TUCSON SUPPLEMENTAL RETIREMENT SYSTEM
BOARD OF TRUSTEES
MEETING MINUTES

DATE: **Thursday, September 29, 2016**
TIME: **8:30 a.m.**
PLACE: **Finance Department Conference Room, 5th floor**
City Hall, 255 West Alameda
Tucson, Arizona 85701

Members Present:	Robert Fleming, Chairman Kevin Larson, City Manager Appointee Rebecca Hill, Interim HR Director Silvia Amparano, Director of Finance Michael Coffey, Elected Representative Jorge Hernández, Elected Representative John O'Hare, Elected Retiree Representative
Staff Present:	Dave Deibel, Deputy City Attorney (arrived 9:17 AM) Neil Galassi, Pension Administrator Dawn Davis, Administrative Assistant Ginny Rath Pepper, Administrative Assistant
Guests Present:	Scott Brayman, Champlain Investment Partners Judith O'Connell, Champlain Investment Partners
Absent/Excused:	None

Robert Fleming called the meeting to order at 8:30 AM.

A. **Consent Agenda**
1. Approval of August 25th, 2016 TSRS Board Meeting Minutes
2. Retirement ratifications for September 2016
3. August 2016 TSRS Budget Vs Actual Expenses
4. TSRS Portfolio Composition, Transactions and Performance Review August 2016

The Consent Agenda was approved by a consensus of 7-0.

B. **Investment Activity Reports**
1. Annual Manager Review – Champlain Investment Partners – Scott T. Brayman, & Judith W. O'Connell

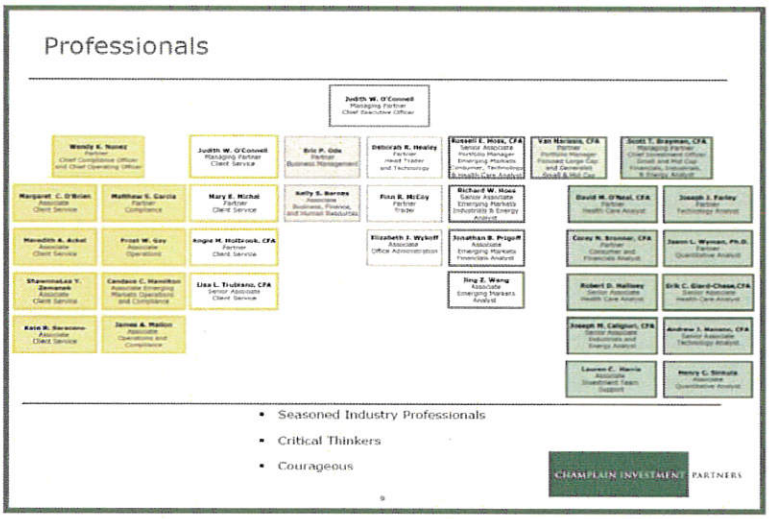
Chairman Fleming asked the presenters from Champlain if they have the list of the questions that the TSRS Board provided to Champlain.

Judith O'Connell stated that Champlain does have the list of questions that were provided and asked Chairman Fleming if it would be okay if Champlain go through the presentation that covers all of the TSRS Board's questions but not in the same order.

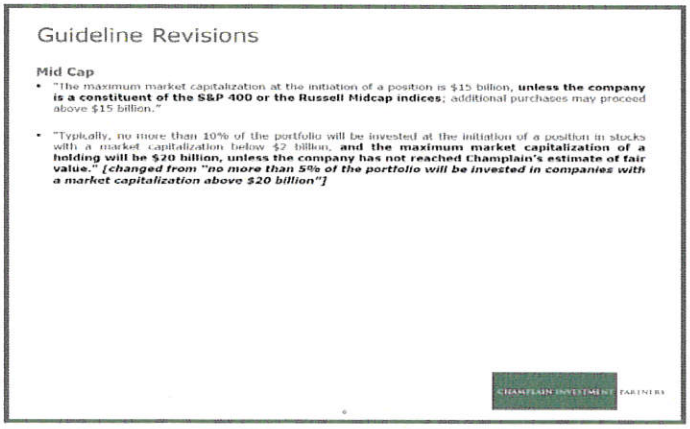
Chairman Fleming stated that he is okay if Champlain does the presentation in any order but would like the presentation from Champlain to be focused solely on the TSRS Board's list of questions rather than Champlain giving a large presentation that wouldn't be productive for the board meeting or be of interest.

Neil Galassi stated to Chairman Fleming that he had spoken with Champlain before the presentation and gave Champlain the general parameters of what the Board is interested in and is confident that the presentation will address the items.

Judith O'Connell stated that the first item she was going to cover is personnel. Judith O'Connell asked that everyone turn to page 9 presented below of the Champlain Investment Partners, LLC, Partners 2Q 2016 booklet. Judith O'Connell stated the personnel highlighted in green comprises their small and Mid-Cap team managed by Scott T. Brayman. Judith O'Connell stated that their partner David M. O'Neal, who is one of the founders of the firm over the covered healthcare sector, will be retiring at the end of 2016 and will remain as a shareholder in Champlain. Judith O'Connell stated that David M. O'Neal made it clear that he will not retire until he felt that Champlain had the appropriate resources in place over healthcare. Judith proceeded to state that founders can retain forty percent of their equity and David M. O'Neal will plan to do that.



Judith O'Connell stated that Champlain made some changes to their guidelines to become more in line with the benchmarks. Judith O'Connell referred to page 6 presented below from the Champlain Investment Partners, LLC, Partners 2Q 2016 booklet. Judith O'Connell stated that as long as withholdings are a part of the benchmark, they can initiate a position above $15 billion and currently about 32% of the Mid-Cap benchmark is above $15 billion. Judith continued to state that as far as holding above $20 billion, that they can do that as long as it is a part of the benchmark. Judith stated that they are not expecting any material changes to the portfolio.



Judith O'Connell stated that assets under management in the Mid Cap strategy are currently at about $3.2 billion, and they plan to close that strategy at $4.5 billion which is similar to what they have done with the small-

cap strategy. Judith stated for reference that when TSRS started with Champlain, Champlain was at $750 million in their Mid-Cap strategy.

John O'Hare asked Champlain Investment Partners how much slippage is there in getting in and out of positions because of size do you have an effect upon the market when you get into position to get out.

Scott Brayman, with Champlain Investment Partners, replied by stating that Champlain runs as much as $4.5 billion in small-cap, Mid Cap is a lot more liquid and has a lot less risk so, he is very comfortable stating that $4.5 billion is an easy number to manage. Scott Brayman proceeded to state that typically 80%-85% of the time, Champlain's activity is against the herd. Scott continued to state when people are fearful, for example, this February 2016 when the market was freaking out and software stocks were down 30% for the year, Champlain was buying and started piling up on networks in the middle of that panic cell. Conversely, after a couple of buyouts this year the software stocks have rallied sharply back, Champlain started cutting the weight on that industry. So a vast majority of the time Champlain is moving against the herd. Therefore, liquidity has not been an issue for Champlain.

Judith O'Connell with Champlain Investment Partners stated that on that topic, Champlain doesn't participate in any separate account wrap programs or give their models to anyone else. Therefore, no one is trading against Champlain. Judith proceeded to state that Champlain manages all of their accounts including Mid-Cap the same, so Champlain is making one call against all of the portfolios.

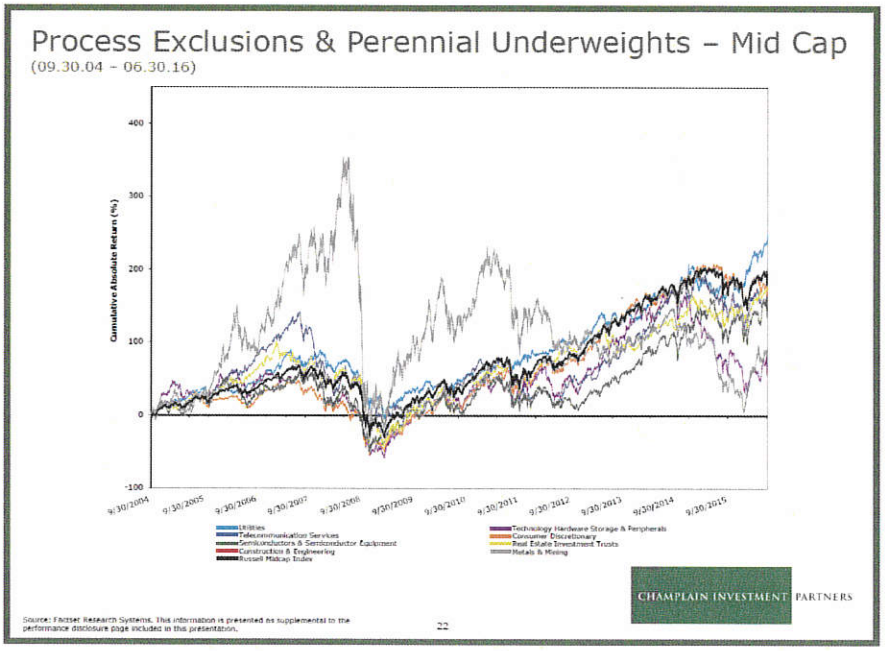
Scott Brayman stated that Champlain does not have many instances in either strategy, but particularly very few instances in Mid-Cap that Scott calls the get off the plane in thirty seconds instance; Chaplain's process does not depend on rapid exits.

