March 11, 2008
Minutes # 434

Minutes of the Board of Trustees' Meeting

Call to Order: Chairman, Donald Pinard called the meeting to order at 8:31a.m.

Present: Trustees: Chairman, Donald Pinard, William Sanders, Chuck Hungler, Jeff Duval, Jennie Angell and Kevin Barry
MECRS Staff: Gerard Fleury and Sandi Aboshar

Absent: Trustees: Mayor Frank Guinta

In Attendance: Attorney, John Rich of McLane, Graf, Raulerson & Middleton, PA as well as Representatives, Mr. Sebastian Grzejka and Mr. Kevin Leonard, from New England Pension Consultants and Mr. Ken Alberts of Gabriel, Roeder, Smith & Co.

Approval of the Public Hearing Minutes:

A motion was made by Trustee Hungler to approve the Public Hearing Minutes of January 8, 2008 regarding amendments to By-Laws Articles II & III and to Administrative Rule, Part 7, seconded by Trustee Duval and passed by all those trustees present.

Approval of the Minutes of the Previous Board Meeting:

A motion was made by Trustee Hungler to approve the minutes of the January 8, 2008 Meeting of the Board of Trustees, seconded by Trustee Duval and passed unanimously by all the trustees present.

Approval of the Immediate Meeting Agenda:

It was moved by Trustee Hungler to accept the immediate meeting agenda, seconded by Trustee Duval and passed by all those trustees present.

Chairperson Comments:

Chairman Pinard reported that due to the lack of a quorum, the Board of Trustees was unable to conduct their scheduled February meeting. However, the trustees present were able to meet informally with representatives from Berry, Dunn, McNeil & Parker who were present for the meeting and to discuss the objectives of the upcoming audit for 2007.

Chairman Pinard summarized their discussions by noting that the firm estimates that 250 hours will be dedicated to the audit and that the total audit fees should not exceed $27,500. The Board may expect the final draft of the financial statements to be completed by May 1, 2008.

Report of the Executive Director:

Member Notification - Mr. Fleury began by reporting that during the month of January, annual member statements were generated and mailed. Also, 1099R tax forms were produced and mailed to retirees and lump sum distribution recipients, directly from State Street Bank.

Base CAFR for 2007 at Advanced Stage - Next, Mr. Fleury reported that the Retirement System is well along in the preparation of the 2007 CAFR. While GASB43 requirements which necessitated expanded formats in some areas of the report are still awaiting information in order to be complete, absent a few exceptions the document is ready for submission to the auditors when they arrive.

Status of the Audit of 2007 - In closing, Mr. Fleury commented that staff members have been working with the auditors since mid January on the review for 2007. Much of the requested information has been compiled electronically and sent in advance of the audit's commencement. The auditors plan to conduct the on site portion of the audit at the end of March and the only issue of concern is the System's inability to persuade the Manchester School District to institute electronic payment for contributions withheld from member salaries. That processing inefficiency has resulted in observations in the two previous audits.

Report of the Investment Committee:

Committee Chairman Hungler reported that at the February 11, 2008, Investment Committee Meeting and with representatives from the System's Investment Consultant Firm, NEPC, in attendance, three Portable Alpha Managers had been interviewed. He noted that NEPC consultants were present for today's meeting and that discuss relative to the interviews would ensue.

Before getting into the results of the manager interviews, Chairman Hungler noted that the next Investment Committee Meeting is scheduled for May 12, 2008. He informed the Board that because of performance concerns in recent quarters, Causeway International would be present to explain why their benchmark had been missed and to inform the Committee of what it could expect going forward. Chairman Hungler also noted that by

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waiting until May 12th, performance numbers for the first quarter of 2008 would be available and that the Committee would review those results at that time.

Having summarized the Committee's actions, Chairman Hungler turned the meeting over to Mr. Kevin Leonard of NEPC to deliver a review and recommendation on the manager interviews conducted on February 11th.

