employees, Teachers and Higher Education Employees Pension Plan**

*Plan Description* - SETHEEPP is a cost-sharing, multiple employer defined benefit pension plan that covers the employees of the state, teachers with Local Education Agencies (LEA's) and higher education employees. The TCRS provides retirement benefits as well as death and disability benefits to plan members and their beneficiaries. Benefits are determined by a formula using the member's high five-year average salary and years of service. Members become eligible to retire at the age of 60 with five years of service or at any age with 30 years of service. A reduced retirement benefit is available to vested members who are at least 55 years of age or have 25 years of service. Disability benefits are available to active members with five years of service who become disabled and cannot engage in gainful employment. There is no service requirement for disability that is the result of an accident or injury occurring while the member was in the performance of duty. Members joining the plan on or after July 1, 1979 are vested after five years of service. Members joining prior to July 1, 1979 are vested after four years of service. Compounded cost of living adjustments (COLA) are provided each July based on the percentage change in the Consumer Price Index (CPI) during the previous calendar year except that (a) no COLA is granted if the CPI is less than one-half percent; (b) a COLA of 1 percent will be granted if the CPI increases between one-half percent and one percent; (c) the maximum annual COLA is capped at three percent. Benefit provisions are established by state statute found in Title Eight, Chapters 34 through 37 of the *Tennessee Code Annotated*. State statutes are amended by the Tennessee General Assembly. Ad hoc increases may only be authorized by the General Assembly. Public safety officers receive an additional supplemental benefit that is paid from age 60 to age 62.

*Superseded Systems and Certain Employment Classifications* - Members of superseded systems that became members of the TCRS at consolidation in 1972, have their rights preserved to the benefits of the superseded system, if the benefit from the superseded plan exceeds that provided by the Group 1 (teachers and general employees) TCRS formula. Likewise, public safety employees and officials of TCRS Groups 2, 3 and 4 are entitled to the benefits of those formulas, if better than the Group 1 benefits.

*Contributions and Reserves* - Effective July 1, 1981, the plan became noncontributory for most state and higher education employees. The contribution rate for teachers is five percent of gross salary. The employers contribute a set percentage of their payrolls, determined by an actuarial valuation. *Tennessee Code Annotated* Title Eight, Chapter 37 provides that the contribution rates be established and may be amended by the Board of Trustees of the TCRS.

**Tennessee Consolidated Retirement System**  
**Notes to the Financial Statements**  
**March 31, 2012**

The administrative budget for the plan is approved through the state of Tennessee's annual budget process. Funding for the administrative budget is included in employer contributions.

The net assets of the plan are legally required to be reserved in two accounts, the Member Reserve and the Employer Reserve. The Member Reserve represents the accumulation of employee contributions plus interest. The Employer Reserve represents the accumulation of employer contributions, investment income and transfers from the Member Reserve for retiring members. Benefit payments and interest credited to the members' accounts are reductions to the Employer Reserve.

**Political Subdivisions Pension Plan**

*Plan Description* - PSPP is an agent multiple-employer defined benefit pension plan that covers the employees of participating political subdivisions of the state of Tennessee. Employee class differentiations are not made under PSPP. The TCRS provides retirement benefits as well as death and disability benefits to plan members and their beneficiaries. Benefits are determined by a formula using the member's high five-year average salary and years of service. Members become eligible to retire at the age of 60 with five years of service or at any age with 30 years of service. A reduced retirement benefit is available to vested members who are at least 55 years of age or have 25 years of service. Disability benefits are available to active members with five years of service who become disabled and cannot engage in gainful employment. There is no service requirement for disability that is the result of an accident or injury occurring while the member was in the performance of duty. Members joining the plan prior to July 1, 1979 are vested after four years of service. Members joining on or after July 1, 1979 are vested upon completion of 10 years of service, unless five years vesting is authorized by resolution of the chief governing body. Cost of living adjustments (COLA) are the same as provided by SETHEEPP except that the local government may elect (a) to provide no COLA benefits or (b) to provide COLA benefits under a non-compounding basis rather than the compounded basis applicable under SETHEEPP. Benefit provisions are established and amended by state statute. Pursuant to Article Two, Section 24 of the *Constitution of the State of Tennessee*, the state cannot mandate costs on local governments. Any benefit improvement may be adopted by the governing body of a governmental entity participating in the TCRS.

*Contributions and Reserves* - Political subdivisions may elect contributory or noncontributory retirement for their employees. The contribution rate for contributory employees of political subdivisions is five percent of gross salary. The employers contribute a set percentage of their payrolls, equal to at least, the percentage determined by an actuarial valuation. State statute provides that the contribution rates be established and may be amended by the Board of Trustees of the TCRS. The administrative budget for the plan is approved through the state's annual budget process. Funding for the administrative budget is included in employer contributions.