Scott Brayman stated that he is now on question number two; investment philosophy, the strategy, and how it's implemented. Scott stated the investment process/philosophy is that we want to own good to great companies but we want to own these at a discount to what we think is their intrinsic or fair value. Scott proceeded to describe how Champlain defines good to great companies. Scott stated these are companies that are highly reliable. Scott stated that Champlain wants to avoid business models that are highly cyclical, capital intensive, labor intensive, or highly regulated. Scott stated that Champlain likes to focus on brands or companies that: control their investment, have steady demands, don't require financing to buy their product, don't depend on interest rate cycles or capital markets, and aren't dependent on consumers having a lot of credit. Champlain looks to companies that focus on products that people consume everyday like food and beverage on the consumer side whereas on the industrial side they like to focus on companies that have business models with a lot of aftermarket or maintenance and repair revenue as opposed to the one time capital expense revenue. They also look for companies that have a high return on capital. These are companies that have a high gross margin structure making it is easier to overcome the inevitable problems and challenges that business throws their way. These companies demonstrate good capital stewardship where management has shown they can earn high returns on capital because the business model is just very profitable but also because management doesn't squander capital. They don't invest prudently or aggressively and are very careful with investment and acquisitions. Scott proceeded to state that each analyst in their sector votes the proxies for the companies in their sector, so they are very attentive to governance issues such as how much skin does management have in the game, who is on the board, and what are the incentives. Scott stated that Champlain focuses on the companies where the board is comprised of operators (i.e. the Business Executive, CEOs, CFOs, and Senior Executive) and comprised of very few referees.

John O'Hare asked Champlain if they like the boards that make decisions that take into account a three year period rather than a quarter by quarter approach. John O'Hare stated that he attended a conference where they were talking about a survey of CEOs and asked CEOs if they had the choice of having a good quarter or having a better one, two to three years down the road; CEOs were always choosing the short term rather than the long term.

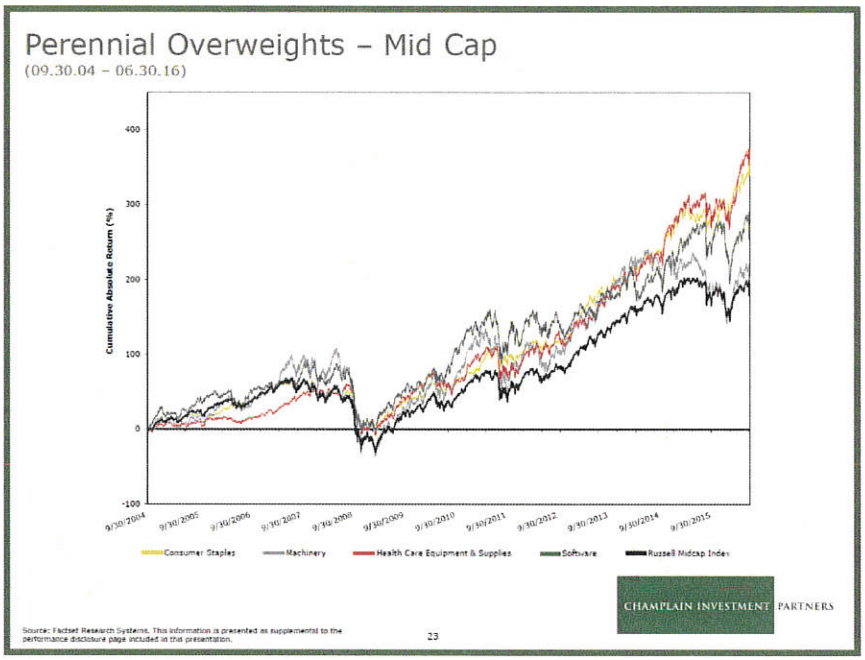
Scott Brayman with Champlain Investment Partners stated that he wants to talk about time horizon as it's something important to Champlain and how Champlain thinks differently than most investors. Champlain looks

for companies that manage the business with a long term time horizon. Scott stated that one of his favorite questions to ask companies is on Champlain's management questionnaire; tell me about a sacrifice you made in the near term earnings to set up a stronger, better company three to five years from now. If they don't have a good answer about a sacrifice that they are making, it tells you that they are running the tank dry and not priming the pump for the future. Scott stated that is a big key to what Champlain does. Scott stated there is a book titled The Compound Effect by Darren Hardy; when you find companies that have good culture and the history of good habits…good habits create little advantages that are almost immeasurable daily, monthly, quarterly, or even yearly, but they add up big over many years. So to really exploit this compound effect, you need to take along a long term investment horizon and Champlain does that. Scott proceeded to state that he wants to be clear that at Champlain, this process that Champlain has, is Champlain's most valuable player. Scott stated that some team members may shift in and out over the years but it's not terribly important. What's important is that Champlain hires the right personality that acknowledges the process is the most valuable player, and doesn't try to over end any other process. Scott stated the heroes in this process are the companies, the management teams that run these businesses. Scott stated that Champlain's process is about having a light impact, and not over engineering that or interfering with the goodness of these companies that are doing great. In regards to the research process, the team meets weekly or twice a week, where they talk about new ideas. Scott stated that Champlain has been doing this for a long time so they are very focused on certain industries. Scott stated that Champlain's process has a sector factor front end which steers them away from about two-thirds of the industries and it focuses only on about one-third. Scott referred to the appendix chart below on page 22 demonstrating the process which shows the industries that Champlain excludes and the industries that Champlain ranks higher. Scott proceeded to state the industries that Champlain excludes are very cyclical and never build a structural advantage relative to the benchmark which is the black line.



Scott Brayman stated that the industries that Champlain focuses on are referred to on the chart below on page 23 as they create a long term structural advantage benchmark, and is why the process is the most valuable player. Scott proceeded to state that the team is very focused on the target rich and very fertile industries that tend to outperform the benchmark over time. Scott stated that the longer you get this process, the greater the advantages should creep. Scott stated that they meet once a week to talk about new ideas. To come up with these ideas they know the industries that are target rich so they know all of the best companies and best management teams. Champlain is watching all of these companies. Some are too expensive, so are on the watch list while others are coming into buy zone. Scott stated that Champlain also gets out and meets with companies and they come out to see Champlain as well. Scott proceeded to state that Champlain has a number of tools that they use to analyze these companies. They have the whole framework which is part of

Credit Suisse and have also added the EBA dimensions which is a model where you take your company's economic profits minus the cost of capital to understand the economic value added. Scott stated that Champlain has built a number of frameworks over the years to help Champlain understand the growth, returns, and the capital allocation.