Mr. Leonard began by stating the reasons why NEPC is recommending portable alpha to the System. The firm views the US long only equity market as a very volatile asset class and their expectation is that the returns will come in lower than the long term average of the S&P 500 over the coming years. In response to this premise, the asset allocation model they are recommending includes a Portable Alpha component in order to help the System achieve the best return possible with lesser risk. Portable Alpha would help the System do that by seeking to obtain rates of return uncorrelated to the performance of the S&P 500.

Mr. Leonard explained that with Portable Alpha, "beta" represents the S&P 500 while "alpha" is the ability of a manager to add return, above and beyond the S&P 500.

Mr. Leonard reported that three managers were interviewed; Austin Capital Management, Gottex Fund Management and Benchmark Plus. He summarized the cost of the beta exposure for all three and touched upon the different approach taken by firms to replicate the beta of the S&P. He went on to address the target alpha, or out performance range for the three managers and noted that they ranged from 3% to 7% with all three returns net of all fees.

Mr. Leonard explained that Austin Capital was the manager that had performed the best out of the three managers interviewed in the last year. Austin uses swap vehicles limited to 3 months LIBOR (London Interbank Offered Rate) without additional basis points. Therefore, Mr. Leonard explained that Austin can seem more appealing to investors on that basis.

Moving on the Gottex Fund Management, Mr. Leonard noted that they are a larger firm which manages their beta exposure. Unlike Austin, Gottex charges LIBOR, plus 27 basis points but he speculated that over time, the 27 basis points could decrease.

Mr. Leonard noted a fundamental difference with Benchmark Plus because of the fact that they use futures to replicate the return of the S&P versus swaps. Mr. Leonard noted that there isn't really any cost in futures other than holding back part of the Systems principal for collateral. When buying futures, cash on hand is necessary for re-

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investment and therefore only 98 % is invested in the alpha generator, whereas the other two managers put 100% of the investor's funds toward alpha.

Mr. Leonard continued to explain the differences between the three Portable Alpha Managers in detail.

Trustee Hungler asked Mr. Leonard to elaborate on use of futures by Benchmark Plus.

Mr. Leonard replied that collateral is needed when buying futures. Collateral is placed in an account where it earns a money market rate. As a result, the collateral is not earning what the alpha generating Hedge Fund of Funds would earn, it only earns money market rate.

MECRS Attorney, John Rich, Jr. asked Mr. Leonard to explain, how a futures contract would work.

Mr. Leonard replied that the most common futures purchased are for the S&P 500. Future contracts are typically bought on a quarterly basis. Buying a future is buying the projected return of whatever the S& P 500 is, whether it be positive or negative, and is done via a brokerage firm. In clarifying the concept, he then provided the trustees with examples of purchasing futures with both positive and negative returns.

Trustee Hungler asked Mr. Leonard to explain why Benchmark's would choose to use futures rather than swaps.

Mr. Leonard replied that it is inherently the structure of their firm. Benchmark may believe that getting exposure to a beta source is easier replicated through a future than with a swap.

Trustee Hungler switched the focus of discussion onto a decision by the Trustees on whether or not to commit to a Portable Alpha vehicle and allocate a percentage to be invested.

Mr. Leonard suggested 5% of assets under investment for an entry into Portable Alpha. That amount would be needed in order to have any impact on a portfolio since anytime money is allocated to any asset class, 5% should be considered the minimum.

A motion was offered by Trustee Hungler that the System to invest in a Portable Alpha Manager, seconded by Trustee Sanders.

Chairman Pinard then asked Mr. Leonard for information about the average allocation in Portable Alpha by other investors.

Mr. Leonard responded that typically, clients are investing 5% to 10 % into Portable Alpha. He noted that the average allocation into Hedge Funds by NEPC clients, which is similar in asset class to portable alpha, is on the average of 8% firm wide. Their client exposure to Portable Alpha represents 35 to 40% of overall clients.

Trustee Sanders complimented the excellent job done by the NEPC representatives in explaining the concept of Portable Alpha and express his opinion that the board should rely on the expert advice received. Mr. Sanders felt that the 5% entry allocation into portable alpha is a modest and appropriate amount and that the board should approve the allocation for portable alpha.

