October 14, 2008
Minutes # 441

Minutes of the Board of Trustees' Meeting

Call to Order: Chairman, Donald Pinard called the meeting to order at 8:35 a.m.

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

Absent: Trustee: Mayor Frank Guinta

In Attendance: Attorney John Rich from the McLane Law Firm as well as Sebastian Grzejka, Analyst and Douglas Moseley, Partner, both of New England Pension Consultants

Approval of the Minutes of the Previous Board Meeting:

A motion was made by Trustee Hungler to approve the minutes of the September 16, 2008 seconded by Trustee Duval and passed unanimously by all those trustees present.

Approval of the Immediate Meeting Agenda:

Trustee Hungler made a motion to accept the immediate meeting agenda, seconded by Trustee Angell and passed unanimously by all those trustees present.

New Business:

NEPC Presentation – Mr. Douglas Moseley, Partner and Mr. Sebastian Grzejka, Analyst of NEPC were present to review preliminary third quarter performance numbers and to discuss fine tuning the MECRS Equity Portfolio. Mr. Moseley explained that proposed Equity changes to the MECRS portfolio would focus on a possible reallocation between midcap and small/mid "Smid" cap. In addition to discussion on equity reallocation, Mr. Moseley noted that he would be willing to address the System's future investment allocation to real estate and to comment on public announcements that another NEPC client is seeking to terminate a manager currently in the MECRS portfolio. Before getting to any of those subjects, Mr. Moseley directed his attention to third quarter investment performance.

Mr. Moseley referred to the Flash Report distributed by Mr. Grzejka at the start of the presentation and stated that for the month of September, achieving returns had been very difficult because of the disappointments in the entire third quarter resulting in a reduction in the S&P of 8.9%. Also, the International Equity Composite and Emerging Markets had been down 14.9% and 179% respectively.

Mr. Moseley explained that pricing in the bond market exerts pressure on the balance sheets, moving institutions towards bankruptcy. The natural buyers of bonds in the marketplace, such as insurance companies, banks and broker dealers are now absent from the scene.

Mr. Moseley continued by providing the trustees with a detailed explanation on the effects of bond exposure in different market sectors and on the impact on the cycle in which banks invest. He listed four affected sectors as the treasury sector, mortgage sector, corporate bond sector and asset back sector in which banks invest.

Trustee Sanders noted that the board had interviewed Private Equity Fund of Fund Managers at their August meeting. Representatives from AIG, Pinestar Capital II had been interviewed at that time and while AIG had not been selected by the board, he expressed curiosity relative to the current status of AIG Pinestar Organization.

Mr. Moseley replied that it has been a very difficult year for AIG. The asset management group would likely to be one of the divisions sold with the private equity asset groups and alternative asset groups being kept in tact. He explained that the assets that they manage are not part of AIG's balance sheet. In the case of private equity, there is a limited partnership set up. AIG is the general partner, they run it and they invest in it. The limited partners own and control those assets which are administered by a third party. In the event that AIG were unable to fund its commitment to the partnership, other investors might be sought but the operation of the fund would likely continue.

Trustee Sanders questioned whether Mr. Moseley is aware of any of the other investment managers, currently in the MECRS portfolio, that are in any situation remotely resembling AIG.

Mr. Moseley responded, "In terms of ownership and stability, no," and he proceeded to provide a brief summary of each of the Systems managers' investment performance.

Trustee Sanders then expressed concerns about the portfolios of the two Hedge Fund Managers.

Mr. Moseley responded that both Hedge Fund of Funds are performing well given the down market because of their exposure to different strategies and different asset categories.

He further stated that the only place an investor can currently be that is positive is US Treasury and global bonds. Those categories are followed by emerging markets equities, international equities, and the third best performance asset category, real estate, noting that it was a small allocation with respect to the total portfolio for the System.

Trustee Hungler asked Mr. Moseley to comment on the performance of Mellon Capital, noting that another NEPC client, Fairfax County, Virginia, had publically expressed its disappointment in Mellon's performance and was seeking to terminate the management agreement.

Mr. Moseley was quick to note that NEPC had not recommended Mellon's termination and that that action had been undertaken solely by the client. He went on to note that Mellon's recent history has been disappointing and is reflective of a strategy that is not working well. He suggested that if the MECRS board was troubled by Mellon's performance that he would like to schedule a meeting with Mellon representatives so that they might come in and explain disappointing past performance.

