TUCSON SUPPLEMENTAL RETIREMENT SYSTEM
BOARD OF TRUSTEES
Meeting Minutes

DATE: Thursday, February 28th, 2013
TIME: 8:30 a.m.
PLACE: Finance Conference Room, 5th floor
City Hall, 255 West Alameda
Tucson, Arizona 85701

Members Present: Robert Fleming, Chairman
John O'Hare, Elected Retiree Representative
Brandy Kadous, Elected Representative
Lani Simmons, Human Resources Director
Karen Tenace, Elected Representative
Kelly Gottschalk, CFO and Assistant City Manager

Staff Present: Allan Bentkowski, Treasury Finance Manager
Michael Jesse, Lead Management Analyst
Dave Deibel, Deputy City Attorney
Melissa Waychoff, Administrative Assistant
Michael Hermanson, Pension Administrator

Guests: Jenefer Carlin, Retiree Representative
Jean Wilkins, Retiree Representative
Rob Van Den Brink (Hewitt Ennisknupp)
Scott Cooprider (Hewitt Ennisknupp)
John Masdea (T. Rowe Price)
Ron Taylor (T. Rowe Price)
Eric Crabtree (Causeway)
Harry Hartford (Causeway)

Absent/Excused: Kevin Larson, CM Appointee

A. Call to order by Chairman Fleming at 8:33 AM.

B. Consent Agenda
1. Approval of January 24th, 2013 Board meeting minutes
2. Retirement ratifications for the month of February 2013
3. January 2013 TSRS expenses
4. 2nd Quarter FY13 TSRS Financial Statements

Motion to approve consent agenda, minus the minutes made by Kelly Gottschalk, 2nd by John O'Hare, **motion approved 6-0 (Kevin Larson absent).** Motion to approve minutes as corrected made by Kelly Gottschalk, 2nd by Karen Tenace, **motion approved 6-0(Kevin Larson absent).**

C. Investment Activity Report Administrative Discussions
1. T. Rowe Price Annual Manager Review – John Masdea, Ron Taylor

John Masdea, (V.P., Institutional Sales) began discussions by stating the firm's philosophy; focusing its efforts on providing slow, measured growth over time, with a tendency to hire from business schools which they believe leads to long, tenured employees. The firm has $576.8 billion assets under management, a strong balance sheet with $2.2B in cash and mutual fund investment holdings and no outstanding long term debt.

Ron Taylor (V.P. – Portfolio Specialist: U.S. Equities) followed, stating TSRS assets managed by the firm in the U.S. Large Cap Growth Strategy were $61.07M at Jan. 31st. The Large Cap Growth product currently has about 70 stock names in the portfolio. On performance, inception to date from Feb. 1, 2012 thru Jan. 31, 2013 (from the additional T Rowe Price performance update sheet) the firm has returned 15.76% net of fees, (16.34% gross) vs. the Russell 1000 Growth Index benchmark at 13.43% or 291 basis points (thru Dec. 31, 2012, returns were 10.42% net, 10.93% gross vs. 8.77%).

Looking to key performance drivers, Financials improved during the second half of the year; Healthcare, Financials, Consumer Discretionary were drivers on a one year basis; Consumer staples were also very noteworthy as a weak sector for the year. Individual stocks really drove returns, and Apple is a stock that hurt them in the 4th quarter, but was a big driver for the first 3 quarters of the year. The allocations to Apple have been reduced down to 3% because they do not expect the growth with Apple to continue. Michael Hermanson noticed they are no longer invested in Stryker?; Ron Taylor responded that they had not generated the profit they were looking for and was eliminated.

Top 10 holdings during 2012 were Apple, Google, Amazon.com, Danaher, Gilead Sciences, Priceline.com, MasterCard, Crown Castle International, Juniper Networks, and Qualcomm. Technology rating has come down. They have major exposure in healthcare, technology, consumer discretionary, and industrial and business services, while they are underweight in consumer staples.