The net assets of the plan are legally required to be reserved in two accounts, the Member Reserve and the Employer Reserve. The Member Reserve represents the accumulation of employee contributions plus interest. The Employer Reserve represents the accumulation of employer contributions, investment income and transfers from the Member Reserve for retiring members. Benefit payments and interest credited to the members' accounts are reductions to the Employer Reserve.

**Tennessee Consolidated Retirement System**  
**Notes to the Financial Statements**  
**March 31, 2012**

**C. DEPOSITS AND INVESTMENTS**

State statute authorizes the TCRS to maintain cash, not exceeding ten percent of the total amount of funds in the retirement system, on deposit in one or more banks, savings and loan associations or trust companies that are qualified as state depositories. The TCRS does not utilize its own bank accounts but invests in the State Pooled Investment Fund for the initial deposit of funds and for its operating cash needs. The State Pooled Investment Fund is authorized by state statute to invest funds in accordance with policy guidelines approved by the Funding Board of the State of Tennessee. The current resolution of that board gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements and various U.S. Treasury and Agency obligations. The State Pooled Investment Fund is also authorized to enter into securities lending agreements in which U.S. Government Securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities.

State statute also authorizes the TCRS to invest in bonds, debentures, preferred stock and common stock, real estate and in other good and solvent securities subject to the approval of the Board of Trustees, but further subject to the following statutory restrictions and provisions:

- a. The total sum invested in common and preferred stocks shall not exceed seventy-five percent (75 percent) of the total of the funds of the retirement system.
- b. The total sum invested in notes and bonds or other fixed income securities exceeding one year in maturity shall not exceed seventy-five percent (75 percent) of the total funds of the retirement system.
- c. Within the restrictions in (a) and (b) above, an amount not to exceed fifteen percent (15 percent) of the total of the funds of the retirement system may be invested in securities of the same kinds, classes, and investment grades as those otherwise eligible for investment in various approved foreign countries, provided that such percentage may be increased by the board with the subsequent approval of the council on pensions and insurance.
- d. Within the restrictions in (a) and (b) above, funds may be invested in Canadian securities which are substantially of the same kinds, classes and investment grades as those otherwise eligible for investment.
- e. The total amount of securities loaned under a securities lending program cannot exceed thirty percent (30 percent) of total assets.
- f. The total sum invested in real estate shall not exceed ten percent (10 percent) of the market value of total assets.
- g. The total sum invested in private equities shall not exceed five percent (5 percent) of the market value of total assets.

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**Tennessee Consolidated Retirement System**  
**Notes to the Financial Statements**  
**March 31, 2012**

State statute also authorizes the TCRS to invest in forward contracts to hedge its foreign currency exposure and to purchase or sell domestic stock index futures contracts for the purpose of asset allocation relating to the domestic equity portfolio. The total amount of the financial futures contract obligation shall not exceed five percent (5 percent) of the market value of total assets.

Title to real property invested in by the TCRS is held by real estate investment holding companies.

**Credit Risk** - Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Credit quality ratings for the TCRS' investments in fixed income securities as of June 30, 2010 are included in the above schedule. Securities are rated using Standard and Poor's and/or Moody's and are presented above using the Standard and Poor's rating scale. The State Pooled Investment Fund has not obtained a credit quality rating from a nationally recognized credit ratings agency.

The TCRS' investment policy specifies that bond issues subject for purchase are investment grade bonds rated in the four highest ratings by one of the recognized rating agencies. In addition, the policy states that private placements that do not have an active secondary market shall be thoroughly researched from a credit standpoint and shall be viewed by TCRS' investment staff as having the credit quality rating equivalent of an AA rating on a publicly traded issue. For short-term investments, the TCRS' investment policy provides for the purchase of only the highest quality debt issues. Commercial paper should be rated in the highest tier by all rating agencies which rate the paper, with a minimum of two ratings required. Commercial paper cannot be purchased if a rating agency has the commercial paper on a negative credit watch. The investment policy also requires preparation of a credit analysis report on the corporation prior to purchasing commercial paper.

As noted above, the TCRS does not utilize its own bank accounts but invests in the State Pooled Investment Fund for its operating cash purposes. Required risk disclosures relative to the State Pooled Investment Fund are presented in the *State of Tennessee Treasurer's Report*. That report is available on the state's website at <http://www.tn.gov/treasury/> or by calling (615) 741-2956.

**Concentration of Credit Risk** - A concentration of investments in any one single issuer of debt securities presents a greater risk for loss in the event that the issuer fails on its obligations. The TCRS had the following investment amounts and percentages of plan net assets, in organizations representing five percent or more of plan net assets, excluding those organizations whose issues are explicitly guaranteed by the United States government, and investments in mutual funds, external investment pools, and other pooled investments:

Issuer Organization	<u>June 30, 2011</u>	
	Fair Value	Percentage
Federal National Mortgage Assoc.	\$2,029,898,227	6.03%

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**Tennessee Consolidated Retirement System**  
**Notes to the Financial Statements**  
**March 31, 2012**

The TCRS' investment policy limits the maximum amount of a specific corporation's commercial paper that can be purchased to \$100 million. There are no specific investment policies that limit investment in any one issuer.

