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NEW YORK CITY TEACHERS' RETIREMENT SYSTEM
INVESTMENT MEETING
held on Thursday, October 4, 2012
at
55 Water Street
New York, New York

ATTENDEES:

MELVYN AARONSON, Chairperson, Trustee, TRS
SANDRA MARCH, Trustee, TRS
MONA ROMAIN, Trustee, TRS
LARRY SCHLOSS, Comptroller's Office, Trustee
JANICE EMERY, Trustee, Finance
JAMIE SMARR, Trustee, Finance
JUSTIN HOLT, Trustee, Mayor's Office
PATRICIA REILLY, TRS
JOEL GILLER, TRS
MARC KATZ, TRS
LIZ SANCHEZ-PAZ, TRS
SUSAN STANG, TRS
MARTIN GANTZ, Comptroller's Office
SEEMA HINGORANI, Comptroller's Office
THADDEUS McTIGUE, Comptroller's Office
BARRY MILLER, Comptroller's Office
YVONNE NELSON, Comptroller's Office
TATIANA POHOTSKY, Comptroller's Office
RICHARD SIMON, Comptroller's Office
ROBERT C. NORTH, JR., Actuary
ROBIN PELISH, Rocaton
CHRIS LYON, Rocaton
MIKE FULVIO, Rocaton
RENEE PEARCE, Broome Law Group
ROBERTA UFFORD, Corporation Counsel
MICHAEL KOENIG, Hamilton Lane

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P R O C E E D I N G S

(10:10 a.m.)

MS. REILLY: Good morning.

CHAIRPERSON AARONSON: Good morning.

MS. REILLY: This is the October 4, 2012 investment meeting of the Teachers' Retirement System.

We'll start with the roll call.

Melvyn Aaronson?

MR. AARONSON: Here.

MS. REILLY: Janice Emery?

MS. EMERY: Here.

MS. REILLY: Kathleen Grimm.

(No response.)

MS. REILLY: Sandra March?

MS. MARCH: Present.

MS. REILLY: Frieda Foster?

(No response.)

MS. REILLY: Mona Romain?

MS. ROMAIN: Here.

MS. REILLY: Larry Schloss?

MR. SCHLOSS: Here.

MS. REILLY: We have a quorum.

Mr. Chairman, I'll turn it over to you.

CHAIRPERSON AARONSON: Thank you very much.

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Good morning, everybody.

The first item on the agenda today is going to be the public agenda of the Passport funds.

MR. LYON: Good morning, everyone.

So, today I'm going to talk about the Passport fund performance. Most of this information is through August 31, and at the end I will give you a quick review of market conditions, at least in an estimate of performance for September.

The first fund I'll start with is the diversified equity fund; and materials we sent out in advance were passed out today. And on the first page you can see the asset levels at the end of August, $9.6 billion in this fund, diversified across all the strategies listed.

All of the composites were within 1.3 percent or less of their targets due to the ongoing rebalancing program. So that is in line with our expectations. And no significant changes in the allocations since the last report.

If you flip ahead two pages to page 3, we'll start in the middle of the page. On the most forward row, the total performance for the diversified equity fund for the month of August, the good news is positive 2.35 percent, all this net of fees. And that was ahead

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of the hybrid benchmark and 15 basis points behind the Russell 3000.

For the month, the international composite was pretty in line with the overall total. The U.S. Equity index composite was a little ahead of the total. The defensive strategy composite was behind with 1.3 percent return. So still positive, but some more muted, not surprising given its nature.

And lastly, the strongest performing composite was the active domestic manager composite, which represents roughly 20 percent of the fund.

On a year to date basis, the total

diversified equity fund was over 12 percent. And the strongest performing composite has also been the active domestic manager composite, which was up, in round numbers, 14 percent ahead of its benchmark.

So that hasn't always been the case, but the leadership in absolute and relative returns has varied over time, and that's why we got multiple composites and it's been the strongest one for that time period.

On a year to date basis, the weakest performance, although reasonable absolute returns, was from the international composite up about 8 and a half percent; but notably, also meaningfully above the EAFE or international developed market benchmark by over a

percent, net of fees.

I will turn next to the other Passport options. But first, any questions on that?

So the next handout has information on the bond funds, which had almost $380 million at the end of August. The performance for August was positive 15 basis points for this option. That was within 2 basis points of the benchmark, as you see on page 1.

And on a year to date basis, the 1.87 percent return is just 1 basis point off of the benchmark. And again, the fund returns are net of fees.

Then, if you flip ahead to page 2, you will see the remaining Passport options for the international equity fund, the inflation protection fund and the socially responsive equity funds. I will present them in that order.

The market value is around $72 million, $30 million and $38 million respectively. The international equity fund performance for the month was positive 2.3 percent. That was a little behind the EAFE index. But on a year to date basis, similar to the international composite in the diversified equity fund, this fund was ahead of its benchmark by over a percent net of fees, with an 8 and a half percent return.

The inflation protection option is shown

next, and for the month it returned 1.6 percent ahead of its benchmark. The benchmark I regularly mention, we don't expect to track that as closely on a shorter time period. But I always point out when we're ahead of it.

(Laughter.)

And on a year to date basis, we have a 9 and a half percent net of fees return from this fund, versus about 4 percent for the benchmark. This fund is a much more diversified fund. It invests in a lot of strategies beyond those included in the benchmark. Whether we look at TIPS or CPI, the objective of this fund is to outpace inflation over a long period of time.

(Mr. Smarr entered the meeting.)

CHAIRPERSON AARONSON: Let the record show that Jaime Smarr has entered the room.

MR. LYON: Finally on this page, the socially responsive equities fund, which on a year to date basis has trailed its benchmark. You can see that's still the case. A slight portion of that gap has been closed with the relative performance in the month of August, where you can see we returned 3.1 percent, while the benchmark was up 2 and a quarter percent.

Again, I will pause to see if there are any questions?

Not hearing any, I'll move to the final

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handout we have for the Passport funds in public session, which is primarily a benchmark performance through September 30, along with some information on the underlying mutual funds in several of the Passport fund options where that primary investment.