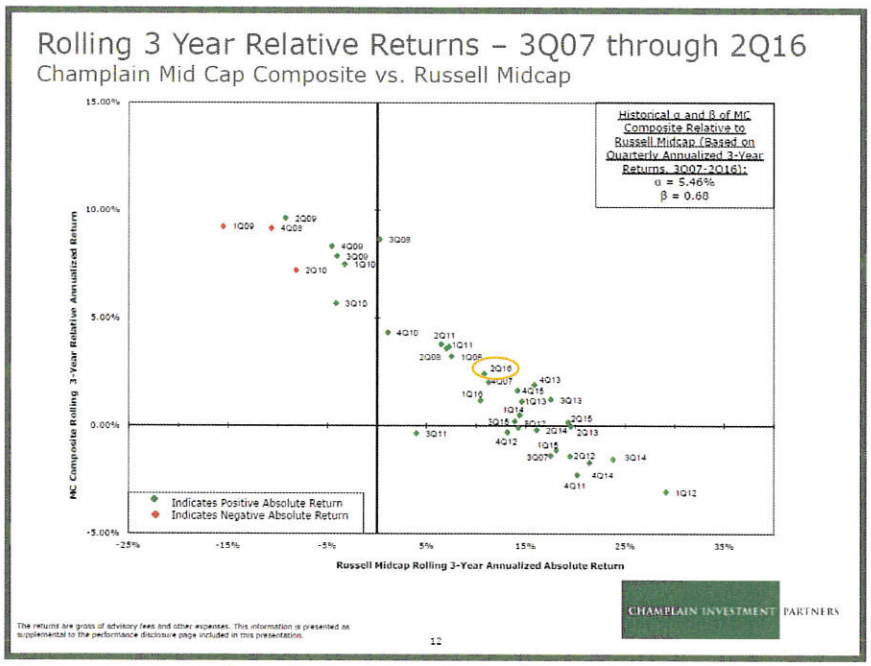
Scott Brayman stated the second meeting they have each week is to make decisions about how to rebalance their client's capital. They are constantly trying to rebalance the capital away from the stocks that are trading rich and above fair value, and to lower existing holdings which are trading at a discount to intrinsic value.

Judith O'Connell with Champlain Investment Partners stated to answer the question, number three, we are bottom up, but for the interest of time, she thinks it makes sense to go to number four first.

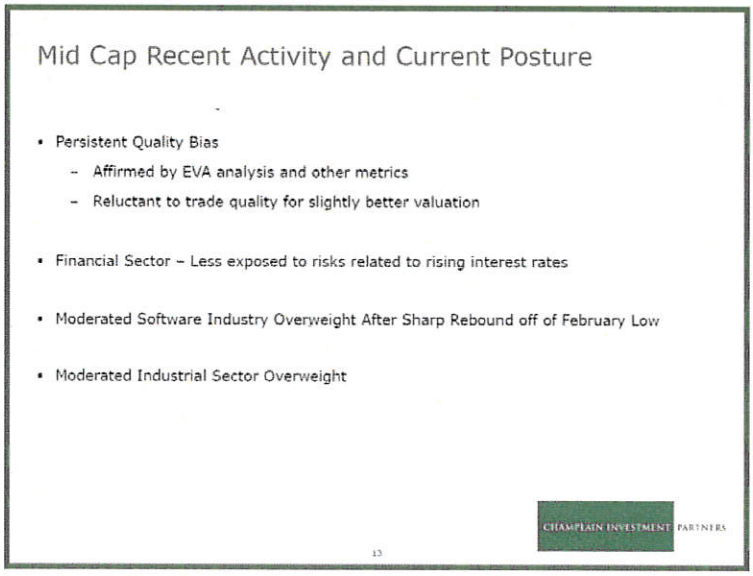
Chairman Fleming replied that would be a good idea and asked Champlain if they already answered question number six.

Judith O'Connell with Champlain Investment Partners replied no, but then stated that she guess's that they covered question number six and concluded to say that they have a lot to say about relative performance.

Scott Brayman asked that everyone refer to page12 presented below as it will answer the question the Board asked about how Chaplain expects to perform relative to the market environment. Scott stated the referred table below shows the historical footprints of Champlain's process. The relative returns for three years are on the vertical axis and the benchmark absolute returns for three years on an annualized basis are on the horizontal axis. If the benchmark is doing 20% a year, on average for three straight years, Champlain expects to be lagging by a couple hundred basis points per year. Scott stated that we have been through that recently and Champlain very much appreciates the patience that TSRS has shown. Scott proceeded to state that as we move into more normalized returns, Champlain expects to be showing TSRS an advantage, and then if we get into difficult markets, Champlain expects to deliver a substantial advantage. Scott stated Champlain expects through a full market cycle, to add quite a bit of value and more than cover Champlain's fees. Scott stated that this little bit of give up is the insurance premium to have this kind of protection. He thinks this is extremely good value proposition with only spending a couple of hundred basis points in the strong markets where Champlain is helping protect the TSRS plan from the difficult markets when the plan may be under pressure.

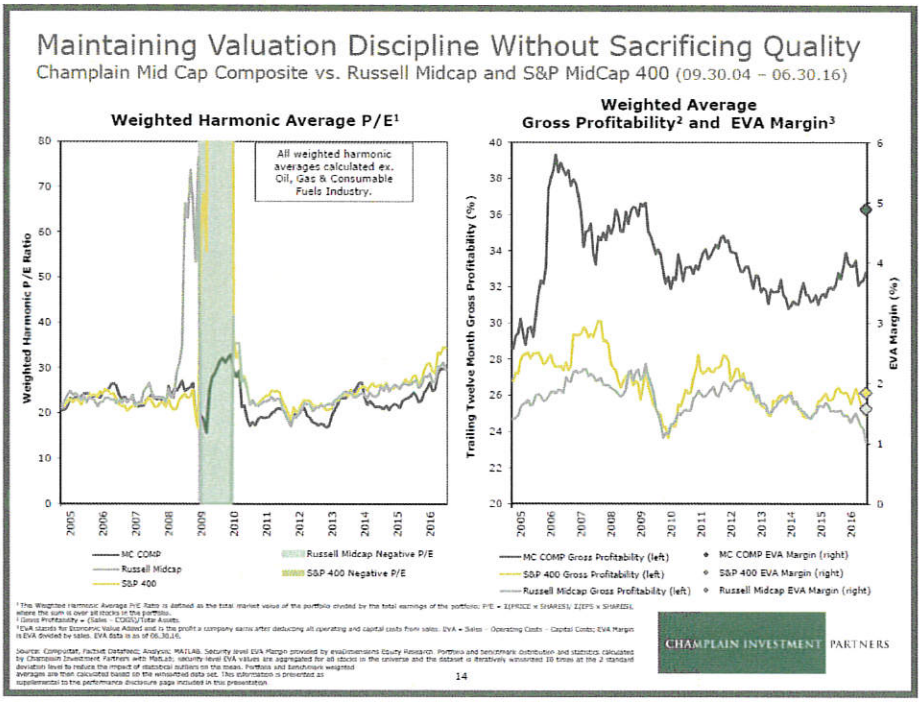


Scott Brayman asked that everyone now refer to page 13 presented below where he will talk about portfolio positioning. Scott stated that the portfolio remains very heavy on quality as evidenced by some characteristics such as borrowing but also the gross profitability and the EVA margin.



Scott Brayman stated the relative advantage to the benchmark is quite significant and is illustrated on page 14 below on the right hand side. Scott stated that you can see the gross profitability on the charts in green and the EVA Margin on the diamond. Champlain is in the dark green in both cases. Scott stated that we are not paying a premium, so we are trading at about the same value valuation as the benchmarks but we own much better quality. Scott stated that he wants to talk about Champlain's financial sector positioning because Champlain has not chased the yield producing investments. We are still outperforming because Champlain has had some very good stock selection and some good events in healthcare particularly, but also the rebound in software stocks has been very helpful coupled with strong industrials. Scott proceeded to state that Champlain's posture in financials is such that we don't need higher interest rates to continue to grow and be

profitable but when higher interest rates occur, if they ever do come, it's going to be very painful for REIT's and utilities. Champlain thinks that you can see permanent capital impairment in these interest rate sensitive industries if and when interest rates ever do go back up. If interest rates do go back up, our banks such as Northern Trust and our insurance companies such as Allied World and Endurance will benefit. They will actually earn more money in a rising interest rate environment than they do today. Scott says that Champlain is geared to benefit from rising rates and thinks much of the benchmark, which Champlain excludes the REIT's and utilities in particular, are going to feel a lot of pain from rising interest rates. Scott stated that Champlain is not smart enough to make a call on interest rates which is why they don't want REIT's and utilities because Champlain will have to make an interest rate call or market timing call. Scott proceeded to state when oil was $27 a barrel last year, we were buying the industrial sector and now that oil has bounced back this year, Champlain has moderated the weight in the industrial sector a little bit. Champlain has also moderated the weight in software which Scott says he covered earlier. Scott proceeded to state that the team has continually demonstrated courage about going into the industries or the areas of the market which are under a lot of pain or where valuations are very attractive. Scott stated that Champlain is still buying good businesses at a discount and has had the courage to unweight the stocks which are much desired. Scott stated an example of that would be one of Champlain's favorite companies, McCormick which is a very simple business; they dominate at 18% market share and their largest competitor is at 6%, so no one is close. Scott stated that it's a great business, but it got way too expensive so Champlain sold it. Scott stated that he loves the company, so it takes some courage for Champlain to sell the great companies that are way too expensive as everyone is chasing dividends and chasing low volatility shares.