Trustee Hungler then amended his motion to allocate 5% into portable alpha, seconded by Trustee Sanders and approved unanimously by all those trustees present. This still left the Trustees with the question of how best to allocate their commitment between prospective managers.

Of the three portable alpha managers being considered, Mr. Leonard expressed an opinion that from a risk return prospective, and in order of size and sophistication of the firm, Gottex Fund Management appeared to be far superior.

Reviewing comparative values, Austin Capital's 5-year alpha return is 7.6%. Benchmark's is 4.3% and Gottex is 3.8%. Although Austin Capital's 5-year return is greater, it was largely attributed to the fact that their 1-year return was 11.8% versus a benchmark of 2.4% thus resulting in a 9% excess return. The 1-year return has a huge impact on the 3 and 5-year returns and lends an appearance of superior performance. The volatility of Austin Capitals product is historically, significantly higher than the other two managers and is projected to be higher moving forward, because of their overall philosophy which allows them to take risks.

Gottex is the most conservative and most diversified, with Benchmark a very close second. Referring to the Portable Alpha Manager Search handout which had been provided to the trustees, the board continued to review the calendar year returns and risk factors of the three recommended Portable Alpha Managers.

Mr. Leonard reminded the board that the goal of NEPC is not to enhance the Systems volatility, but to dampen it. Without the volatility of the MECRS' current managers, Archstone and Attalus in the System's portfolio, Austin Capital might have been recommended. In light of existing exposure to Hedge Funds of Funds, to increase that exposure in order to pursue portable alpha, NEPC must be mindful of volatility, very tight to the S&P 500. Austin Capital's volatility would be significantly higher which made them less attractive.

Chairman Pinard asked, of the two managers, Gottex or Benchmark, which one uses futures.

Mr. Leonard replied that Benchmark uses futures.

Chairman Pinard then asked if that would be a sound rationale for possibly splitting the 5% allocation between the two.

Mr. Leonard replied that the method used to replicate beta should not be the reason for choosing two managers. It would be best to focus on which managers provided the best measure of diversification in the underlying the Hedge Fund of Fund exposure.

Trustee Duval then noted that Benchmark Plus only sent one marketing representative to be interviewed by the Investment Committee, where the other two managers sent both a marketing representative as well as an account representative.

Trustee Duval expressed his feelings that Gottex would be the best choice in portable alpha.

Trustee Hungler felt that based on the recommendation by NEPC and risk factors, splitting the 5% would be in the best interest of the System.

Trustee Hungler moved to allocate 5% of the System funds to two Portable Alpha Managers naming, Gottex and Benchmark Plus, seconded by Trustee Sanders.

For the record, Attorney Rich commented on how well the Investment Committee Meeting minutes had been done by Mr. Fleury in light of the fact that they had been compiled from meeting notes. He then went on to ask Mr. Leonard about the size of the Benchmark Plus organization, and whether there needed to be significant concerns over any possible departure of one or two of the key principals at Benchmark. Should that concern be a point of consideration in deciding the hiring of the firm?

Mr. Leonard replied that key person risk is an important consideration in the decision making process but he seemed comfortable that the risk was acceptable in this case.

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Trustee Angell expressed concerns about procedures used by NEPC to maintain an awareness if key representatives were to leave an Investment Management team and she questioned how soon would NEPC know of and notify the System of such a change.

Mr. Leonard replied that it is a professional obligation for the managers to notify NEPC of the any change in their organization. Upon such notification, an internal memo is generated immediately by NEPC and distributed to affected clients.

As a follow up, Trustee Angell speculated about a significant change within the Investment Manager's organization taking place, and she questioned what options might be available for withdrawing funds in the event of such an action.

Mr. Leonard replied that the Benchmark Plus investment would have annual liquidity with 60-days notice but would provide quarterly liquidity with 30-days notice on a best efforts basis. Gottex has monthly subscriptions and quarterly redemptions with 75 business days notice.