What you can see is, it would be an exception of long Treasuries, which has been a part of the defensive composite benchmark in the diversified equity fund, that we're in positive territory again for the month of September, with all these major indices that are relevant to the Passport fund, with the broad U.S. Equity market up around 2.6 percent during the month.

So, we hope when the actual results come in for the diversified equity fund that there will be something not different than the hybrid benchmark of about 2.4 percent for the month of September.

So, any questions on that?

CHAIRPERSON AARONSON: Anybody?

MR. LYON: That's everything we have for the public session for the Passport funds.

CHAIRPERSON AARONSON: Thank you very much.

We'll go to public session for the pension fund.

MR. SCHLOSS: Thank you, Mel.

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Everybody have their August monthly reporting package?

August was a pretty benign month. I won't walk you through any of the slides. I'll just jump to page 33. You can see the total assets are at an all time high of $45 billion, and in September up again, so we're pushing about $46 billion now.

I'll jump to the asset allocation on page 37. Everything is pretty much in the bands. We added bank loans. Cash is down, so less than 1 percent cash.

If you look at page 42, the markets were generally up, so the fund made about 1 and a half percent, bringing the fiscal year up to about 2 and a half percent. September was also a good month. The Fed launched QE3, so we're probably up 4 to 5 percent for the first quarter; which I would say don't annualize.

But it's better to be up than down in the third quarter.

MS. MARCH: Have a more positive attitude.

MR. SCHLOSS: Sorry; doing this too long.

(Laughter.)

And that was about it. It was a very benign month, not much to talk about, really. September was up, so again, not to waste everyone's time, not that much going on to report.

Any questions on the financials?

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That gets us to the IPSs. I think there's more work that needs to be done on the IPS, so we'll postpone that discussion. But I'd like to talk about the private equity IPS, so I'll turn it over to Barry and Hamilton Lane.

(Brief discussion off the record.)

MR. MILLER: Our topic for the moment is the private equity policy statement, which is on page 111 of the book. What I thought would make sense is to talk a little about the changes that we're proposing, as opposed to granularity of the detail.

So if we look at page 113. So the first proposal we have out there, under Section 4, this is letter D. This is the benchmark. So just by way of reference, the current benchmark for the private equity portfolio is the Russell 3000 plus 500 basis points.

The recommendation that we're making to the board is to change that to the Russell 3000 with a quarter lag plus 300 basis points. The genesis of the quarterag is the nature of the private equity returns when they are reported to you, they are reported with a quarter lag. So this idea of comparing apples to apples.

With regards to the change from plus 500 basis points to plus 300 basis points, as we talked to

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Hamilton Lane and we talked to other pension funds in the marketplace today, we believe that the Russell 3000 plus 300 is the more widely accepted benchmark, and is clearly a benchmark people are moving towards.

There has also been some discussions in the previous policy statement about using the venture economics, the median benchmark. And we talked with Hamilton Lane about that and we talked to other people and we had meetings.

One of the challenges we always have, and I have said and made recommendation to the board for private equity funds, is that people don't wake up in the morning and say they want to be in the middle, everyone says they want to be the best and top quartile.

The challenge is the data set for that information, frankly, is just not very good. And as a result of that we thought it would be better to use this public benchmark. But when we do the individual recommendation for funds, we will use the Thompson or the frequent information with regards to quarterly information.

The second recommendation that we are proposing is on page 114. This is in Section 5. All this really is just adding a little more granularity to the existing policy statement. So again, by way of

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reference, the way the policy statement is set up, there's a targeted range for buyout of 60 to 80 percent. There is a targeted rangefor venture which is 10 percent, and then there is the catch-all bucket of "Other."

So we thought it made a lot more sense to give you more granularity to get a better idea of what your private equity portfolio looks like. So what we detailed is different strategies: buyout, growth, special situations, et cetera.

And then the strategic or tactical plan that we talked about in previous meetings in the executive session, in there, we talk more about what the allocations would be. Again, the policy statement is not something we believe that you change on an annual basis. But as you look at the market and you think about how the portfolio is maturing, the ability to be more tactical makes more sense to review on an annual basis.

Then, if we go to page 115, under Section B, it's the last bullet point. This is some language on emerging managers. All this is, is memorializing the previously approved program you had, which at the time we called it SEM 2012; now we call it EM 2012. This is just memorializing that program in the policy statement.

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So we thought that was important to cover.

If we continue on to page 118, Section D, Number 2, the co-investment and direct secondaries. The way the previous investment policy was set up is that you had the ability to do co-investment in a fund structure. You had the ability to do secondaries in a fund structure, but you didn't have the ability to do them not in a fund structure.

So, if a private equity fund would give us the opportunity to co-invest in an individual transaction, you were precluded from doing that in the previous policy statement.

And we felt the recommendation we would make to you all is, it is important to have as many tools in the tool box as possible. And again, it's important to note, this is not asking for discretion for something; because if there is an opportunity do a direct co-investment or direct secondary we would bring it to the board and the board would either give us consensus or not give us consensus.

Again, this is just widening the fund, give you more opportunities to invest in different types of products. Again, you can invest in the fund structure today, that's already in the policy statement. This just gives you the ability to do direct secondaries or

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direct co-investment.

Finally, if we look at page 119, on the top, Section E, Numbers 1 and 2, labelled "Exceptions to the IPS." The way the existing policy statement is set up, there are things that come out of the IPS which actually may create an exception to the IPS. But the mechanism to report that to you all as trustees is not as clear as it could be.

So we thought it was important to create a more clear, concise mechanism if there was an exception to the IPS. Effectively, this is just a notification process, so you all have a better idea of what's going on, and then you can choose what path you want to take with that.

Finally Section 9, 6, which is titled "Manager Risk." As a result of really two factors, one is the allocation to the asset has increased for the Teachers' Retirement System. And the denominator, so the size of the pension fund has continued to grow.

We're making a recommendation to increase the band, the amount of capital you can deploy to an individual fund. As your policy has gone from 4 to 6 percent, as the pension fund has grown significantly, we thought it was prudent to widen the band.