Moving on to other sectors, Mr. Moseley addressed the international equity manager line-up. Flash Reports inclusive of those September investment results available as of the meeting date indicated that both of the MECRS' international equity managers, Gryphon and Causeway had performed well in the recent down market with both managers 3% or 4% ahead of their benchmark. Mr. Moseley stated that NEPC is very comfortable with the investment strategies of both Causeway and Gryphon and both have very strong long term track records.

Mr. Grzejka then addressed the question of equity allocation and recommended a transition to a small and mid cap allocation. That transition would be combined with a switch from a Midcap index approach to an active strategy, especially for a small cap core manager.

Attorney John Rich of the McLane Law Firm, counsel for the System stated that it is his understanding that the asset allocation policy is based upon how the various asset classes are expected to perform given past performance. The past year has seen a completely different market environment which places questions on traditional assumptions. A key component of the System's portfolio is a bond fund that has done very well in the past. The performance report for this year failed to display the asset class correlations expected by the model. Attorney Rich questioned whether in light of these results, if investment consultants would be apt to revert to the more traditional 60/40 treasury bonds and equities portfolio structures or would they assume that the future will mirror performance trends leading up to 2008?

Mr. Moseley replied that, no, the consultant will not suggest going back to the 60/40 asset allocation model. He explained that Asset Allocation Models are created by looking at the past and the current status of the System today. Inflation assumptions are reviewed and taken into consideration as well as bond yields and stock return relationships. The use of an asset allocation model in the investment policy is meant to take the emotion out of investing. While the model requires periodic rebalancing, this is done periodically rather than in response to market volatile because the transaction costs associated with rebalancing can be very expensive.

In order to act upon Mr. Grzejka's recommendation a brief discussion ensued regarding the date for next Investment Committee Meeting, the complications introduced into the regular schedule by numerous holidays in the month of November, and the availability of the trustees needed to achieve a quorum. The board agreed to forego a separate meeting of the Investment Committee and to address November investment issues at the full board level. As a result, they scheduled the next monthly board meeting for Monday, November 10th, and targeted the review of all investment performance results for the 3rd quarter under the report of the Investment Committee.

Mr. Moseley noted that NEPC would invite Mellon Capital representatives to the November board meeting to explain their investment performance. He noted that Mellon is focused on the developed markets and that NEPC would provide comparative returns from other Tactical Asset Allocation managers for the board to consider. He reiterated however, that at this time, NEPC is only recommending rebalancing of global tactical allocation and not replacing Mellon as the System's TAA manager.

In closing NEPCs' presentation, the trustees also agreed to hold "Smid" Core Manger interviews at the full board level at their January meeting. The question of whether an RFP needed to be issued was raised by Mr. Moseley. Mr. Fleury suggested that given the conservative size of the allocation, that an RFP might be overkill since the investment policy does not mandate their use and he suggested interviewing from a short list of recommended manager to be compiled by NEPC. The board was not opposed to the suggestion and Mr. Moseley indicated that it would be done.

Report of the Executive Director:

State of Legislative Sponsor for 2009 - Mr. Fleury began by reporting that as of Tuesday, September 30th, Representative Baroody had filed the draft of the MECRS legislative housekeeping amendment with legislative services in Concord. Legislative Services has since issued LSR #2009-H-0125-R to identify the bill and would eventually issue the text of the draft. Mr. Fleury noted that as soon as that text becomes available, he plans to notify the BMA and seek their approval.

September 25th Bank America Private Equity Annual Meeting – Next, Mr. Fleury noted that on September 25th Bank America conducted its 2008 Private Equity Annual Meeting via live web cast. Mr. Fleury had participated in the web cast and in summary, early conservative estimates about the negative returns of the fund had proven too pessimistic and the fund's returns life to date, had since become positive. Approximately 93% of the investments have been distributed to investors with an estimated 3% to 5% anticipated for distributions by the end of 2008.