Allan Bentkowski asked about market rumors; is there a "bubble" forming in the equity markets? Ron Taylor responded no, but in terms of what the market thinks; he would say there is cautious optimism, and in the last 5 months inflows into the Equity markets have been high. Of course, there is still some consternation, and equities won't be climbing straight up. John O'Hare asked if the next 10 months should be about 10% and Ron Taylor responded he hates to quote a number on record, but January is typically a good indicator of what the Market will do for the year, so it is possible we could see the market up 10%. Scott Cooprider asked about turnover among analysts increasing recently. Ron Taylor responded that historically turnover has been low, but recently the Healthcare team left the firm, to launch a hedge fund. This announcement brought publicity so the perception is greater than reality. Chairman Fleming asked if this report could be received electronically, and Ron Taylor responded yes, he could do that. Additionally, staff was asked if the materials could be posted to the TSRS website as a repository for similar large reports in the future, so that Board members could have a place to access them.

2. Causeway Annual Manager Review – Eric Crabtree, Harry Hartford (President)

This manager has total assets under management of ~$16B, with various Causeway strategies including International Value Equity $12.4B, International Value Select $826M, Global Value Equity $1B; Emerging Markets $451M; Opportunities including International Opportunities (International and Emerging Markets) $1.7B, Global Opportunities (Global and Emerging Markets); Global Absolute Return $62M. The firm has 55 employees, including 14 fundamental and 4 quantitative research professionals and 100% owned by (18) employees as of November 2012.

The TSRS portfolio was $45,835,208 at December 31, 2012, with 98.41% invested in 59 named holdings. Many companies in the portfolio have minimal debt and the dividend yield in portfolio is above the bond yield on a weighted basis at 3.4%. Overall, equities are considered attractive versus bonds. Valuation across market cap is fairly uniform and 2012 returns were 24.14% vs. MSCI EAFE at 17.90%; since inception, regrettably not as good returning 5.82% vs. the benchmark at 4.37% (145 basis points). Chairman Fleming stated he would like to see performance comparisons net of fees and they said they will include it going forward (however, a comment was made that the benchmark index does not assume any fees).

In the Eurozone there is a wide diversity in returns and low returns tend to be dominated by peripheral European countries. Core countries have significant returns in comparison to periphery countries. The TSRS portfolio received a modest boost of returns due to appreciation in currency. Causeway has now increased exposure to Japan at the margin. Looking at securities from the bottom up, Japan is a bifurcated market where they see a lot of companies performing very well and a lot of companies that are not. Harry

Hartford thinks the Japanese equities market and economy will transform, but he remains suspicious based on past experience.

Causeway has no exposure in Australia because it is an expensive equity market and it is a cyclical market. Every two weeks if you are working, 9% of your salary is taken out and placed into a retirement plan called a superannuation fund for each of its working citizens. Another unique aspect for Australian markets is, many companies are "dual listed", meaning they sell shares in an Australian company, but they also have a listing elsewhere, like in the U.K.; Causeway chooses to invest in the dual listing located outside of Australia because they are **cheaper and do include a tax charge on the investment**.

John O'Hare asked if we are gaining because of currency valuation change? Harry Hartford responded that yes, the weakness of the dollar is adding to returns from this product. Then, John asked if the firm expects the weakness of the dollar to continue? The expectation is that Bank of Japan's balance sheet will mirror the Fed's balance sheet, and whichever one expands the most will have the weakest currency and at the moment the bank expanding the most is the Bank of Japan.

Performance attribution by region indicates a majority of returns are from European stock selections, with substantial returns from industry arising from Technology, Hardware & Equipment, Software and Services, and Banks. Portfolio positions today are higher in Materials, Capital Goods, and Energy. John O'Hare asked what Causeway's sense of portfolio growth for the next 10 months was, Harry Hartford responded it is reasonable to expect moderate returns, as equity risk premiums are moderating from high levels. Finally, Harry closed by stating the prevailing view today is equities are the asset of choice because alternatives are unattractive, but he does not agree with that view. John O'Hare thanked Harry for his presence, commenting it is nice to have the actual portfolio manager come in for this report.