Again, it is important to note these are not

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discretionary bands, these are recommendations we make to you all, and you make the ultimate decision whether or not you want to give consensus or not give consensus.

The balance of the changes made for the IPS are not structural, they are just cleaning up languages, dotting I's, crossing Ts, things like that. These are the salient changes that we are proposing to the boards.

With that, we'll leave it open for any questions or comments and so forth.

CHAIRPERSON AARONSON: Mr. North?

MR. NORTH: Could you discuss the plus 300 basis points a little bit more in terms of how that will look relative to the long term expectations for top quartile? And also, how about the risk reward capital asset pricing model kind of relationship, does it keep everything in line on a risk-adjusted basis?

MR. MILLER: With that question, I will defer to Mike from Hamilton Lane.

MR. KOENIG: I'll spend a couple of seconds on the benchmark and speak to that question.

I think the one thing we know is, there's still a lot of difference in the marketplace for what the appropriate benchmark is, and it's a function of everything Barry described. There's challenges with a number of benchmarks.

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If you were to look again and zero in on this illiquidity premium specific to an opportunity benchmark, academic evidence has the same thing. There's a lot of variability. There has been studies that look at forward Treasury rates, that have looked at forward cash rates, spreads. They all come back to something a little bit different.

I think, specific to your point, when thinking about the risk reward -- I'll deal with that one first. I think 300 basis points, A, it is consistent with the marketplace for plans like yours. Meaning, on a portfolio approach, with a large portfolio deploying capital consistently to establish a bottom end of the barrier, or what you think of the opportunity cost, 300 basis points feels appropriate.

So when you match the portfolio, the desired risks in the portfolio with your expected return, that 300 feels, and we would agree, is an appropriate number.

Specific to the top quartile, if you were to look historically at the point where a fund becomes top quartile and you were to look historically at the Russell plus 300, there would be a little bit of a gap there. I think the challenge is when you are thinking about constructing a portfolio and owning or taking an interest in funds at various points in their life cycle,

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all of which the desire is to be top quartile investors, the results and the comparison for an opportunity cost might get more challenging than to benchmark solely against that top quartile number.

And so that, again, when you identify that bottom bound to what your performance target is, the 300 is an appropriate number.

MR. NORTH: Historically, I believe the board has heard the message that to be successful in private equity you want to be in the top quartile because of the spread of returns. And to the extent that 300 basis points is less than what that would be expected to be, it seems like cutting back against what is one of the other objectives of the board, which is to get a truly above average expectation out of the private equity, not the median that everybody else does.

MR. KOENIG: I will make a comment and let Barry do the same.

I think the goal for finding top quartile funds remains in effect. Again, it's thinking about what is the appropriate bottom bound to a portfolio return comprised of, A, an existing portfolio and, B, layering in new investments over time.

So, I don't think in any way we change the goal of sourcing and committing to top quartile

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investments. I think we're identifying a bottom bound to an opportunity benchmark. That is a bit different. Again, for a lot of reasons, it is consistent with the approach and consistent with the market.

MR. MILLER: I think it's important to note that the underlying standards that we're utilizing and the recommendations we're making to the trustees, to the board, that has not changed at all.

Again, we have been very consistent on really two things. One, we believe you should be writing larger checks to fewer managers. And two, we believe you should be investing with best of breed managers. And that has not changed.

So this is the reporting metric. This, we believe, makes it more consistent when comparing. But it is very important to note that the recommendations, the underlying standard has not changed at all.

CHAIRPERSON AARONSON: Thank you for your question, Mr North.

Anybody else?

MS. EMERY: I have a follow-up question to Mr. North's question.

I know that historical performance is not an indicator of what we might expect in the future; but do you have any historical data you can provide to us that

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shows that a Russell 3000 plus 300 -- I'm assuming it's a net of fees benchmark, because it's not actually stated in here -- is reasonable, with regard to what would have been a top quartile return in the past?

I'm just looking for some sort of background education or data that would support the recommendation.

MR. KOENIG: We have tons of information I can provide. I don't have a specific study with me today, but I can tell you in thinking about, not specifically to your questions and the analytics of it, but if you were to look again at the market, we did a survey where we looked at 25 large institutional plans undertaking private equity, not dissimilar.

I think four of them in total were at a 500 basis points premium, and three of the four were foundations and endowments. So that, again, speaks to a difference in what you are trying to achieve.

But we can certainly think about how to show you this historic relationship between the 300 benchmark premium and the benchmarks, all taken with Barry's original point, the challenges with benchmarking of the private benchmark.

MS. EMERY: That would be very helpful. Thank you.

MR. KOENIG: Sure.

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MR. MILLER: Any other questions?
MS. EMERY: I have a couple other, if I may.
With regard to the purpose statement and the investment policy statement on page 113. In looking at this -- first of all, I think that you have done a wonderful job of updating this document and modernizing it, and thank you for all the work you put into it.
As I'm reading the purpose and the investment philosophy statement, I'm reading it and asking myself the question, What is the role of private equity in the total portfolio? And what do we believe in terms of our investment philosophy? And those are the things that I would expect to see here.
So, for example, we might say we believe that private equity markets are inefficient and illiquid and should provide us with the opportunity for superior returns; that we believe that there's a return premium to investors who are willing to take an opportunistic approach; we believe we can manage risk by doing this and that; we believe that successful programs have these characteristics.
That's the sort of thing I expect to see in an investment philosophy statement.
Can we perhaps better define what our philosophy is with regard to private equity?

MR. MILLER: The short answer is yes. The longer answer -- and I would defer to Mel as chairman of the Teacher's board -- what the board would like us to do, we will do. So I would defer. Once there is a consensus on what that language should be and what people would like, we're more than happy to incorporate it.
CHAIRPERSON AARONSON: I don't see any reason to change the language. When we vote on this, we will make that decision.
MR. MILLER: Okay.
MS. EMERY: Might I perhaps propose some language for a review at the next meeting?
CHAIRPERSON AARONSON: I believe that we should be looking at this as carefully done, and that we would vote on it today.
MR. MILLER: Questions?
MS. EMERY: I have some questions with regard to the asset allocation section, which is Section 5 on page 114.
I understand that you removed the ranges to be a little more flexible, and certainly can understand that. My concern is that the ranges were in the policy in the past. I think for the purpose of defining the risk profile of the program, which is essentially what

an investment policy is designed to do, we can't predict the return, but what we can do is set risk parameters as a board. And I am somewhat concerned by the removal of the ranges, because it does then remove the definition of how risky we want the program to be.