**Interest Rate Risk** - Interest rate risk is the risk that future changes in prevailing market rates of interest will have an adverse effect on the fair value of debt investments. The fair values of securities with long terms to maturity may be highly sensitive to interest rate changes. The TCRS' investment policy does not specifically address limits on investment maturities. The fixed income portfolio, however, is benchmarked against the Citigroup Broad Investment Grade Index and tends to have a duration within a range around that index. Duration is a measure of a debt investment's exposure to fair value changes arising from changing interest rates. It uses the present value of cash flows weighted for those cash flows as a percentage of the investment's full price.

**Asset-Backed Securities** - The TCRS invests in various collateralized mortgage obligations (CMOs) which are mortgage-backed securities. These securities are based on cash flows from interest and principal payments on underlying mortgages and could therefore be more sensitive to prepayments by mortgagees as a result of a decline in interest rates.

**Derivatives** - The TCRS may buy or sell fixed income and equity index futures contracts for the purposes of making asset allocation changes in an efficient and cost effective manner and to improve liquidity. Gains (losses) on equity index futures hedge losses (gains) produced by any deviation from the TCRS' target equity allocation. The gains and losses resulting from daily fluctuations in the fair value of the outstanding futures contract are settled daily, on the following day, and a receivable or payable is established for any unsettled gain or loss as of the financial statement date. TCRS was under contract for fixed income and equity index futures and the resulting payable is reflected in the financial statements at fair value.

The international securities expose the TCRS to potential losses due to a possible rise in the value of the US dollar. The TCRS investment managers can reduce foreign currency exposure by selling foreign currency forward contracts, at agreed terms and for future settlement, usually within a year. The manager will reverse the contract by buying the foreign currency before the settlement date. A gain (loss) on this transaction pair will hedge a loss (gain) on the currency movement of the international security. The TCRS can sell up to 80% of its foreign currency exposure into US dollars. Forward currency forward contracts expose the TCRS to foreign currency risk as they are denominated in foreign currency. Any unrealized gain on foreign currency forward contracts has been reflected in the financial statements as an investment. The notional amount of the foreign currency forward contracts has been reflected in the financial statements as a receivable and a payable. Any unrealized loss on foreign currency forward contracts has been included in the payable established for the contracts.

The TCRS is authorized to invest in To Be Announced (TBA) mortgage backed securities similar to the foreign currency forward contracts. The TCRS enters into agreements to purchase pools of mortgage backed securities prior to the actual security being identified. The TCRS will roll this agreement prior to settlement date to avoid taking delivery of the security. Any unrealized gain on TBA mortgage backed securities has been reflected in the financial statements as an investment. Any unrealized loss on TBA mortgage backed

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**Tennessee Consolidated Retirement System**  
**Notes to the Financial Statements**  
**March 31, 2012**

securities has been included in the payable established for the mortgages. The notional amounts of these agreements have been included in the financial statements as a receivable and a payable. The TCRS invests in these derivatives to adjust its exposure to mortgage coupon risk and to replicate the return on mortgage backed securities portfolios without actually purchasing the security.

The TCRS is authorized to enter into option contracts and any income earned on option contracts has been included as investment income on the statement.

The fair values of foreign currency forward contracts are estimated based on the present value of their estimated future cash flows. Futures contracts and TBA mortgage backed securities are exchange traded and their price is based on quoted market prices at year end. It is the TCRS policy to conduct derivative transactions through the custodian bank and high quality money center banks or brokerage firms. The credit risk of foreign currency forward contracts is managed by limiting the term of the forward contracts and restricting the trading to high quality banks. The credit risk of futures contracts is managed by maintaining a daily variation margin.

**D. COMMITMENTS**

**Standby Commercial Paper Purchase Agreement** - The TCRS has agreed to serve as standby commercial paper purchaser for commercial paper issued by the Funding Board of the State of Tennessee. By serving as a standby commercial paper purchaser, the TCRS receives an annual fee of 60 basis points on the \$350 million maximum issuance under this agreement during times when both Moody's and Standard and Poor's investment ratings assigned to the State of Tennessee's general obligation bonds are Aaa and AAA respectively, 80 basis points during times when either Moody's or Standard and Poor's has assigned ratings of Aa and AA respectively, or 105 basis points during times when either Moody's or Standard and Poor's has assigned ratings lower than Aa and AA respectively. In the unlikely event that the TCRS would be called upon to purchase the commercial paper, the TCRS would receive interest at a rate equal to prime plus 75 basis points during the first 30 consecutive days, plus an additional 50 basis points for each consecutive 30 days thereafter, up to a maximum rate allowed by state law.

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