In regards to Trustee Hungler's motion to allocate 5% of the Systems Portfolio to two Portable Alpha Managers, Mr. Fleury noted his concern for specifying the dollar amount as well as identifying where the funds will be transferred from, if action is taken by the full board. Also, Mr. Fleury suggested as part of the motion to include that the Portable Alpha contracts be subject to a review by System's legal counsel prior to signature by the Chairman and the execution of fund transfers.

Trustee Hungler amended his motion to change the 5% to 7.5 million dollars investment to be split between Gottex and Benchmark Plus with the details of when the funds are invested and where the funds are transferred from to be negotiated by Mr. Fleury and the System's Investment Consultant, NEPC, seconded by Mr. Sanders and passed unanimously by all those trustees present.

Next, Mr. Leonard referred to the Investment Performance "Flash Report" for the period ending January 31, 2008. He reported the overall composite for the month, noting that the Plan was down 4.5%. The policy index for the same period was down 3.6% but for the trailing year, the portfolio was up 5.3%, outperforming the policy index of 5.0%.

Mr. Leonard then turned the meeting over to his colleague, Mr. Sebastian Grzejka, to address the details of the Flash Report. Mr. Grzejka reported that State Street Global Advisors is slightly behind their benchmark, down 4.8% versus 4.0% for the Russell 3000 value. Cadence Capital Management down 9.9% versus 7.8% for their index.

Overall, Cadence is up 4.6% for the last year versus 5% for the index and is doing well. Vanguard is right in line with the index for the month. Gryphon International was down 11%. Ironically because of their position on the MECRS watch list, Causeway was up 200 basis points through January. Mr. Grzejka reported that although City of London had a negative number, they had outperformed their index and had a positive month in February.

Mr. Leonard pointed out that withdrawn funds from emerging markets at the end of 2007 had proven to be a favorable decision for the System's portfolio.

Mr. Grzejka continued with the Fixed Income Composite, citing Income, Research & Management with a 1.5% return, which was one of the best performing investment in January. Loomis Sayles, the MECRS' other fixed income manager had a flat return due to a high-yield exposure.

In closing, Mr.Grzejka informed the board that the two Hedge Fund Managers had under performed their benchmarks; however they outperformed the S&P 500.

There being nothing further to report and no further questions of NEPC, Mr. Leonard and Mr. Grzejka departed the meeting.

Report of the Administrative & Accounting Committee:

Committee Chairman Barry reported that next Administrative & Accounting Committee Meeting is scheduled for April 7, 2008 at 8:00 a.m. COLA's will be addressed as well as Legislative Statutory By-Laws and Rule amendments. In that latter category, Counsel has recommended a minor amendment to Admin. Rule 7.2 to make it consistent with the rest of Rule 7.

Chairman Barry informed the board that the Executive Director is also recommending a new Rule on the methodology for calculating average final earnings for retirees with less than 3 years of creditable service and that the Committee will discuss the rationale for such a rule at that meeting.

Report of the Benefits Committee:

Committee Chairman Angell reported that SB373, which would have expanded the existing health subsidy so that it would also be applicable to dental coverage, was presented to the BMA, but did not receive BMA support. As a result, the Advisory Committee voted to ask that the sponsor retract the bill. That has been done and so SB373 is a dead issue for 2008.

Committee Chairman Angell also informed the trustees that her former seat on the Advisory Committee as a non-affiliated representative has been filled by Ms. Kim Desrosiers, an employee of the Manchester Parking Authority.

Chairman Angell concluded her report by notifying the board that Mr. Tim Soucy who had joined the Advisory Committee as a representative of the department heads had had difficulty in attending the meetings due to schedule conflicts. As a result, Mr. David Cornell, the City Assessor, had expressed interest in joining the committee as a replacement for Mr. Soucy and planned to attend the next Advisory Committee meeting. Mr. Paul Porter had also resigned as a representative for the retiree group and former Advisory Committee Member Ronald Ludwig had expressed interest in replacing Mr. Porter.