So I would be interested in hearing Rocaton's perspective as our general consultant, as well as Hamilton Lane's perspective of what other clients are doing with regard to their policy statement. Is this unique, is this something that now other clients are starting to do, and why?

MS. MARCH: I have a statement.

I believe the reason why we have Hamilton Lane as a consultant is because our general consultant indicated that we should have a private equity consultant who is more expert in the area.

So I think Hamilton Lane and Barry should answer the question; and I don't think Robin should answer the question; because the reason why this board has hired Hamilton Lane to work with our investment advisor, the Comptroller's Office, is for the reason that Rocaton is not an expert in this area.

MR. MILLER: With regard to the policy statement, the policy statement has been reviewed by Hamilton Lane and been reviewed by Rocaton. We thought

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that was prudent as the general consultant. So it has been reviewed.

I think it's also important to note -- not to go into too much detail, because it was something that was previously discussed and approved in executive session -- but I think it's fair to say at this juncture the recommendation to the Teachers' Retirement System is to give more granularity on the strategy. And the way it had been previously approved in executive session -- can't go into too much detail on that -- that this is the way it should be. But I would defer to Mike as well, but that would be our position.

MR. KOENIG: I think it gets down to a practical application of what you are trying to do. And so when you add this level of granularity, I think establishing targets that you would put in a document like this, rather than a strategic plan that you do with a lot of frequency and can demonstrate the strategy and the implementation of it, I think makes more sense.

So the strategic plan certainly referenced in this document is something you are used to seeing, and I think in our minds -- it's hard to give you an incredible peer comparison. All of these plans are very different in a lot of different regards.

But speaking specifically to this one, I

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think when you add the detail of granularity that you have here, trying to establish those ranges in a document like this rather than something with a lot more flexibility and frequency of update is challenging.

MS. EMERY: What do your other clients do today?

MR. KOENIG: I think there's a variety of different approaches. I can tell you it would be very uncommon, I think for the reasons Barry laid out. Having this level of granularity is important and makes sense. It would be uncommon for clients to then have this level of granularity with a finite allocation target attached in a document like this.

So what they do is sort of what we are recommending, although this may read different; and that is to prepare a sort of comprehensive review on an annual periodic basic that would set out the strategy, set out the targets and also show how that gets implemented.

CHAIRPERSON AARONSON: Since we're going to vote on this today, let's move on.

Do you have any other questions?

MS. EMERY: I do.

MS. MARCH: I did not mean to stymie Rocaton's comments. If Rocaton disagrees with what I

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said, then please feel free to make a comment at this point if you would like to. I assume from what Barry said you already had your input with the existing private equity consultant and with the person at the Comptroller's Office who is responsible for private equity.

MS. PELISH: That's correct.

MS. MARCH: Thank you.

MS. EMERY: I have a couple of questions with regard to some of the investment evaluation criteria that are on pages 120 and 121. And this is a question for Barry.

Would you be providing the general partners with this investment evaluation criteria alone, or would you be providing it with the entire investment policy statement?

MR MILLER: I'm not sure I understand the question.

MR. SCHLOSS: Provided to whom?

MS. EMERY: To the general partners.

MR. SCHLOSS: The GP?

MS. EMERY: Yes.

MR. SCHLOSS: Why would they want it?

MS. EMERY: With regard to a couple of bullets here about not entertaining proposals that have

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potential for eliminating public sector jobs and rejecting investments that would pose representational risk to the fund. Is that something we provide to our general partners?

MR. MILLER: I would make a couple of comments. With regard to this policy statement, the information here, this is more of an evaluation, this is not what we propose to them. With regard to those two comments I would defer that to Richard Simon from our counsel office.

MR. SIMON: They are aware of it, because in these early stages of diligence we send them an advisory notice that summarizes the board's key policies. I believe that makes reference to public sector jobs and other factors.

Second of all, early on in negotiations, they see our form side letter which also spells all that out.

So a couple of points. Before a deal is closed, they are aware of your key policies.

MS. EMERY: I note there is a section earlier on in the investment policy statement with regard to the entire program being subject to the exclusive benefit rule and all other applicable laws, including the requirements of prudence.

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So certainly that's the overriding principle with regard to the total investment policy.

And the source of my question is, do the general partners see the entire policy along with this statement, the qualified statement attached to it? Are they merely seeing these excerpts? And if so, should we be modifying it in some way to insure that it does tie back to the requirements of prudence?

MR. SIMON: These general partners deal with a lot of public funds, all of whom either under their respective state laws, or if it were more like a Taft-Hartley fund under ERISA, are subject to the exclusive benefit and prudence requirements, as well as the common law requirements of exclusive benefit.

So, I would feel certain that every general partner, their inside counsel and outside counsel, are well aware that, just as they all know that they're subject to investment advisor and similar statutes, that the funds with whom they deal, the pension funds at one time or another, are also on the other side subject to exclusive benefit prudence requirements.

So I don't think that it adds anything to tell them what they already know, that we're subject to prudence and exclusive benefit.

MS. EMERY: It doesn't hurt, either?

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MR. SCHLOSS: There are sections in the document that talk about fiduciary prudence, standards of care, best efforts, indemnification. These are 100 page documents, GP, that the first couple of comments you referred to are embedded in all of the documents.