Neil Galassi asked Champlain Investment is there a certain level of capitalization that a company Champlain holds attains where they say this is too big for our strategy and they sell off the investment in that company?

Scott Brayman with Champlain Investment Partners replied by stating that Champlain just changed the guidelines to give them more headroom to take their winners of beyond $15 billion, but this is a Mid Cap strategy and Champlain is trying to focus on buying stocks under $15 billion. Scott proceeded to state that the benchmark has 32% of its weight above $15 billion and 16% above $20 billion, so Champlain wants to be able to take them above $20 billion if they are at a discount and they are still a good business. Scott stated that Champlain has been recently seeding the Mid-Cap strategy with their best ideas from Small-Cap, so some of the new names coming to the portfolio are actually at the low end of the market. So the movement to low

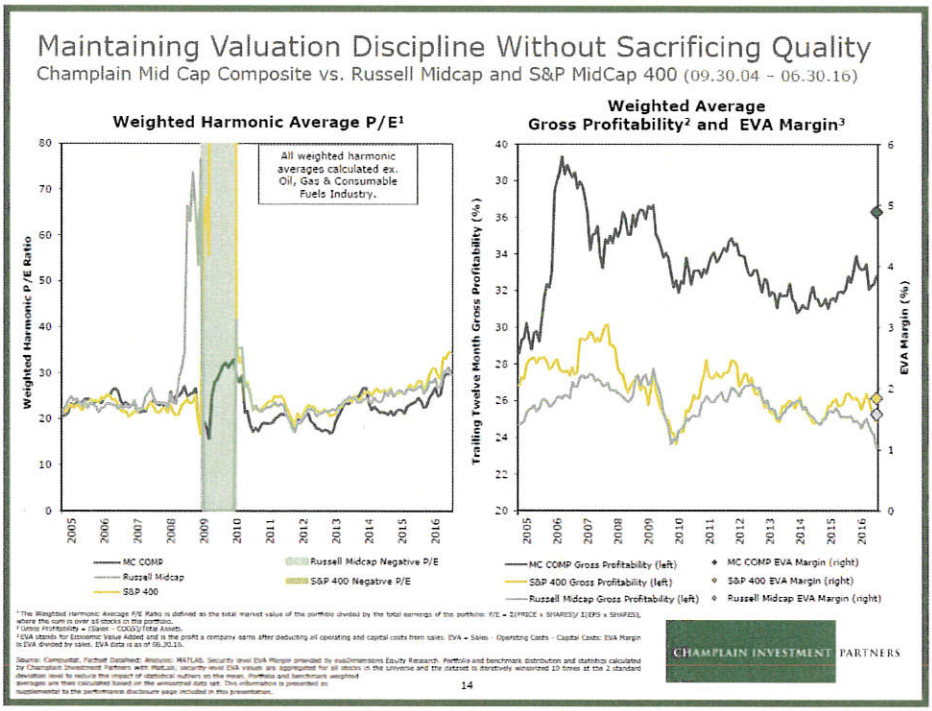
volatility has emphasized the larger companies and the better value is at the smaller end of the market cap right now.

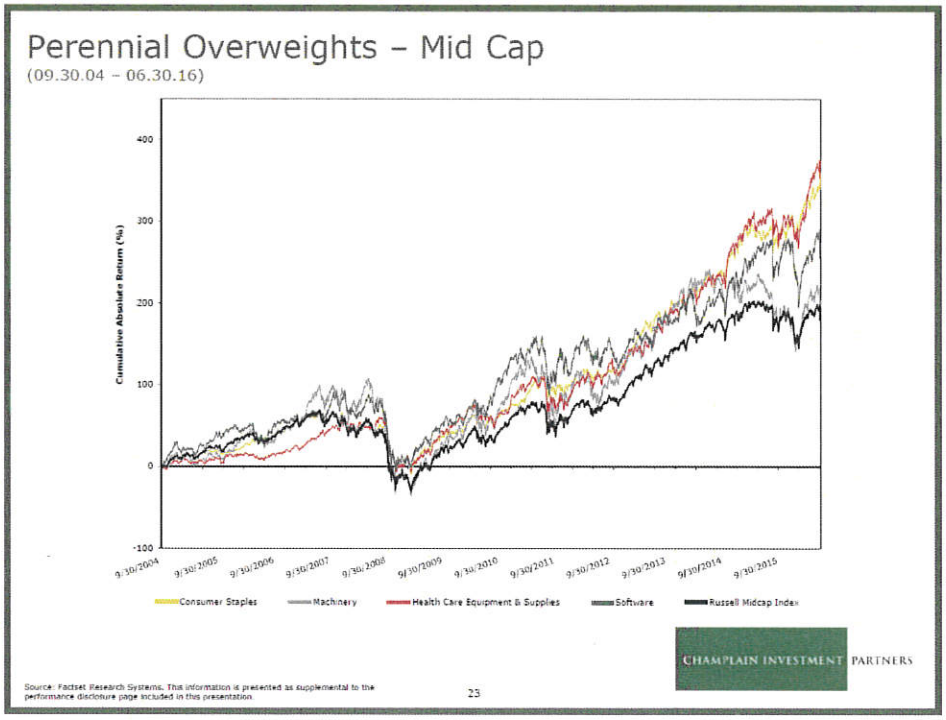
Chairman Fleming replied to Champlain Investments that all they need to do now is tell us about the future.

Scott Brayman replied by stating that he has no idea what is going to happen with the stock market but referred back to page 14 below. Scott stated that he feels pretty good because Champlain has gone through the toughest years with TSRS where the benchmark returns are quite stone. Scott stated that he doesn't know when we are going to have this, but that's just the nature of markets; you run out of buyers, and something happens and it creates sellers and you've exhausted the buyers, so you have downward volatility, it's inevitable. Scott stated that he wants TSRS to know that Champlain isn't afraid of it. Scott stated that we saw earlier the stocks that Champlain likes on the green line on page 23 as referred to below. He stated that the big drop in the green line, Champlain bought that dip for TSRS, so when the market gets clobbered it's a great opportunity to re-prime the portfolio to get good companies at bigger discounts which will probably improve the quality of the portfolio. Scott proceeded to state that he doesn't know what the future holds in terms of how much we decline or how much volatility we see, but we've had a dearth of volatility here recently and Scott thinks that we will have some at some point in the future and Champlain is ready to take advantage of it. Scott stated that there is a lot of reasons, but Champlain just owns great companies and the advantage that he showed earlier in terms of the gross profitability and EVA margin is so big, the longer you get, the better relative terms are going to be produced. Scott proceeded to state that what is important is that we aren't paying a premium, we are at the same P/E as the markets but it's the same as the benchmarks and we own much better companies.

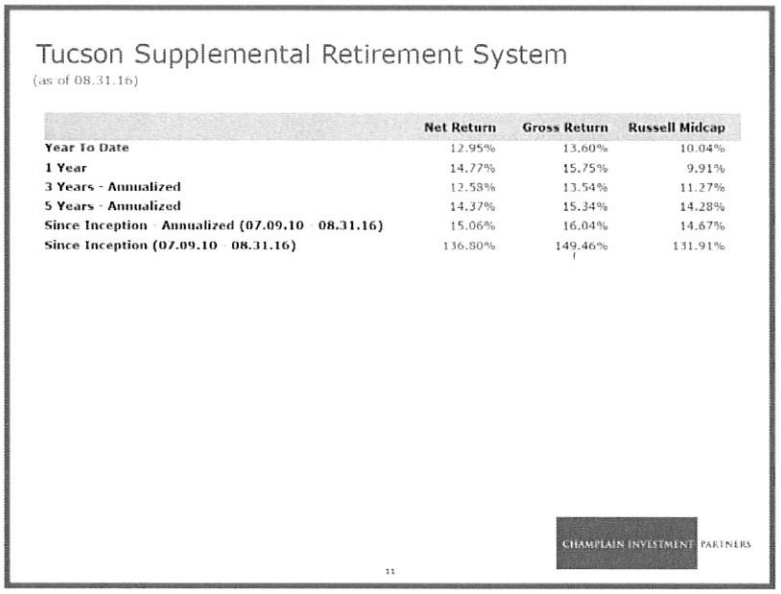
Neil Galassi stated that he has noticed that the Small and Mid-Cap strategies that we hold have done well the past few months, so what fact factors have led to the Small and Mid-Cap space doing well over the past few months and do you see some of those factors continuing?