3. Hewitt Ennisknupp December 2012 (Q2) Prime Report – Rob Van Den Brink, Scott Cooprider

Rob Van Den Brink began; stating the TSRS portfolio is still digging out of the hole on a 5 year basis because of the financial crisis. It's easy to see where the attribution is (P. 18) in the PRIME report for December 31, 2012 shows the story. Most of the performance was manager added, which is what they would expect. The slightly underweighting in International Equities, did not help overall performance.

Scott Cooprider took over, stating that last year was a stronger performance than anticipated and it could be said that last year was "less bad"; where nothing got significantly better, but nothing got a lot worse either. Fixed Income is not overly attractive, equities relative to bonds look attractive, but equities on a stand-alone basis, Hewitt remains cautious. Without top-line growth, it's hard to know where the bump is going to come from. The market anticipates sequestration will come in some form, the Social Security tax increased by 2% taking money out of paychecks, GDP growth is going to be restrained regardless; there are pockets of opportunities, but no must-haves. More money is going out than coming in. Karen Tenace asked if the Board needs to scrutinize the rate of return. Rob thinks an asset liability study should be at hand. Michael Hermanson stated our timing will be with the June 30, 2013 valuation report. If the plan's assumption rate declines, contributions to the plan will have to increase. Scott Cooprider added that the investment assumption really depends on the asset allocation.

Skipping the calendar performance (PRIME report) for a moment, Scott referred to the Performance Update for 2013 through February 22nd, showing equities are up 6.6% (S&P 500 Index), so 2013 has been very good so far, which he admitted is a nice surprise to see that much positive performance in only 7 weeks.

For 2012, Equities have been the place to be, however in 2012, Champlain underperformed relative to their benchmark, up 13.1% vs. 17.3%. There has been dramatic outperformance from PIMCO fixed income, posting a 13.4% return vs. Custom index at 10.6%, even though there have been outflows in this strategy partly because they are offering a lot of different StocksPlus products. However, TSRS has been well rewarded by being patient and waiting out their down performance from a couple of years ago.

Comments on underperformance for Champlain. High beta and low quality stocks did the best in 2012 and a lot of it is recovery stocks. Champlain always follows quality and thus, they were not rewarded for that in

2012 with performance during this period (Champlain's history indicates they tend to underperform in up markets and outperform in down markets). Champlain is current rated as a "BUY" and there have not been any changes in personnel (Scott reminded the Board there is an InBrief analysis of Champlain in the PRIME report).

Pyramis is "HOLD" rated and there are slight concerned about analyst turnover, but performance has been great at 23.5% vs. Ru 2000 index at 16.3%. Causeway has had a fantastic three years – also "BUY" rated. Aberdeen posted a strong absolute outperformance with 15.9% return vs. MSCI AC world ex us index at 16.8% – they are "BUY" rated, a growing product in both developed and emerging markets. More conviction means more positives or better on the downside.

The new allocations to fixed income mandates instituted in the first part of 2012 have worked well in both the short and long term: BlackRock continues to match the index at 4.3% vs. 4.2% for the Barclays Agg. Index; PIMCO has done a great job since their underperformance in the third quarter of 2008. Emerging markets are still growing and currencies of local markets are expected to appreciate.

Real Estate: JP Morgan's core portfolio (the Strategic Properties Fund) has a queue of nine months to get in; LaSalle is in liquidation mode; JP Morgan Income & Growth has been averaging 6-7% income in addition to value appreciation. This JP Morgan portfolio has more debt or leverage relative to the core portfolio.

In Infrastructure, both have held up fairly well. Macquarie has mostly airports in their portfolio. Last year was a very good year on an absolute and relative basis.

4. Portfolio composition, transactions and performance review

Allan Bentkowski provided a brief overview, as Hewitt covered the manager review already. As of January 31, 2013 the TSRS portfolio was valued at $625.5M, compared to $606.7M at Dec 31, 2012, on February 27th, 2013, the value was at $625.1M. During the month, $1.8M was moved ($300k from Alliance, $1.5m from Pyramis) to the Investment Pool Account to meet cash flow needs for retiree payments.