Then we have a side letter that just deals with our issues. And every public pension fund has its own set of issues, so you end up with a compendium of

side letters that deal with each fund's desires.
MR. SIMON: And the side letter, among other things, references our being subject to, for example, Section 177 of the retirement and Social Security law, which lays down all kinds of requirements including that basket clause investment, of which this is one, that are subject to the prudence requirement even though otherwise they are more flexible than the other enumerated permitted investments in 177 of the RSSL.
MS. EMERY: Very good.
Would they be required to report to us any exclusions that they make in terms of investments with relation to these particular clauses?
If they were to exclude an investment as a result of one of these, do they report back about these exclusions?
MR. SIMON: We don't actually have access to
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their internal due diligence. No doubt they look at many dozens of investments before they settle on the handful that they think will be suitable for a fund. And we don't ask. They probably consider proprietary the many considerations that would go into evaluating each investment.
I think it's more the converse. If nonetheless they decide such an investment is appropriate for all members, then when it is presented to us, both to our consultants and from further inquiry to the general partner, we can assess the existence and severity of any problem that might run afoul of these criteria and make an evaluation in light of the policy and the prudence and exclusive benefit issues, whether it would be appropriate to exercise in that case.
MS. EMERY: Do you report back to the board, or does BAM report back to the board on the opt-outs? I guess I haven't seen any since I have been on the board.
MS. MARCH: It might be that the managers understand that this system has been in existence since 1917, and that public funds in this country have operated for many years. And it might be that there are those managers who follow the policy of the entity that they are investing money for. And in my career here on the board, which goes back to 1984, our managers follow
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policy. And if they don't, then there is always a choice we have to end our relationship.
MS. EMERY: It's rather difficult to end a general partner relationship, however. So in cases where there is an opt-out, do we see that? Does the board get some accounting of the opt-out?
MR. MILLER: No. In my period as being with the retirement system, based on the policies that Sandy has discussed, we have not been in a position to opt out of any portfolio companies.

MS. EMERY: Could we perhaps put something in the policy where the board would be alerted if there were a case --

CHAIRPERSON AARONSON: Someone's who's been working for all these years, I don't think there's any reason to add --

MS. MARCH: This board and the investment advisors that we give consent to operate as our investment advisor every month has followed all of our board's rules and regulations. This board has always operated under applicable law. And I would make a suggestion at this point, if this is the last of the questions on the topic, I would suggest we move forward and we come to consensus about adopting the present IPS that has been presented to us.

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MR. GANTZ: I'd like to add one thing.

This really is very similar to what we have in every one of our public market accounts. We have very specific investment guidelines which may or may not be the same as other public funds or other funds that the managers manage for, where they would buy something or sell something for our account, not for another account, because of the policies of the board, and our limitations in our accounts.

MS. MARCH: Thank you for that statement.

I would like to assure you that if this board were uncomfortable our investment advisor would know about it. And we have never reached a level of discomfort.

MR. SMARR: Sandy, I don't think it's so much saying there's a level of discomfort. And I don't think anyone's saying the processes haven't worked. I think it's a matter of whether the policy should reflect how and when things are communicated. That's the point that Janice is making. She's not saying it hasn't worked. She's saying who knows it and when? And should that be as per a matter of written policy?

MS. MARCH: Every three months our board, which you have sat on, makes a decision as to whether our investment advisor is dealing with the investment

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world as we want them to do deal with the investment world.

And do not fool yourself, Jaime, putting in lots of words does not necessarily make it any different.

But every three months we make that decision, and we can change our investment policy at any time that we want. And what I am saying is, as a trustee I am very comfortable with the changes that our investment advisor, namely the Comptroller's Office, has presented to us.

I especially feel very comfortable because I do know over at the Comptroller's Office there is as much knowledge about the private equity world that we can have in the name of our CIO and in the name of Barry Miller.

We are dealing with people who really know the private equity world. So at this moment in time I have a great level of comfort, and I understand your right to ask the question. We have always asked the questions when we feel uncomfortable.

But putting the dots, the I's and the T's doesn't necessarily make it any different, because this investment policy has served our purpose to date, and individuals over at the Comptroller's Office over the

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last two or three years have brought us great changes and great improvement working with Hamilton Lane in our private equity portfolio.

So I would suggest at this time that we move forward if we have consensus, unless there is a different question on the IPS.

MS. EMERY: I have a different question.

I have a couple of questions about non-U.S. exposure.

Do we define risk limits to non-U.S. exposure as a risk control in the policy?

MR. MILLER: We do not.

MS. EMERY: Is that something that clients ought to think about with regard to controlling risk?

MR. SCHLOSS: I would say you should have it in the general IPS as opposed to an asset class.

MS. EMERY: Is that in our general IPS?

MR. SCHLOSS: Currencies are.

MS. EMERY: Total program currencies, overall?

MR. SCHLOSS: There's a discussion of currency in there. So we'll talk about the general IPS next time to review it.

MS. EMERY: So we will take a look to see if it is in there.

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I see we have the emerging market country list on Exhibit A.

When was the last time we reviewed our approved equity markets?

MR. SCHLOSS: About 18 months ago.

MS. EMERY: Okay; good.

I would actually like to see the documentation and the data with regard to the benchmark before approving this. I feel like I need to have a little more education on that topic, so I'd like to ask that this be held over as we're holding over the general IPS until next month.

MS. MARCH: I would move that we move forward. There is no reason not to have education on the benchmark. We can have that education. And if the education leads the board to believe that 300 basis points is incorrect, we can simply change the 300 basis points.

So at this point, I would move, if we have consensus, for the adoption of the IPS, for the private equity IPS.

Do we have consensus?

MR. SCHLOSS: We're okay with it.

MS. MARCH: And the Teacher's trustees.

CHAIRPERSON AARONSON: So that is it, and

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thank you very much for the hard work.

MR. MILLER: Thank you very much. We appreciate it.

MR. SCHLOSS: That ends the public agenda for the pension fund.

CHAIRPERSON AARONSON: We can go into executive session.

MS. MARCH: I move that we go into executive session under Public Officer's Law 105 for the purpose of discussing sales of securities and other investment matters.

CHAIRPERSON AARONSON: Do I hear a second?

MR. SCHLOSS: Second.

CHAIRPERSON AARONSON: Any objection?

Seeing none, we're now in executive session.

Robin?

MS. PELISH: This is a pension item. There's a question. Everyone received a handout talking about the EAFE equity composite structure. There was a recommendation made at the last investment meeting regarding a change in the proposed structure for developed market international portfolios.