Previous Business:

Mr. Fleury reported that in November of 2007 and at the recommendation of legal counsel, he had been directed by the board to carry out the provisions of Chapter 218:15 IV which empowers the board to periodically re-examine disability recipients to confirm their continued eligibility for that benefit. Mr. Fleury had informed the Board at that time that a lack of funding for Independent Medical Examinations was problematic and so the Board had authorized the transfer of funds to cover IME costs.

A retiree was selected and the System has received the necessary Independent Medical Examination results. Mr. Fleury reported that the IME results unquestionably indicated that the retiree is not able to return to the job from which they had been deemed disabled. Mr. Fleury recommended that the board accept his report and place it on file in order to demonstrate compliance with its fiduciary obligations pursuant to the statute. Furthermore, he recommended that the disability award currently being received by the member be allowed to continue.

Moved by Trustee Sanders to accept and place on file Mr. Fleury's report regarding re-examination of a disability recipient and the continuation of the retirees benefit, seconded by Trustee Duval and passed unanimously by all those trustees present.

Consent Agenda:

It was moved by Trustee Sanders to accept the February and March Consent Agendas, seconded by Trustee Duval and passed unanimously by all those trustees present.

Chairman Pinard recessed the meeting at 10:35 a.m.

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Chairman Pinard reconvened the meeting at 10:40 a.m.

New Business:

Acceptance of the 2007 Actuarial Valuation – Mr. Ken Alberts of Gabriel, Roeder, Smith & Co. began his presentation referring to page A-7 of the Annual Actuarial Valuation Report distributed to the trustees. He reported that there are two components of the contribution rate reconciliation which are the pension component and the health component. Last year the pension component was 13.27% and the health component was 1.24%, totaling 14.51% contribution rate. Over the last year there have been changes, such as normal cost change, miscellaneous changes in group demographics, employer portion of SB402 purchases, COLA, experience gain and a change in health utilization, all of which are factors in determining this year's employer rate of 15.82%.

Mr. Alberts explained that the Retirement System is 72.6% funded for pension benefits and 15.0% funded for health subsidy benefits as of December 31, 2007. The pension unfunded actuarial accrued Liability (UAAL) of $52,606.105 is being amortized over a 26-year period: the health subsidy UAAL of $10,837.90 is being amortized over a 28-year period.

Mr. Alberts noted that experience during 2007 was more favorable than expected, resulting in an experience gain of $3,928,259. The primary sources of this gain were investment return (7.5% assumed versus 10.5% recognized) and turnover (more members terminated than expected). Gains were partially offset by losses due to retirements (more benefits were added to the rolls than expected). As a result, the pension funding status improved from 73.5 to 75.9%, before reflecting the revised assumptions.

Mr. Alberts noted a benefit change of a 2.00% attributed to an ad-hoc COLA which was granted July 1, 2007 for all retirees and beneficiaries eligible for benefits as of July 1, 2006. This resulted in an increase in accrued liabilities of approximately $331.000.

Mr. Alberts also reminded the Board that the adoption of SB402, allowed for members to upgrade their benefit multiplier under Chapter 159 from 1.5% to 2% per year of service rendered prior to 1999. Because of that legislation, liabilities increased approximately $447,000 as a result of members who elected to upgrade their pre 1999 service during 2007. An additional $223,000 in member contributions was contributed as a result of these elections.

Trustee Sanders inquired about the utilization rate for retirees availing themselves of the health insurance subsidy benefit.

Mr. Fleury replied that currently about 37% of retirees are using the benefit.

Mr. Alberts noted however that initial utilization of the subsidy might be low and he cited reasons for it. The post-retirement health subsidy valuation results are included in the valuation and they use of an election assumption of 70% for future retirees which impacts the funding requirement for the benefit.

Mr. Alberts went on to note that the valuation phases in the final component of the 2% Pre-funded COLA assumption. That final funding step recognizes more liability and increases the estimated cost, by adding 1.45% to the contribution rate, bringing the total employer contribution rate beginning in July of 2008 to 15.82%.

Chairman Pinard asked what the effect would be of any COLA granted above the Pre-funded assumption rate if a higher COLA were to be granted.

Mr. Alberts replied that each 1% ad-hoc COLA increase above the assumption would cost 9 basis points or $773,000 to the following year's employer contribution obligation.