Calendar Year Performance (January 2013 only): Total Composite Fund, up 3.39% vs. 3.01% for custom plan index; total Fixed at -0.19% vs. -0.70% for the Barclays Aggregate; total Equities up 5.34% vs. 5.35% for the Equity Composite; all managers are performing well in the month of January; with 6 of 8 managers either meeting or exceeded their benchmark. Aberdeen and Causeway Capital were the two that lagged in the month of January: Champlain returned 7.52% vs. the Russell Midcap at 6.84%, there is nothing to compare against Real Estate at this point since the NCREIF-ODCE only posts returns quarterly.

Fiscal Year to Date Performance (July 2012 through January 2013): Total Composite Fund was up 10.61% vs. 9.22% for the Custom Plan Index; Fixed income performing well at 4.22% vs. 1.1% for the Barclays Aggregate; Total Equities have returned 14.02% vs. the Equity Composite at 14.13%; Real Estate returned 7.68% vs. the NCREIF at 5.19% for two quarters (through December 31, 2012); Total Infrastructure returned 8.62% vs. the CPI+4% at 2.7%.

D. Administrative Discussions

1. TSRS Trustee Training Policy

Karen Tenace drafted a summary for the Board's consideration after she reviewed policies adopted by other Pension plan. The last section of the draft indicates new Board members shall be given a binder with basic reports at the beginning of their term. Mike Hermanson asked if any board members might prefer to receive and maintain these documents on a flash drive rather than a binder. At the same time, Mike asked whether any Board members would prefer have delivery of Board packet materials electronically rather than by hard copy paper. Responses from Board members were mixed, indicating some might prefer and others, would not (so the flash drive is an option, but they would need to be asked individually). Another comment suggested board materials be posted to a location on the City's website so that Board members could access these reports over time. At this point, Chairman Fleming asked for a motion to discuss the training policy.

John O'Hare offered a **motion** to accept the training policy drafted; but adding a requirement for all Board members to attend two conferences per year, Kelly Gottschalk provided a **2nd to the motion**, for purposes of discussion. Kelly expressed concern over this stipulation, because if Board members are required to attend two conferences per year, that requirement may limit the pool of employees eligible to run for the elected board positions if they are unable to vacate their jobs during the conference period (sometimes they can be up to 3-4 days) for the Board. Brandy Kadous has a problem with required conferences, because he wants more flexibility in how he can obtain annual training for the Board. John O'Hare would change his stipulation to requiring a certain amount of money budgeted for conferences. Chairman Fleming called for a vote, asking all those in favor of requiring 2 annual off site trainings for each board member, 1-5, **motion failed** (Kevin Larson absent). In an alternate motion, Brandy Kadous motioned to adopt training policy as designed with electronic binder included, 2nd by Karen Tenace, motion passed 5-1 (John O'Hare opposed, Kevin Larson absent).

2. Report on Feb. 26 Mayor and Council action to consider TSRS Board recommendations related to amortization period and FY14 pension contribution rates

Mike Hermanson reported that on February 26, 2013, TSRS Board Chairman Robert Fleming followed an introduction of the item by City Manager Richard Miranda and CFO Kelly Gottschalk. Chairman Fleming noted the Board's unanimous vote for changing the Plan's funding assumptions; affecting the period of amortization used for unfunded liabilities, recommending a 20 year amortization period instead of the current 15 year period used; recommending a definition change that will affect how our variable rate is determined for employees hired on/after July 1, 2006.

Our GRS Actuary Leslie Thompson followed, spending a good measure of time explaining how our original approach of the variable rate definition determined from 40% of the "ARC" was unintentionally burdening our newest employees. She also explained the difference between how Normal Cost and the ARC is constructed; and how the funded ratio of the Plan could actually improve with a standing recommendation to overfund the plan by continuing the FY13 employer contribution rate into the coming years, and following a level employer contribution rate approach could attain full funding in 23 years.

Reaction from Mayor & Council was mixed, some appeared to be in favor of the recommendations after gaining a better understanding of the methods and reasoning provided by our actuary; but several Council Members indicated (Uhlich and Kozachik) it was a lot to take in at one sitting. Council Member Uhlich stated she had received statements from a TSRS Board member not in support of the Board's recommendation (John O'Hare offered that he was the Board member), which caused her to hesitate and question whether the vote was unanimous; Council Member Cunningham stated the actuary's 7.75% investment earnings assumptions were unattainable, stating that our Actuary was using "Madoff-like" assumptions that could not be realized. Consensus from Mayor & Council was they wanted to table the item and request time for further study and a future vote on the recommendations.

