

Minutes of the TCRS Board of Trustees meeting on September 28, 2012

The Board of Trustees of the Tennessee Consolidated Retirement System met on Friday, September 28, 2012 at 10:05 a.m. The meeting was held in the Nashville Room of the William R. Snodgrass/TN Tower 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; Mr. Justin Wilson, Comptroller to the Treasury; Commissioner Rebecca Hunter, Department of Human Resources; Commissioner Mark Emkes, Department of Finance and Administration; Ms. Jill Bachus, Director of TCRS; Mr. Greg Elliott, Mr. Michael Barker, Mr. Alfred Laney, Ms. Patsy Moore, Mr. Bill Kemp, Mr. Ken Wilber, Mr. David Seivers, Mr. Tommie Pendergrass, and Mr. Harold Morrison.

Board of Trustees Appointment

Chairman Lillard introduced Mr. Harold Morrison a new member to the Board. Mr. Morrison is the middle Tennessee teacher representative and will serve a three-year term. Chairman Lillard administered the Oath of Office prior to the meeting.

Approval of the June 29, 2012 Minutes of the Board of Trustees

On a motion by Mr. Wilber and seconded by Mr. Elliott, the minutes of the June 29, 2012 TCRS Board of Trustees meeting were unanimously approved.

Committee Reports

Chairman Lillard introduced Mr. Barker to review the audit committee report. Mr. Barker stated the audit committee reviewed the annual audit from the Comptroller of the Treasury and the internal audit report. The audit committee discussed the Treasury Property Standard and Professional Conduct and Control Culture. The committee also discussed a reporting mechanism for a member or public to express concerns to the audit committee. Mr. Barker mentioned there has been ways to report in the past through the Comptroller's office but after discussion with the Treasurer, he indicated the need to be sure that information is routed to the appropriate location. The audit committee gave approval for the Director of Internal Audit to approve the reporting mechanism. Mr. Barker mentioned the audit committee reviewed the private equity disclosure report. Ms. Bachus provided the audit committee an update on the Concord system.

Chairman Lillard introduced Ms. Bachus to review the administrative committee. Ms. Bachus mentioned Mr. Fred Marshall provided the administrative committee with an update on the Concord system noting the imaging portion was implemented in March 2012. The payroll phase is scheduled for implementation in February or March 2013. The final phase, active member and employer reporting, is scheduled for late 2013 or early 2014. Ms. Bachus mentioned a new user interface would be used in the Concord system. The interface will make the experience for active and retired members more intuitive. Ms. Bachus also stated the Actuarial Experience Study will be presented to the Board in March 2013.

Chairman Lillard updated the Board on the investment committee meeting. The investment committee reviewed performance of the fund and final version of the Asset-Liability study. Chairman Lillard mentioned the investment committee reviewed and adopted changes to the investment policy.

Audit Committee Appointment

Mr. Barker recommended Mr. Tommie Pendergrass be appointed to the audit committee. Mr. Erick Huth's term expired June 30, 2012.

The motion was seconded by Mr. Hargett, and the Board approved the appointment of Mr. Pendergrass to the audit committee with Comptroller Wilson abstaining.

Investment Report

Chairman Lillard introduced Mr. Michael Brakebill to review the investment report. Mr. Brakebill provided a review of the performance of the portfolio. He noted that TCRS had returned 5.6% for the 2012 fiscal year and that this return placed TCRS in the 98th percentile of its peers. The portfolio also outperformed its benchmark by 0.7%. Further, he noted that most pension funds had seen a return of between 0% and 3% during the same period.

Mr. Brakebill provided some additional portfolio and department updates. He noted that the fund is becoming increasingly sophisticated and, as an example, the key initiatives underway include investing in non-core real estate, implementing a strategic lending allocation, and emerging market equities. Additionally, staff has been traveling overseas and around the country and will continue to do so into the future to visit current and potential external managers. Mr. Brakebill added that there could be one or two new hires in the coming months to replace departing employees and to support the additional work load from the new investing programs.