MS. HINGORANI: The EAFE search we did.

MS. PELISH: There was a recommendation for the structure, which is summarized on page 2 of the

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handout. That was made at the last investment meeting. There was a question raised whether there was a persistent and significant style bias introduced in that structure. And the following pages in the slide detail the analysis that we did.

And I can go through it in detail or I can summarize the conclusions, which were that there was a slight, moderate growth tilt within the proposed structure. However, that was as a result of active manager decisions and primarily resulted from the underweighting of financials, which have a very significant weight in the benchmark.

And we also analyzed the transaction costs that would be associated with moving assets further within the composite.

And so, based on all of this analysis, we've come to the conclusion, along with BAM, that the recommended composite does not include a significant or persistent style bias, although the most recent analytics indicates there is a modest style growth bias. That again reflects the fact that we are including a significant number of active managers, and those managers were underweight financials relative to the benchmark.

So we continue, along with BAM, to support

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the recommendation made at the last investment meeting.

CHAIRPERSON AARONSON: Questions?

MS. EMERY: Thank you for the extra work. Very helpful.

MR. AARONSON: Next?

MR. SCHLOSS: That's all we have.

MR. LYON: We have one item for the Passport funds before we do attorney-client. This was also sent out ahead, and is being passed out as I speak.

We mentioned we were going to come back to the board to discuss the active composite, the active domestic manager composite inside the equity funds, Variable A for short, diversified equity funds.

And so, this is a review that is really intended to talk about a strategic direction and longer term vision for the structure of how we invest in this fund. But today we are not recommending a specific set of changes or adopting a precise target allocation; but rather directionally presenting a vision that we hope you are on board with, or that we'll tweak with your comments. So that as we start to make manager changes, that we have that longer term vision in mind, even though we're not necessarily suggesting all changes be made at once.

So, starting on page, 2, there's a little

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bit of background here. Much of this is familiar territory. We talked about the funds so frequently. The active domestic equity composite, as a reminder, has a target of 20 percent of the overall diversified equity fund. That's 12 underlying managers. The majority of the managers in the entire fund are here.

It used to have two sub-composites or separate composites, most of which you are familiar with. Fifteen percent of the 20 was in a risk controlled composite with mostly enhanced -- lower expected tracking error strategies. And the other 5 percent are in what we call the eclectic composite -- and those were merged together in approximately 2010.

It's got a pretty low tracking error on a combined basis, and that tracking error has remained fairly consistent. The excess return, however, has been a bit more over the map, and on average over the past ten years has been negative 12 basis points. So nothing to be overly concerned about, but disappointing net of fee results. So, moderately disappointing.

If you look at it on a rolling basis, there is some slightly better observations we can make.

The manager composition has changed. There were four managers added in the last five years, and four managers removed during that period.

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On page 3 we have information about the current manager roster, including their respective since inception dates and since inception performance. And the current roster looks a little bit better when you look at the managers in aggregate and on average, because, of course, some of the managers contributed to the negative returns to the overall composite performance, or at least negative relative returns, have been terminated.

So the current roster on average, since inception returns look a little bit better.

There is also an important backdrop or market context on page 4 as well, which is that in recent periods, which of course influences various other trailing numbers, that these benchmarks have been particularly hard to beat or active management has been particularly challenged, particularly with whipsaw and different market forces and what's driving stock returns. And although it calmed somewhat, there's continued volatility in the market.

What this table shows on page 4 is the percent of managers that outperformed the benchmark in these various categories. We focused primarily on equity categories. The first six line items you can see large core growth and value, small core growth and

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value. They're all highlighted in yellow because less than half, and some cases significantly less than half of the managers, in those universes over the past year outperformed their benchmark. So it's a tougher recent period for active managers, particularity in the U.S.

MS. PELISH: And this is gross of fees, so imagine what the numbers would be if it were net of fees.

MR. SCHLOSS: This is the whole universe --

MS. PELISH: These are institutional managers that provide data to the investment database, which is the largest manager database for institutions.

MR. SCHLOSS: What do you think is -- is it the weirdness of the last three years?

MS. PELISH: When you talk to managers, they tell you it's very difficult to select stocks and do well based on fundamentals when there are macro-events that really drive sentiment. I think that's a large part of it; the dominance of Apple, a couple of factors.

MR. SCHLOSS: If you took a step back, do you think that those peculiarities are going to happen for the next couple of years? Just give up on the whole thing for a couple of years?

MS. PELISH: There's always an alternative.

(Laughter.)

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MR. SCHLOSS: Put it all in the index and move on.

MS. PELISH: You could. At a minimum, that's always a default, and that's what we've done with most of the money in this fund.

MR. SCHLOSS: Right.

MS. PELISH: At a minimum, what we are suggesting is pare the list down; because as the rest of the pages will show, we're really overdiversified. If you look at the number of holdings that are held in common by lots of managers in this 20 percent composite, it shouldn't be surprising, but it's pretty impressive.

And so we're overdiversified with lots of names, lots of managers. And so what we're proposing is, the game has always been hard, gotten even harder, and so let's try to identify a small number of what we think are outstanding managers and focus on those firms. Those exist; we have some of them.

MR. SCHLOSS: Can you go back in time? We had this conversation yesterday. We're looking across all the different pension funds in the city. And it was clear that the Teacher's U.S. equity did better than everyone else's. We did the attribution, and it was because it was passive. It didn't matter who the managers were --

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MS. MARCH: For 24 years I've been saying that.

MR. SCHLOSS: We are getting converted. It was astounding.

MS. PELISH: It's worth noting, however, this is focused on U.S.

MR. SCHLOSS: We came to the same conclusion looking across here and the other four systems.

Could you do this analysis annually for the last 20 years?

MR. LYON: I'm not sure if we could go back 20 years, but we can go back a while. When you do that, you see it's cyclical.

MR. SCHLOSS: Maybe we're supposed to bug out for a little while and come back --

MS. PELISH: I'll tell you what, it's easy to sell and hard to buy.