Scott Brayman replied by stating that there are some things that could be positive for stocks and thinks when the Brexit vote happened, there was an initial panic reaction. Scott proceeded to state that some people thought this is the first redemption on the Euro Ponzi scheme is his opinion, and that's why they went down and right out the gate on the Brexit. Scott proceeded to state that others intuitive reaction was that wow, this is putting a lot of pressure on the politicians to start to get more fiscally involved in the economy. Scott stated that he thinks the market is scaling sharply back from the initial couple of days of pain from the Brexit because they see the pressure building on politicians to start spending money; they can't just rely on central banks and you've seen two candidates running for office in this country talk about big spending on infrastructure and other types of spending. Scott proceeded to state that there is another idea out there and if nobody has noticed it, he thinks they will start to notice it. It's the idea of jubilee or debt forgiveness for student loans. If that were to happen, it would be extremely bullish for inflation and for the economy because if you were to just say, your loan is forgiven, all is good, you have a lot of new car buyers, a lot of new home buyers, a lot of people looking to go out and spend money at restaurants and everything would boom. Scott said those are in the pipeline and thinks that is why the market has really shot back because people are seeing this fear in politicians that might actually get voted out so now they are going to start to gear up and spend. He feels that politicians are getting more fearful.





John O'Hare asked Champlain about the annualized return presented on page 11 as referred to below, four rows down. John O'Hare continued by asking Champlain, on annualized basis gross return versus the index, if I'm reading this right, that Champlain made 137 basis points gross annualized over the six year period since TSRS has been with Champlain.



Scott Brayman answered in the affirmative.

John stated to Champlain that the fees have been at 98 basis points if you subtract the gross from the net, so basically Champlain, over that six year period, is making more in fees than TSRS is getting in net value.

Scott Brayman answered in the affirmative.

Scott Brayman stated that is the insurance policy that TSRS has been paying for in this environment. Scott stated that if we get into this environment, and we don't more than offset, if Champlain doesn't give TSRS a great return on that investment that TSRS has made, and who knows when the music stops, it could have happened during the last six years but it's likely to happen in the next six years and stocks never go up in a straight line without big corrections every so often, and we are probably due as there is a lot of uncertainty around a couple of big issues out there. Scott stated that what Mr. O'Hare is stating is true, and he is confident that he will be sitting here with us some day showing TSRS a great return on the investment that TSRS has made. Scott proceeded to state that the problem for all of us is that we just don't know and Champlain's process isn't about trying to predict that, and he doesn't think that TSRS should be trying to predict that frankly.

John O'Hare stated that the he guesses that the question is that if the Board wants to pay that rich premium, the insurance premium, and maybe that's for the future to discuss.

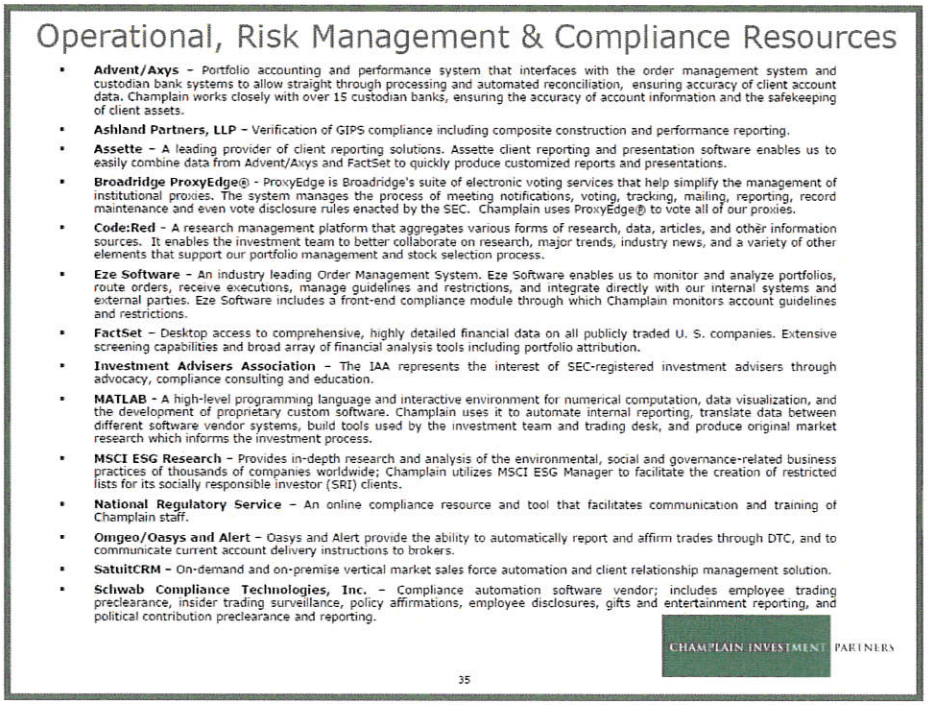
Scott Braymen replied by stating that there is another factor to be thinking of and that is that Champlain has given TSRS a market like return since inception after fees but we haven't taken as much risk as the market, and we don't currently hold a number of key risks that we see in the market., So, Champlain has managed to produce market like returns without owning the interest rates in sensitive stocks. So, if that ever goes the other way, Champlain thinks that there is a huge opportunity for us relative to the benchmark so if you go with passive management; you take on that interest rate risk.

Mr. O'Hare stated to Champlain that when active managers come in on the hiring process, the question is always asked if you would like to be evaluated at certain earnings over the index because we don't want to pay active manager fees if the active manager is only going to be giving us an index return, and they always come out and say sure, for example 3% over the benchmark net for an active manager. Mr. O'Hare stated that he thinks that 150 basis points would be fair net and he doesn't see doesn't see 150 basis points here.

Scott Braymen replied by stating that he appreciates what Mr. O'Hare is saying and suggested to Mr. O'Hare to think about this environment relative to historical storm blown environments where we've have had a central

bank backstopping the market in an extraordinary manner and an unprecedented manner in an effort to, one could argue, stamp out the bear market. Scott proceeded to state that he thinks that this has been a fairly unprecedented environment, and so at some point he thinks the reliance on central banks backstopping the markets becomes risky and it becomes imprudent. Scott stated that Champlain's portfolio is not positioned with a perpetual dependence, or a perpetual effectiveness in the Federal Reserve ban built into it. In fact, when faith dissipates in central banks, the free money environment, vigilantes may take the bottom market apart and cost the capital may go up if the Fed wants it to or not, and we aren't exposed to that risk. Scott proceeded to state we are looking at a 6 year window, which has been unprecedented in terms of monetary policy, and it may not always be that way, but if TSRS is confident that in the next six years is going to look like the past six years, and you don't want this insurance policy, that reasonable choice to make. Scott stated that Champlain isn't here to tell TSRS that Champlain is right but are here to tell TSRS this is Champlain's value position and that this environment is going to happen someday even if the central banks have become very political and have become a bigger force in the markets.

John O'Hare referred to page 35 presented below of the Champlain Investment Partners, LLC, Partners 2Q 2016 booklet, and asked Champlain how they vote TSRS's proxies or does somebody else vote the proxies. Mr. O'Hare referred to the Proxy voting service on the 4th bullet point down.