Following the report, Dave Deibel recommended future conversations with Council members be conducted in M&C offices. Chairman Fleming expressed he would be happy to volunteer for that; Brandy Kadous also indicated he would be willing. Lani Simmons expressed dismay with Mr. O'Hare, that Council members found it very confusing there was a TSRS Board member with a counter position. Dave Deibel said Board members faced with dual roles need to be sure that they are advising Mayor & Council from a fiduciary obligation perspective; and, if they are inclined to disagree with a recommendation, they must clearly express that as their personal opinion, because the Board already voted to recommend it. Dave Deibel stated you should not, as a Board member, speak against a Board action unless it is clearly stated as your personal opinion. Lani Simmons asked John if he was speaking for the retirees, or for the Board of Trustees, or if neither, exactly whom was he was speaking for? John indicated that he was speaking for himself. John O'Hare stated his intent was to have more time to think it on through.

3. Intern from the Eller School of Management at the U of A

John O'Hare contacted the school to discuss the process and options there and will be prepared to give more information at the next meeting.

4. Benchmarks for the actively managed funds

John O'Hare would like to set a specific figure for active managers to be evaluated at 2% over the index. Chairman Fleming asked if this needs to be discussed. John O'Hare would request we set for a vote at the next meeting. John O'Hare stated we do not put active managers on the watch list if they beat the benchmark. Allan Bentkowski commented that approach takes a narrow and simplistic viewpoint because there are a number of other factors available to put a manager on a watch list, as stated in the investment policy. Michael Hermanson stated it seems appropriate to consider this in the investment policy, and should be discussed in May when Hewitt is scheduled to be here. Hewitt agrees it is appropriate to have expectations, but they do not recommend this absolute view, since that approach may put the Board into a position of painting itself into a corner.

5. Reconstituting advisory committee in City code

Michael Hermanson stated Section 22.40.L in the City code allows the Board to establish advisory and sub-committees. Chairman Fleming would like to put this on the agenda for the Board retreat for October 2013.

6. Proposed FY14 budget for TSRS

Michael Hermanson advanced the FY14 budget to the Board for their review and consideration at next month's meeting, and included everything submitted to the Budget department. Brandy Kadous pointed out that for 2013-2014 there is a budget total of $18,000 for training, including travel.

E. Disability Applications *
   1. Harold Handley

Motion to enter Executive Session made by Lani Simmons, **2nd by Kelly Gottschalk, motion passed 6-0** (Kevin Larson absent). **Motion** to exit Executive Session made by Brandy Kadous, **2nd by Karen Tenace, motion passed 6-0** (Kevin Larson absent). **Motion** to approve Harold Handley disability application made by Kelly Gottschalk, **2nd made by Lani Simmons, motion passed 6-0** (Kevin Larson absent).

F. Articles for Board Member Education / Discussion
   1. A Widening Gap in Cities – Shortfalls in Funding for Pensions and Retiree Health Care – The Pew Charitable Trusts report dated January 2013
   2. Advisor to Detroit Pensions Guilty in Pay-to-Play Scheme – Feb. 11, 2013 PlanSponsor.com

G. Future Agenda Items
   1. Follow-up on the Jan 24 motion directing staff and actuary to make recommendations for improving the funded status of the plan
   2. Review of Section 22-40(I) to be considered at October 2013 (annual retreat) meeting.

H. Call to Audience – Jenefer Carlin states concern over distributing materials electronically. Michael Hermanson clarified it is just an option, not mandatory. Jean Wilkins asked if there was a date set for Board's recommendations to come back to Mayor & Council and Lani Simmons responded not yet.

I. Adjournment - Chairman Fleming stated we are adjourned at 11:37 AM.

Minutes Approved:

Fleming	3/28/13		3/21/13
Robert Fleming, Board Chairman	Date	Michael Hermanson, Plan Administrator	Date