MR. SCHLOSS: The answer is, this comes and you play through it. But the underperformance is pretty big. On a dollars basis, the biggest asset class. And if you give up 300 basis points --

MS. PELISH: Really, 300?

MR. SCHLOSS: If you pick 300.

MS. PELISH: Three hundred seems like a lot. The U.S. Equity composite is over 300?

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MR. SCHLOSS: We had variations amongst the funds.

MS. PELISH: We can provide more data.

MR. SCHLOSS: The best and the worse in U.S. equities was a couple hundred basis points, and it was people who were most active. We looked at it and said the conclusion is, Teachers has it right, passive is the right way to go.

That's pretty hard when you start comparing all your managers to figure out was it temporary or a specific manager? What you're saying is, it not may not be so temporary.

MR. LYON: But it also says that we only protect in related points. We don't expect there to be free alpha just because we're active. We need to focus on managers where we think the approach is significantly differentiated.

The other thing that is relevant here is making sure that we get in and out (unclear) for evaluating active managers; and that we also keep in mind that the overall objectives for this entire investment option (unclear) are to try to keep up with the markets with less volatility.

You may still need to have some role for active management, because some of the things in

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defensive (unclear) we may need excess return to help make up for that, trying to keep the total return (unclear).

MR. SCHLOSS: The other overlay is a pension fund problem. The only way to add a manager is through an RFP procurement process. And that's pretty time consuming. You can't just say let's add it. Whereas in these funds, you can add. You say, all right, let's add a manager.

MS. HINGORANI: We can take off.

(Laughter.)

MR. LYON: In the interest of further discussion and Robin's comments, I think, from my opening comments summarizing, we're going to go to page 5.

On page 6 the primary point here is that, actually some of the larger allocations that you have to some of the large cap core managers, for instance, the first five line items -- PIMCO, because the actual alpha of the underlying fixed income is a little hard to model in this context. Plus DNA is more than -- it can't be modelled as opposed to -- it doesn't contribute.

But what we've done is, in the far right column, page 6, we looked at the recent time period, the contributions to active risk from these different

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strategies.

And what you can see is that some of the smaller allocations, the more active managers, actually contributed more of the active risk than the big allocations to the risk control managers. And that's because there's a lot of overlap between them, they're very diversified and have low expected return.

The same holds true if you look at, for instance, how many managers hold unique holdings within the composite. We actually look at, for instance, the individual stocks in each portfolio, how many of those stocks are unique going to that manager that the other eleven managers in that composite don't hold?

And similarly, we can see if you go across the third row in the table on page 7, you can you see that some of the smaller managers have as many or more unique modelling than some of the bigger managers.

So again, there may be some level of overdiversification, given the history of where we came from with the focus on risk control managers. And that it's imprudent to have risk control managers, but when we think on a forward looking basis about what might help the performance here, and in the context of the overall Variable A structure with a large allocation indexing, that kind of iteration of the composite

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involves fewer and on average more active managers.

So on page 8, we revisit the objectives here. And in general, the composite is very diversified and has a low tracking error. So that muted performance. To the extent that it's underperforming, it muted the underperformance, too.

But when it's been working well -- and there have been time periods it's worked well also -- it doesn't make as much of a contribution to the fund as a whole.

The second thing that's noted in this is, to an extent a lack of style balance has also contributed a bit to recent underperformance. And it generally hasn't helped when there's been style balances. So some of that is a function of a specific manager imbalance, timing to replace managers and other things.

But, for instance, over the past two years through June, active management added 74 basis points. But the mix of manager styles that we had detracted 22 basis points.

In the second bullet, this really comments on the point we were making all along, which is that we think it may make sense to reduce the number of managers and focus on having more active risk. But we're not talking about in the grand scheme of things making the

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active risk so high that it's a highly volatile composite. But we are talking about a noticeable uptick in active risk.

MS. PELISH: If you're going to have this as part of the portfolio, let's make it more active with fewer names. That's what these three samples on page 9 will demonstrate.

MR. LYON: Page 9 shows three samples. These are not recommendations. We're not asking for action other than some feedback. But the direction we think we'd like to at least move as far as sample 2 -- and I will give exact manager changes and the exact construct -- but at least as far to give you a sense, even if you go all the way out to sample composite 3, the predicted tracking error goes from today about 1 percent to a little over 3 percent.

So the more active risk, by tracking error we mean it's a standard deviation from the expectations around the benchmark, so two-thirds of the time we expect the active return to be plus or minus 3 percent around the benchmark.

And this 3 percent tracking error is fairly similar to the tracking error you would expect if you added a couple of risk control managers; and is much lower than the tracking error with many individual more

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active managers. So not a high degree of tracking error, but it is a notable uptick from where we are today.

And this 3 percent tracking error is used by adding in a few growth names, removing a few managers we have been concerned about for various reasons, and removing in this example -- kind of, perhaps extreme -- removing all of the large cap core managers.

So making that significant rationalization of the manager line-up gives around 3 percent tracking error, and we think that is potentially reasonable. But directionally, that may be a longer term thing. But we seem sample 2 as being where we think of trying to stick together over the next 12 to 18 months.

MS. EMERY: For these risk budgets, what are you thinking about in terms of alpha?

MR. LYON: It varies a little bit once we come back with a specific scenario. But we think that it's reasonable to try to achieve a .3 type information ratio, and so we're talking about that being on a net of fees (unclear). We hoped to do better, but that's a reasonable expectation in U.S. Equities.

MS. EMERY: Probably the best we can expect?

MS. PELISH: It depends how much risk you are willing to take. Our goal would be --

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MS. EMERY: For these risk budgets, what you expect?

MS. PELISH: For U.S. Equity active, yeah, getting .3 is good.

MR. LYON: So that would be the ratio of how much excess return relative to risk you are taking.

So there's some other analysis in here. But if you go to page 11, I will talk briefly about the proposed next steps.

The reason that we wanted to have feedback directionally is that we have for some and are expecting it to worsen -- which is potential changes you might make -- we're all underweight to growth, and that could be exacerbated to the extent that some of the managers we've been talking about, are concerned about together in the programs. Perhaps Profit and/or Rainier for different reasons are on that list.