Operational, Risk Management & Compliance Resources

- **Advent/Axys** – Portfolio accounting and performance system that interfaces with the order management system and custodian bank systems to allow straight through processing and automated reconciliation, ensuring accuracy of client account data. Champlain works closely with over 15 custodian banks, ensuring the accuracy of account information and the safekeeping of client assets.
- **Ashland Partners, LLP** – Verification of GIPS compliance including composite construction and performance reporting.
- **Assette** – A leading provider of client reporting solutions. Assette client reporting and presentation software enables us to easily combine data from Advent/Axys and FactSet to quickly produce customized reports and presentations.
- **Broadridge ProxyEdge®** - ProxyEdge is Broadridge's suite of electronic voting services that help simplify the management of institutional proxies. The system manages the process of meeting notifications, voting, tracking, mailing, reporting, record maintenance and even vote disclosure rules enacted by the SEC. Champlain uses ProxyEdge® to vote all of our proxies.
- **Code:Red** – A research management platform that aggregates various forms of research, data, articles, and other information sources. It enables the investment team to better collaborate on research, major trends, industry news, and a variety of other elements that support our portfolio management and stock selection process.
- **Eze Software** – An industry leading Order Management System. Eze Software enables us to monitor and analyze portfolios, route orders, receive executions, manage guidelines and restrictions, and integrate directly with our internal systems and external parties. Eze Software includes a front-end compliance module through which Champlain monitors account guidelines and restrictions.
- **FactSet** – Desktop access to comprehensive, highly detailed financial data on all publicly traded U. S. companies. Extensive screening capabilities and broad array of financial analysis tools including portfolio attribution.
- **Investment Advisers Association** – The IAA represents the interest of SEC-registered investment advisers through advocacy, compliance consulting and education.
- **MATLAB** – A high-level programming language and interactive environment for numerical computation, data visualization, and the development of proprietary custom software. Champlain uses it to automate internal reporting, translate data between different software vendor systems, build tools used by the investment team and trading desk, and produce original market research which informs the investment process.
- **MSCI ESG Research** – Provides in-depth research and analysis of the environmental, social and governance-related business practices of thousands of companies worldwide; Champlain utilizes MSCI ESG Manager to facilitate the creation of restricted lists for its socially responsible investor (SRI) clients.
- **National Regulatory Service** – An online compliance resource and tool that facilitates communication and training of Champlain staff.
- **Omgeo/Oasys and Alert** – Oasys and Alert provide the ability to automatically report and affirm trades through DTC, and to communicate current account delivery instructions to brokers.
- **SatuitCRM** – On-demand and on-premise vertical market sales force automation and client relationship management solution.
- **Schwab Compliance Technologies, Inc.** – Compliance automation software vendor; includes employee trading preclearance, insider trading surveillance, policy affirmations, employee disclosures, gifts and entertainment reporting, and political contribution preclearance and reporting.

CHAMPLAIN INVESTMENT PARTNERS

35

Scott Braymen answered in the affirmative that, that is the service that Champlain uses to cast their ballot. Scott stated that Champlain makes the vote themselves. Scott stated that Chaplain reads research from Glass Lewis and ISS. Scott proceeded to state that Champlain does read outside research, but Champlain makes the vote and the choice themselves. Scott stated that if TSRS gives Champlain guidelines, that Champlain will consider those guidelines and if not, they will use their own guidelines. Scott stated that Champlain isn't rubberstamping management's compensation packets.

John O'Hare stated that CalPERS seems to be a very progressive fund as far as voting proxies and everything and he is wondering if there is any value in TSRS piggybacking upon how CALPERS votes their proxies.

Chairman Fleming responded by stating to let's have a conversation about it and bring in some outside resources to figure out whether that is a good idea.

John O'Hare asked Champlain if the fees are based on assets under management, which is the value of TSRS's funds with Champlain, and if Champlain's total assets under the management go up 100%, how much do your expenses go up? Do they go up or down 100% just because your assets under management have gone up 100%.

Judith O'Connell answered in the affirmative. Judith stated that Champlain has over time expanded the research team and Champlain is also investing in the business. Judith proceeded to state that Champlain has made significant investment in their tools such as EVA dimensions, and is in the process of building out a data warehouse system and is partnering with SEI, and has added resources to compliance activities. Judith stated it's not a dollar for dollar; it's a leveragable business model.

Mr. O'Hare stated that it is one of the great scalable businesses. Mr. O'Hare asked is it 20%, 30%, 50%, 70%.

Judith O'Connell with Champlain Investment Partners responded that she doesn't know off of the top of her head.

Scott Braymen stated that it is scalable but also there is a lot of alignment in their business model because if Champlain doesn't make assets grow, their compensation goes down. Scott stated that if Champlain doesn't deliver a credible value proposition to the marketplace like this, then Champlain doesn't have a business. Scott stated if this doesn't happen, then Champlain is extinct. When you build this value proposition and continuously deliver this value proposition, you have very good business and clients also have very good outcomes.

John O'Hare stated, looking at what the other Small to Mid-Cap active manager in the portfolio, Fidelity, over the last 60 months, he believes they have returned 400 basis points and Champlain which is a bottom has only returned about 103 basis points.

Judith O'Connell asked John O'Hare if that is Small-Cap or Mid-Cap.

John O'Hare stated that it is Small-Cap he believes the Mid-Cap product to be similar.

Scott Braymen stated that Champlain's Small-Cap has a similar advantage right now, if not more.

John O'Hare asked if TSRS should be in Champlain's Small-Cap.

Scott Braymen replied that Small-Cap and Mid-Cap are apples and oranges. Scott proceeded to state that he doesn't own any passive strategies in any account of his, his relatives have no passive exposure, and he hears Mr. O'Hare's argument. He's a shareholder of Champlain; he believes in active management, he believes in this value proposition, that this is his career and his livelihood. Champlain is gaining share in the market where a lot of active investors are being divested where Champlain is actually growing assets particularly in Mid-Cap.

John O'Hare replied by asking if Champlain has a defined contribution or a defined benefit plan for their employees to help with employee retention.

Judith O'Connell answered in the affirmative. She stated it's a defined contribution plan. Judith stated that Champlain has a profit sharing plan so it goes into there.

Scott Braymen stated that Champlain also makes all key employees owner operators; they are all shareholders. Scott stated that everyone at the firm knows that if Champlain doesn't deliver on this end of the spectrum, then Champlain is toast.

John O'Hare asked if Champlain Investment Partners is a privately held company.

Scott Braymen and Judith O'Connell answered in the affirmative.

Chairman Fleming thanked Scott Braymen and Judith O'Connell with Champlain Investment Partners for their presentaiton.

C. **Plan Administrator's Report**

1. Report on Office Operations and Key Facts and Figures From the Past Month

Chairman Fleming stated that the next item on the agenda is the Plan Administrator's Report.

Neil Galassi thanked Chairman Fleming. Mr. Galassi stated, first of all he would like to introduce to the Board, Ginny Rath Pepper. Mr. Galassi proceeded to state that she came on board as the new Administrative Assistant for the Retirement Office this past Monday, and the office is excited to have Ginny here. Mr. Galassi stated that she is from the Phoenix area and believes that she brings many skills sets to the table that will really benefit the office. Mr. Galassi asked Ginny tell the Board a little bit about herself.

Ginny Rath Pepper introduced herself. Ginny stated that she is new to the Tucson area and is from Phoenix. Ginny proceeded to state that she has been here for a month and a half and is happy to be here. Ginny stated prior to working at the City of Tucson, she was a math teacher, a GED teacher, has a bachelors in Education, and has associate degrees in business and accounting. She has worked in the insurance field as a property adjuster.

Neil Galassi welcomed Ginny and stated that he is happy to have her here with us.

Neil Galassi stated that he wants to mention to the Board the efforts of Veronica Natividad and Cindy Garcia, two administrative assistants within the Finance Department. They both took time from their normal roles to assist the Retirement Office as they worked toward hiring the Administrative Assistant's position. Mr. Galassi stated that their help was very much appreciated by staff and wants to relay that to the Board.

Neil Galassi went over some operational highlights., For month of August, we have processed six normal retirements, five deferred retirements, and two disability retirements. The board may have noticed that there is one retiree on the ratification report that had retired last year but is presented on this month's ratification report. The timing was due to a legal issue for this member's retirement and nothing on the retirement's office's end.

Neil Galassi stated that we have had a total of 2,942 pension payment across all categories in August and of that 2,923 were direct deposit, and 19 were live checks, so we are keeping the live check number low. Mr. Galassi proceeded to state that 20 refunds/rollovers were processed and totaled approximately $219,439.14. Mr. Galassi stated that during the month we had external auditors here, the week of September 5, and that he will go into that in more detail during his operation highlight. Mr. Galassi stated that he did receive the draft of the actuarial valuation from the Actuary, Gabreil Roeder, Smith, and Company. He indicated the Actuary mentioned the draft was provided to us three weeks earlier than they typically do. So, Mr. Galassi wanted to commend the efforts of the retirement office, particularly Dawn Davis and Bob Szelewski who worked diligently to answer the actuarial data questions as well as the Accounting Operations Division for turning around the financial data quickly. Mr. Galassi proceeded to state we began drafting the Comprehensive Annual Financial Report for TSRS now that we have the financial data from Accounting Operations. Mr. Galassi proceeded to state the CAFR process involves coordination from the Investment Consultant and the Actuary as there are pertinent sections where those parties will provide us information. Mr. Galassi stated the he anticipates if all goes smoothly we will have a CAFR draft ready by early November, and it will definitely give us ample time for our internal and external auditor review process to submit a time for the Government Finance Officer's Association award.