Communications Regarding Insurance Coverage from AIG – Mr. Fleury stated that the MECRS insurance underwriter for various types of coverage, AIG, has been in the news recently. While press accounts would have us believe that the company has sufficient reserves to pay claims, Mr. Fleury noted that he sent a message to the broker requesting confirmation that the System can expect claims, (if any were to be incurred) to be paid in return for premium payments which had been made. A response was subsequently received quoting State Insurance Commission sources that there was no need for concern. Mr. Fleury has placed all related communications on file.

Pre-Retirement Seminar Issue – In concluding his report Mr. Fleury informed the trustees that during the MECRS Pre-Retirement Seminar, the financial planner conducted a raffle for a set of Boston Red Sox tickets. Participants filled out a contact sheet in order to be eligible. While it was confirmed that the tickets were in fact awarded to MECRS members, Mr. Fleury noted that he was contacted a few days following the seminar because the financial planner was calling attendees to see if they were interested in a one on one follow up meeting with him. There was some suspicion that contact names and telephone numbers had been provided by the MECRS office which was quickly refuted. Individuals who submitted their names for the Red Sox ticket drawing provided the contact numbers in question and not the MECRS office. Mr. Fleury commented that while he was aware of the raffle, he did not know in advance that participants would be asked to provide personal contact information or he would have disallowed the drawing. Greater care will be taken for future events.

Report of the Administration and Accounting Committee- Committee Chairman Barry summarized that at its committee meeting earlier in the day, the committee reviewed the revised draft of the MECRS 2009 administrative budget inclusive of changes requested by the committee from its previous month's agenda.

Chairman Barry moved to adopt the 2009 operating budget in the amount of $966,560 seconded by Trustee Duval and passed by all those trustees present.

Trustee Duval next offered a motion that as of January 1, 2009, all MECRS staff members receive a cost of living increase of one step, 2.5%, in accordance with the 2007 Condrey, Salary and Compensation Study, which was commissioned by the board in 2007, seconded by Trustee Hungler and passed by all those trustees present.

Next, Trustee Duval reported that the committee also discussed longevity steps for MECRS staff members, duplicating the way in which Manchester City employees receive longevity increases for every 5 year years of service. Because longevity increases have not been given in the past to MECRS staff members the implementation of a MECRS longevity policy would be prospective with respect to the longevity amounts being awarded. Trustee Duval moved to award all staff a longevity increase, of 2.5%, one step on the Condrey Study, as of July 1, 2009, and for staff members to receive additional step increases following the completion of each additional five year increment on their anniversary dates. This motion would effectively amend the existing MECRS personnel policy by adding the longevity provision. Motion was seconded by Trustee Hungler and passed by all those trustees present.

Executive Director Fleury asked that on behalf of himself and his staff, it be stated for the record that the they would like to thank the board for their generous consideration.

Consent Agenda:

Trustee Hungler referred to the Consent Agenda #1, Retirement Office Expenses and asked if the reports were public information.

Mr. Fleury responded that the reports in question are public information, and are furnished to anyone upon request.

Trustee Hungler noted that the agenda listed the name of a member applying for disability and he expressed his concern that the member's identity should not be disclosed.

Mr. Fleury agreed that for the purpose of that particular consent agenda item, the member's name need not appear and that names would be omitted from future reports of this nature.

A motion was offered by Trustee Sanders to accept the Consent Agenda, seconded by Trustee Duval and passed unanimously by all those trustees present.

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New Business:

Request for Motion - At the request of the Executive Director, it was moved by Trustee Sanders to transfer $350.00 from a budget line with an appropriation surplus to another budget line for medical evaluations to cover a small deficit attributed to a greater than expected number of Independent Medical Evaluations having been performed. The motion was seconded by Trustee Hungler and passed by all those trustees present.

Chairman Pinard recessed the meeting at 10:23 a.m. to enter Attorney/Client Privileged Session.

Chairman Pinard reconvened the meeting at 10:50 a.m. with no action having been taken during the recess.

Next Meeting Schedule:

Chairman Pinard noted that due to the coincidental occurrence of Election Day on the board's regularly scheduled second Tuesday meeting date on November 11th, that the next meeting of the Board of Trustees will instead be scheduled for Monday, November 10, 2008 at 8:30 a.m.

There being no further business to transact, Trustee Sanders offered a motion to adjourn at 10:51 a.m. seconded by Trustee Duval and passed unanimously by all those trustees present.

Respectfully Submitted,

Gerard E. Fleury
Executive Director