And so, in addition, we've also been talking about Martingale as a manager we'd like to move away from. And so, in the first phase which could extend -- and there are some other complicating factors -- but the potential custodian change at the wrong time to move managers accounts all around.

But let's say over the next six months in this first phase we could terminate some or all of those

managers and at the same time be working on a growth search so as to add growth year managers who potentially are terminated to come out. We can maintain growth exposure, within the manager or managers. And so that is an important first step.

And then Phase 2, we would get to something closer to one of the sample scenarios, which is further rationalization in the large cap core space. And so before allocating money to growth managers, we'd come back with what the Phase 2 looks like, so that we have in mind how the assets would eventually move at that time.

So we're interested in your comments, questions or feedback.

MR. SCHLOSS: I think this is great.

MR. NORTH: A question. You did include in your samples in large cap value continuing. And the large cap value would seem to be one of those areas where expected excess is difficult to get.

Have you considered with respect to the large cap space if you're balancing, just put it in another passive vehicle rather than the risk must be applied primarily through the small and possibly mid?

MR. LYON: The large cap value manager has been in place for 31 years. They haven't been able to

generate a net of fee return of 70 basis points annualized during that time period.

And so, although we may not always lead with large value, in the first place you want to be active.

It has been a long successful relationship in that particular case.

But as you think about large cap in general and we think about as pieces shake loose, we'll inevitably make changes over time and not just as part of a fresh look. In large growth, for instance, where we may have a manager to replace, we also have concerns about the small mid-growth manager.

One of the things that we're looking at are all cap managers who have more degrees of freedom to allocate. So we may recommend replacing large growth and mid-growth managers with one or two all cap growth managers to address that very point.

MS. EMERY: You made the point earlier about style drift having a negative effect. How do you control that if you're hiring an all cap? This would be a capitalization drift. How do you control that if you're hiring all cap managers?

MS. PELISH: It's been a pretty modest cost, and I think it's a fallout of using active managers. And so, again, I think it's been a cost, because growth

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has done so well lately and we terminated some growth managers.

But I think, longer term, we would not want it to be a big source of tracking error. We would monitor that pretty closely. This is going to be the only active U.S. Equity portion of the fund, and we accept that at times that there will be some style drift based on our active decisions, and I think we just accept that as part of the active project.

MR. LYON: If we do present all cap managers we will present and ask them to comment on the extent to which they can dramatically change the overall portfolio characteristics; because most of them are fully investing across the cap spectrum at all times and may be able to tilt it more towards smaller, towards large, based on their views, if you're willing to accept that. But we are not talking about managers who are all of a sudden 80 percent small cap.

MS. PELISH: Because they're going against the all cap benchmark.

MS. EMERY: You would show us scenarios over time of how that might have looked, an inflection point or something, just so we could see how much of a capitalization bias they might be taking on, something like that?

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MS. PELISH: Absolutely.

MS. EMERY: It looks like, given what the portfolio looks like today, who knows what it will be in six months in terms of drift.

Can you show us, if we are going to be taking on a bit of a smaller cap bias in the portfolio, Phase 2 of this project, can you educate us where we are in the small cap valuation cycle so that we're aware of when we're getting into it?

MR. LYON: We actually don't necessarily intend there to be a significant small cap bias. So moving to all cap replaces (unclear) both the large cap allocation and the small mid-cap allocations. And some of the core managers are Russell 3000 benchmark. But we're not intending for this to be a specific play on smaller cap bias, but we're weighting that.

MS. EMERY: A couple of scenarios that you are modelling, you do show additional money to small cap, so I think there would be a value --

MR. LYON: We will look at analysis similar to what's shown in here and other things we've done. We'll present that.

CHAIRPERSON AARONSON: Thank you for the discussion. You will come back to us when --

MR. LYON: Our intention is several months.

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MS. MARCH: Thank you very much.

CHAIRPERSON AARONSON: That concludes --

MR. LYON: Other than one item for attorney-client.

MS. MARCH: I suggest that, since lunch is not here, maybe the board could stay here and do the attorney client privilege? Should we go out of session and summarize?

CHAIRPERSON AARONSON: Do we need a motion to end executive session?

MS. MARCH: I move we end executive session.

MS. ROMAIN: Second.

CHAIRPERSON AARONSON: Any discussion?

MS. STANG: In executive section of the pension fund there was a discussion of the structure of the international equity market.

In the executive session of the variable fund there was a discussion of the structure of the strategy of the active domestic equity composite of Variable A.

CHAIRPERSON AARONSON: So we have that report.

Do I hear a motion?

MS. MARCH: I make a motion that we move into executive session to discuss legal matters.

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CHAIRPERSON AARONSON: Any discussion?

MR. SCHLOSS: Second.

CHAIRPERSON AARONSON: We will go into attorney-client.

(Time noted: 11:17 a.m.)

(Recess taken.)

(Time noted: 11:27 a.m.)

CHAIRPERSON AARONSON: Are we ready?

MS. MARCH: I move that we go out of session for purposes of discussing legal matters.
MS. EMERY: Second.
CHAIRPERSON AARONSON: Any discussion?
Seeing none, we're out of legal session. Now back into public session.
MR. GILLER: For a legal issue, consensus was reached, to be announced at a future date.
CHAIRPERSON AARONSON: Thank you very much.
Any other business before the board?
Do I hear a motion to adjourn?
MS. MARCH: So moved.
MR. SCHLOSS: Second.
CHAIRPERSON AARONSON: Any discussion?
Seeing none, we are adjourned.
(Time noted: 11:28 a.m.)

C E R T I F I C A T I O N

I, Jeffrey Shapiro, a Shorthand Reporter and Notary Public, within and for the State of New York, do hereby certify that I reported the proceedings in the within-entitled matter, on Thursday, October 4, 2012, at the offices of the NYC TEACHERS RETIREMENT SYSTEM, 55 Water Street, New York, New York, and that this is an accurate transcription of these proceedings.

IN WITNESS WHEREOF, I have hereunto set my hand this _____ day of _____________, 2012.

____
JEFFREY SHAPIRO