Neil Galassi stated in regards to TSRS investment activity during this month, the portfolio remained relatively unchanged from July to August, but during September we had seen some gains equating to roughly 70 basis points mostly in the past week. Mr. Galassi stated that there seems to be three major factors in play this month: a surge in oil prices toward the end of the month lifted the equity indexes with the announcements about OPEC cutting oil production in November. This will give the market some stability in regard to oil prices.

Second, is the presidential election outcome given the differing economic policies of the candidates. Lastly, are the actions of the Federal Reserve. Mr. Galassi stated that there was a Federal Reserve meeting this month. They acknowledged that they have seen progress towards its goal of full employment and has seen stability in regards to interest rates. Mr. Galassi stated that they have given indication that they would like to see progress be more stable and continue that trajectory before a rate hike so they have indicated they are going leave rates on hold taking a Dovish as opposed to an aggressive tone when looking at their projections. Mr. Galassi stated with that we have seen some Fed induced market volatility last month. Leading up to the Fed meeting, the portfolio was declining with speculation on what the Fed was going to decide, and after the meeting when there was some clarity, the portfolio started going up in general when the markets reacted. So, we started seeing gains toward the end of the month Mr. Galassi stated that it is worth noting that a raise in interest rates does have potential to cause volatility in our fixed income portfolios so we are looking to be educated on that area with Callan and Associates giving a presentation at the retreat next month. Mr. Galassi asked the Board if they have any questions about his operational highlights or investment report.

John O'Hare asked Neil Galassi if the Fiscal Year 2018 and the budget calendar out yet.

Silvia Amparano replied by stating that it has not come out yet.

John O'Hare asked Sylvia Amparano if she can give it to the Board when it comes out.

Sylvia Amparano asked John O'Hare if he was referring to the City's Budget.

John O'Hare answered in the affirmative.

Sylvia Amparano answered in the affirmative.

Michael Coffey asked Neil Galassi about the external audit that took place recently and asked if we are going to be printing results from it.

Neil Galassi replied by stating that he will be going into the external audit process, so hopefully he will be able to answer questions.

2. TSRS Operation Highlight – The External Audit Process

Neil Galassi stated for this month's operational highlight he chose the external audit process. Mr. Galassi stated that our external auditors are CliftonLarsenAllen, and they were on-site the week of September 5th. Mr. Galassi stated that the audit process is important because it leads to the opinion on the Financial Statements of the TSRS as to them being free from misstatement in all material respects. Mr. Galassi stated what that means is that our members, the Board, our actuaries, and other interested parties can rely on the information presented in the Financial Statements and related notes for decision making. Mr. Galassi stated the auditors use audit techniques that generally involve analytical analysis, direct confirmation of amounts, like reviewing statements from our custodian bank BNY Melon and investment manager statements, and sampling transactions to determine the functionality of our internal controls over financial reporting. Mr. Galassi stated that they had three auditors on-site and they actually scheduled the visit for 2 weeks, but due to our level of preparation for the process they were able to accomplish their on-site objectives within a week. However, they will be following up with some of the final financial reporting areas for the CAFR later on. Mr. Galassi stated that he thought it would be important for the Board to have an idea of what they did. Mr. Galassi stated that the external auditors drew samples of new retirees during the year, and a sample of recurring pension payments from existing retirees, to verify controls over our calculations of benefits and continuing payment of benefits are functioning. They also reviewed our controls over lump sum payments. The auditors drew a sample of those, and reviewed our internal control processes over that area. They took a sample of employees entering in the system during the year to verify that they were set up with the correct contribution rate as Tier 2, and determine the functionality of controls over contributions ensuring that those are recorded in the plan's records. Mr. Galassi stated that he wants to mention that we do a lot of reconciling of the actuary system to the general ledger, so the auditors reviewed the reconciliations performed over the related areas. They also

reviewed all of the investment balance reconciliations from the accounting records to the reports of the Custodian Bank, BNY Mellon. In addition, they interviewed and performed observations regarding the performance of our duties and our internal controls. Mr. Galassi proceeded to state that it was a very robust process, generating a lot of questions, and he is happy to report the initial results indicate no audit findings for the plan. He believes this is very exceptional given the level of turnover that happened in the Retirement Office during the fiscal year. Mr. Galassi stated that in his experience as an auditor, significant turn over typically led to some audit findings. So, he is very happy to report that initial results indicate a clean audit. Mr. Galassi proceeded to state, that he will of course educate the Board if anything comes up as the auditors complete the audit process.

D. **Administrative Discussions**

1. Renewal of Investment Consultant Contract

Chairman Fleming stated that the next item is the renewal of the Investment Consultant Contract.

Nail Galassi stated that he wanted to add just a few comments before we start. Mr. Galassi stated as part of the audit process, he did find that our investment consultant contract with Callan expired as of June 30, 2016, and there is a provision that he provided to the Board, in the existing contract for us to renew for two additional years under the same fee structure. Mr. Galassi stated that both parties need sign a written amendment to execute the provision. Mr. Galassi stated that Callan has already indicated that they intend to renew with, us as you can see by Gordie already signing the amendment. So, this agenda item is to determine if we want to continue with them for two additional years.

Chairman Fleming stated that if we are going to continue with them for two years, then we will need a motion.

Chairman Fleming stated to Neil Galassi that he thinks that should we get to do one at a time. Chairman Fleming asked Neil Galassi if we are doing it for two years.

Nail Galassi replied by stating that we can renew for two, one year periods. Mr. Galassi stated that this amendment is basically our indication that we are going to stay with them until June 30, 2018.

Chairman Fleming asked Neil Galassi if it is for both of the years then.

Neil Galassi answered in the affirmative.

Chairman Fleming presented a motion to approve the contract amendment.

Silvia Amparano replied second.

John O'Hare replied by asking about the contract provisions for a 30 day mutual bailout.

Neil Galassi responded by stating that he is not sure of that.

Silvia Amparano stated that provision number 4 on the contract addresses that.

John O'Hare responded by asking if we can see if it is available, the breakout of the total fee charged by Callan for their services

Neil Galassi responded we would request that of Callan and Associates.

Chairman Fleming asked if there is any further discussion or questions.

Chairman Fleming stated to the board, all of those in favor of the motion to sign the two, one year extension agreement, indicate by "I".

TSRS Board all replied "I".

Chairman Fleming asked the board if anyone opposed.

Chairman Fleming stated that he will vote that "I" passes unanimously.

2. Board Member Education Plan Discussion

Chairman Fleming stated that the next item on the agenda is the Board Member Education Plan.

Nail Galassi thanked Chairman Fleming. Mr. Galassi stated that Board requested educational lists for Board members. Mr. Galassi stated that he contacted the COPERS, the City of Phoenix's Retirement System. Mr. Galassi stated that their Director has experience as a pension lawyer, and he provided this list from the National Association of Public Pension Attorneys. It's a very robust list of educational sites that hopefully will give the Board some guidance as they look for education opportunities moving forward. Mr. Galassi stated that the next thing he wanted to mention is that when he wrote his synopsis for the Board, the Board Education Plan, he probably should have provided what was stated in our Board adopted Governance Policies, where his synopsis was derived from. Mr. Galassi stated the reason he provided this to the Board is that if we were to change how we require Board member education, it would involve a change to our governance policies. Such changes would have to be approved by the Board. Mr. Galassi wanted to reiterate our current framework as dictated in Governance Policy, is that Board members should identify areas in which they might benefit from additional education and then in turn work with staff to find reasonable and appropriate educational opportunities.

Mr. Galassi asked John O'Hare if he has any proposals to bring forth regarding potential changes to this Governance Policy at this time.

John O'Hare replied by stating that he doesn't at this time.

Chairman Fleming stated that this is a helpful list and wonders if any of anybody on the list holds educational events the Board could attend.

Neil Galassi replied by stating what he plans on doing is going down the list of organizations and monitoring them. As he sees events occurring he will communicate those to the Board. Mr. Galassi proceeded to state that he did provide the list should anyone on the Board want to go on the websites of these organizations and see what resources they may have available.

Chairman Fleming stated that it strikes him as maybe not terribly productive to look up the National Educations Association, or the National Council on Teacher Retirement, but there are probably ten of these that if they happen to be convenient times and easy locations we would benefit from it.

Neil Galassi stated that some of these organizations may have webinars and other types of online education to look at too.

Chairman Fleming stated that maybe we can set ourselves the task of everybody doing a little bit of moseying around to see if they can find out maybe we can share that back to the group at some future date.

John O'Hare stated that there is the annual Opal Public Funds conference coming up January 9-11, 2017.