Mr. Brakebill provided an update on the implementation of the securities lending program. He stated that a firm had been selected after conducting interviews and the implementation process is close to being finalized. Mr. Brakebill stated that staff was currently implementing a change in the way the fund obtains exposure to small cap equities. Historically, the fund invested in Russell 2000 futures with an underlying cash portfolio. However, the Russell 2000 performance has deviated from the S&P 600 which is the benchmark for small cap stocks. Therefore, staff has begun accumulating an S&P 600 portfolio to better reflect the returns of its benchmark.

Mr. Brakebill concluded his comments by providing a disclosure that he would begin serving in an additional role with the Tennessee Valley Authority Retirement System. Mr. Brakebill currently serves on the investment committee of the Tennessee Valley Authority Retirement system (TVAR) as a non-voting member. In addition to this role, Mr. Brakebill will be serving as a non-voting Investment Committee member on the TVA Nuclear Decommissioning Trust Fund.

Mr. Pete Keliuotis of Strategic Investment Solutions was asked to provide a review of TCRS's recent performance and asset allocation as well as an overview of the Asset-Liability study that

SIS completed for TCRS. Mr. Keliuotis stated that TCRS asset allocation was close to target at the close of the quarter ending June 30, 2012. The fund is underweight to international equities, real estate and private equity. He noted that it was strong year for the fund with a 5.6% annual return. He reiterated Mr. Brakebill's comments that this was a very good return relative to peer pension funds. He stated that most of TCRS's peers earned below a 3% annual return. The year was dominated by a risk-off environment that caused volatility in equities and interest rates to fall. He noted that domestic equities generated 0.5% of alpha, while the Canada fund struggled due to concerns about the energy sector and a strengthening dollar. Mr. Keliuotis noted that fixed income performed very well as the yield curve dropped and duration sensitive securities outperformed.

Mr. Keliuotis moved on to the presentation of the Asset-Liability Modeling study that was performed by SIS. Mr. Keliuotis provided an initial presentation to the Investment Committee in March. He directed the members of the Board of Trustees to page eight of the presentation. He noted that the "median normal" was used as the targeted asset allocation. This new allocation will include the addition of a 5% allocation to emerging market equities, an addition of a 5% allocation to strategic lending and a reduction in the allocation to treasury inflation protected securities from 8% to 4%. He noted that this allocation was determined by the historical risk tolerance of TCRS and the models prepared by SIS that suggested that additional allocations to riskier assets would increase the risk level to an undesired level.

Investment Policy

Mr. Brakebill next presented the proposed changes to the TCRS Investment Policy. He noted that the changes could be classified into three categories. The changes are either editorial, changes that improved the policy's compliance with the legal code, or changes to enact the new asset allocation. Mr. Brakebill covered all of the proposed changes. Some of the editorial and legal changes included a change in the role of the Investment Advisory Council, the requirement of additional reporting to the Council of Pensions and Insurance and the specific internal controls that are overseen by the internal auditors. Mr. Brakebill noted that the internal controls are not new, but that it is the first time it has been explicitly noted in the investment policy.

Many of the additions in the policy were added to allow investments in new asset classes in emerging market equities and strategic lending and to govern how these investments would be made. The table for the target allocations was edited to represent these additions. In addition, language was added to require a consultant for strategic lending. Mr. Brakebill stated that the consultant would be working with staff to develop guidelines for the strategic lending program. Mr. Brakebill added that there was an additional amendment to the policy that had been distributed to members of the Investment Committee. This amendment to section 2.f.(ii) on page 21 requires the written approval of the Treasurer to make changes to strategic lending investments or commitments. Mr. Brakebill concluded by noting that the new asset allocation to strategic lending would include a sunset provision in 2017.

On motion by Commissioner Emkes and seconded by Mr. Barker, the Board unanimously approved changes to the Investment Policy.

Other Business

Chairman Lillard summarized to the Board a new 529 College Savings program called TN Stars. The program will be administered by the Treasury Department.

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 Commissioner Hunter and seconded by Mr. Laney, the Board unanimously approved the TCRS Board of Trustees meeting be adjourned.

With no other business, the Board of Trustees adjourned at 11:10 a.m. on September 28, 2012.

Respectfully Submitted,



**Jill Bachus
Director, TCRS**

Approved:



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