Mr. Alberts then directed the trustees to page A-8 of the valuation entitled "Computed Contributions for the Fiscal Year Beginning July 1, 2008". He explained the calculations shown on that page and using the contribution rate of 15.82% and the projected payroll of $31,596,319 he explained formulation of the city's two lump sum contributions in the amount of $2,454,086 with all the other agencies making payroll contributions at 15.82% of actual payrolls and paid weekly.

The trustees continued to discuss the effect of the health subsidy usage of retirees at length.

Trustee Duval inquired about the COLA phase-in and possibility of amending the percentage and the phase-in period in order to mitigate the employer rate.

Mr. Alberts reminded the board that it was a recommendation of the actuary to recognize the COLA, as part of the Experience Study, and it was the decision of the board to phase it in within a four year period. Mr. Alberts expressed agreement that the valuation could be amended to extend the phase-in period for one more year.

Continuing with his presentation, Mr. Alberts noted that economic activity dictates the Plan's gains and losses. He directed the trustees to turn to page A-4 of the valuation entitled, "Development of Funding of Assets", and he gave a brief overview of the effect of the System's investment performance on the Funding Value of Assets and Market Value.

After lengthy discussion of the valuation results, Trustee Duval moved to phase-in the last ½% component of the COLA over the next two years, seconded by Trustee Sanders and passed unanimously by all those trustees present.

Trustee Duval then questioned whether Mr. Alberts could revisit the health subsidy assumption in hopes of lowering the 70% utilization in the re-issue of the valuation.

Mr. Alberts agreed to review the health subsidy assumption, at no additional cost.

At 11:30 a.m. Trustee Duval moved to extend the BOT meeting beyond the 3 hour limitation, seconded by Trustee Hungler and passed unanimously by all those trustees present.

Trustee Duval then moved to have Mr. Alberts to review the health subsidy utilization rate, currently at 70%, and to reduce that assumption as much as possible while being careful to remain at a comfort level with respect to adequacy of funding, seconded by Trustee Sanders and passed unanimously by all those trustees present.

Trustees Sanders expressed his need to depart at 11:35 a.m. but Mr. Alberts felt it important to note prior to Mr. Sanders departure that the methods and assumptions used in the valuation, satisfy the parameters of GASB 43 but will not satisfy the parameters of GASB 45 and therefore should not be used for the City's GASB 45 reporting.

Mr. Albert's qualification so noted, a motion was made by Trustee Duval to accept the 2007 valuation as presented contingent on Mr. Alberts revising the valuation to a) change the phase in of the last 1/2% component of the COLA over the next two years, and b) reduce the health subsidy utilization rate as much as possible seconded by Trustee Angell and passed by all those trustees present. It was understood that Mr. Alberts would make the specified changes and reissue the revised valuation report. The valuation report presented at the meeting would be considered a preliminary valuation.

Request from the Executive Director to attend the annual New England Public Employees' Retirement Seminar on July 16th and 17th - Mr. Fleury expressed interest in attending the NEPERS conference this summer and presented the Board with a formal request to attend. A motion was made by Trustee Duval to approve the Mr. Fleury's request to attend the NEPERS conference, seconded by Trustee Barry and passed by all the trustees present.

January 25, 2008 Communication from NH Judicial Retirement Plan – Mr. Fleury informed the trustees that he had received correspondence from Mr. Chuck Douglas, Chair of the Judicial Retirement System in NH and he is suggesting collaboration between various public plans in NH for joint fiduciary training. Mr. Fleury felt that there may be some merit in participating and is asking for the board's approval in researching this further.

The board agreed to have Mr. Fleury investigate this issue further.

Next Meeting Schedule:

Chairman Pinard noted that the next meeting of the Board of Trustees is scheduled for April 8, 2008 at 8:30 a.m.

It was then moved by Trustee Duval to adjourn the meeting at 12:06 a.m. seconded by Trustee Hungler and passed unanimously by all those trustees present.

Respectfully Submitted,

Gerard E. Fleury
Executive Director