Neil Galassi answered in the affirmative. Mr. Galassi stated that he did provide the board a copy of that announcement.

John O'Hare stated that it is a very convenient one as it is in the Phoenix area.

Chairman Fleming responded in the affirmative.

John O'Hare stated that you can go off on a day trip for the meet and greet portion of the conference if people are concerned about time.

Neil Galassi stated that one other comment he would like to make is that he did a little research. Mr. Galassi stated that the Board collectively can attend a conference. Mr. Galassi stated that all we need to do is post a notice that they are doing so, and that no discussion on the Plan or anything regarding business of the Board will be held. Mr. Galassi proceeded to state that as far as members not being at the same session, as long as we announce that a group will be up there, we are perfectly covered and legally.

John O'Hare stated that it is a good thing that Neil is reaching out to the COPERS, plus that he knows Paul Matson who is the head of the ASRS. They are great resources and that all those people are willing to talk to TSRS Board members also.

Neil Galassi stated that Paul Matson wanted to come to our retreat but he had a conflicting Board meeting on that day. Mr. Galassi stated he works to build good relationships with the other retirement systems as he feels it is very important to the TSRS.

Chairman Fleming stated that is good to know and thanked Mr. Galassi.

3. Report From Board Member on 2016 Public Funds Forum

Chairman Fleming stated that the next item is a report from John O'hare. Chairman Fleming asked John O'Hare if the Public Funds Forum is on the list.

John O'Hare responded stating that he didn't see it but that we can put it on there.

John O'Hare stated that this is some of his takeaways from the Annual Public Funds Forum where about 200 fund trustees show up. Mr. O'Hare stated it's 14 sessions over a 4 day period and the featured speaker was Ben Bernanke and it was interesting to get an insider's view on the 2008 economic meltdown and how he saved the country. Mr. O'Hare stated one of the things mentioned is that the Fed has done about all that it can do obviously, and that the country needs a pro-growth policy, and that the CEOs should be looking at the long term instead of a quarter by quarter basis. The conference had a theme that a good long term horizon is a 3 year term. Mr. O'Hare proceeded to state that a study that Mr. Bernanke quoted says that 70%-90% of productivity value comes out about the 3rd year and not on a quarter by quarter basis. Mr. O'Hare stated that there was an author there that wrote a book that it is called "What They Do With Your Money" and it is based upon all of the hidden fees that people are taking out of the transactions and that it amounts to about 2%. If those fees could get down to 1%, the author says that the US economy would grow by 40% which is a pretty startling claim. Mr. O'Hare stated that there was a session on best governing practice for Boards, and it was mentioned a best practice involves the Board benchmarking against other Boards and thinks that we will be able to do that in the future sometime. Mr. O'Hare stated that they were also talking about seeking out specific skills for the Trustees and it is a best practice, which is already built into our Code that the trustees have to have those certain skills. Mr. O'Hare said that they mentioned that advisory committees are a good thing and he thinks that we should look into potential formation of one. Another best practice advises that the boards should be setting their own budgets and that we do that now basically. Another best practice presented involved having a formal education process for new trustees. Mr. O'Hare stated that they recommended a book for new trustees titled, "The Random Walk Down the Wall Street". Mr. O'Hare stated that he thinks the book is about 20 years old.

Chairman Fleming stated that it's rewritten every 5 years or so.

Mr. O'Hare stated that in regards to investing and climate change issues; instead of not investing in companies that don't follow climate change protocol that investors should be engaging those companies and helping them. Mr. O'Hare stated that David Axelrod spoke at the forum who was President Obama's campaign manager for

2008 and 2012, and it was interesting to see how they won the 2008 and 2012 elections. Mr. O'Hare stated that shareholder activism came up, meaning a shareholder's ability to influence a corporation's behavior. We are shareholders on the Board, and with that said what can a $750 million dollar fund, which is a small fund, do in the active shareholder area whereas larger funds like ASRS, a $35 billion dollar fund, and CalPERS plus CalSTRS, which is the California Teachers Fund, totals about $300 billion. Mr. O'hare feels we can align ourselves with what they are doing.

Chairman Fleming thanked Mr. O'Hare.

4. October Board Retreat Update

Mr. Galassi stated that he passed out a draft of the agenda for the October retreat prior to the meeting. Mr. Galassi stated that we are holding it at the Arizona Inn again this year. Mr. Galassi stated that there will definitely be a robust range of speakers; we have planned roughly 5 hours plus of meeting time. Mr. Galassi stated the first presenter will be Andrew Goldberg from JP Morgan. Paul Erlendson from Callan brought him to the table after hearing his presentation called "A Guide to the Capital Markets. Mr. Galassi stated that after that we will have our Actuary, Gabriel Roeder Smith and Company (GRS) do their presentation on the actuarial report. Mr. Galassi stated that he asked GRS to do a comparison of us to the other Arizona plans to help give the Board an idea of where we stand in relation to the other plans in Arizona. GRS will also go into the risk sharing features of our current Tier 1 variable and Tier 2 structures as well as the discussion of a potential Tier with a 50/50 split per request of the Board. Mr. Galassi proceeded to state our external legal counsel, Catherine Langford, will come right after her and give the Board a refresher on the Arizona Constitution as it relates to pension provisions so that the Board is up to date on the State legal requirements over pensions. Mr. Galassi proceeded to state that we are working on having an executive summary for the funding policy as we talked about in June, so it will hopefully bring something to the table for the Board on that to help make that document more digestible for our members and any other interested parties. Mr. Galassi stated that Ms. Langford will also provide the Board with a fiduciary training presentation. Mr. Galassi stated the afternoon will be more investment driven. Mr. Galassi stated that one of our investment managers, PIMCO, will give a presentation on the two strategies they currently manage for us. Callan will present right after PIMCO and go over the Fixed Income Portfolio Composition as they mentioned during their attendance at last month's Board meeting. Mr. Galassi proceeded to state that Gordon Weightman from Callan is going to bring John Pirone with him, who is one of Callan's fixed income strategists, Callan will also address one of our future agenda items, an action plan for Black Swan events. Mr. Galassi stated an administrative discussion will be held on the potential formation of an Advisory Committee which has been a future agenda item. Mr. Galsassi stated that he can add the board member education item to the retreat as well.

Chairman Fleming stated that he thinks the answer is, let's see Mr. O'hare's written proposal and circulate that, but don't put it on the retreat agenda; let's look at it before we get it on the agenda.

Neil Galassi answered in the affirmative.

Michael Coffey stated that it is a massive agenda and wonders if Mr. Galassi thinks it's possible for him to distribute materials more than a week in advance.

Neil Galassi replied by stating that he has been in contact with all of these individuals, and they are aware of their individual presentation requirements. Mr. Galassi proceeded to state he will contact the presenters over the next day to facilitate provision of materials to the Board as early as possible.

Chairman Fleming stated what would good if there was a webpage where you can just stick stuff electronically when you got it and we can all have the link.

Neil Galassi replied by stating that we can either do that or he can email Board members the information when he gets it.

Chairman Fleming thanked Mr. Galassi.

John O'Hare stated that maybe the webpage is something to think of because there are members beneficiaries that are interested.

Chairman Fleming stated that he was thinking that we could do that for all future meetings too if it turned out to be easy to do.

Neil Galassi answered in the affirmative, and indicated he would post the materials on the TSRS webpage as they are received.

Michael Coffey stated that he would also appreciate a hard copy of the material.

Neil Galassi stated that we are planning on doing compiling binders with the materials as has been done in the past.

Mr. O'Hare stated that we tend to benchmark ourselves with other people in the state but because of the size of our fund, we should possibly be benchmarking ourselves with those of similar size and nature fire throughout the country.

Chairman Fleming asked Mr. O'Hare if we could see what this looks like first. Chairman Fleming stated that he thinks that there are some questions other than just investment issues; there are government issues that are probably controlled by state statutes.

Neil Galassi stated that is why we are having Cassie do a refresher on the State of Arizona Constitutional provisions.

E. **Call to Audience** – none heard.

F. **Future Agenda Items**
1. Duties and Selection of Advisory Board
2. TSRS Board Annual Evaluation of Staff and Consultants
3. RFQ for Actuarial Services
4. Action Plan for Black Swan Events

G. **Adjournment** – 9:53 AM

Approved:

~~Michael Coffey, Acting Chair~~	10/28/16		10/28/2016
Chairman of the Board	Date	Neil S. Galassi Pension Administrator	Date

Robert Fleming