December 8, 2009
Minutes #454

Minutes of the Board of Trustees' Meeting -1-

Call to Order: Chairman, Donald Pinard called the meeting to order at 8:30 a.m.

Present: Trustees: Chairman, Donald Pinard, Jennie Angell, Richard Molan, and Chuck Hungler
MECRS Staff: Gerard Fleury, Sandi Aboshar and Suzanne Wilson

Absent: Trustees: Mayor Frank Guinta, William Sanders and Kevin Barry

In Attendance: Attorney John Rich of McLane Law Firm
Mr. Ken Alberts, Actuary, Gabriel, Roeder, Smith & Co.

Approval of the Minutes of the Previous Board Meeting:

A motion was made by Trustee Hungler to approve the minutes of the November 10, 2009 board meeting, seconded by Trustee Molan and passed unanimously by all those trustees present.

Approval of the Immediate Meeting Agenda:

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

New Business:

Acceptance of the Five Year Experience Study - Mr. Ken Alberts of Gabriel, Roeder, Smith & Co. was present to explain that the study was conducted for the purpose of reviewing and, where necessary, updating the assumptions used in the actuarial valuation model. He noted that the study covers the period from January 1, 2004 through December 31, 2008 and it is based upon the active, inactive and retired member data submitted by retirement system staff for the December 31, 2003, 2004, 2005, 2006, 2007 and 2008 valuations. As part of the study, a file matching technique was utilized to track individual member activity from one year to the next.

Mr. Alberts went on to explain that when a pension plan is first implemented the cash demands are nil because there are no retired members. As the plan ages, the cash demands begin to grow as more and more members retire. If the plan follows the pay-as-you-go principle, the following will happen, cash contributions will slightly exceed the cash benefits, contributions will start very low and continue to escalate as a percent of the active member payroll until the plan matures, generally over a period of 50 or more years. During that time, benefits currently accruing will become a financial obligation for future generations, and the entire cost of the benefits currently accruing will be paid in the future.

Mr. Alberts noted that many plans including MECRS finance their obligations in a different manner, pre-funding with level percent of payroll contributions. The key to this second financing arrangement is the level percent of payroll contribution. This contribution is computed by the means of an actuarial valuation which is essentially a mathematical model. The mathematical model is necessary in a defined benefit plan because there are "knowns" and "unknowns" that must be evaluated before the level contribution rate can be determined.

Mr. Alberts went on to explain why the assumptions need to be reviewed. He stated that when System experience deviates from expected experience during the valuation process, a gain or loss is generated. This gain or loss is then amortized over a period of future years and applied as an offset or addition to the normal cost contribution. Over time, it is expected that the gains and losses will offset each other. If they do not, then one or more of the actuarial assumptions may need to be modified to reflect actual emerging experience.

Mr. Alberts further explained that if the assumptions are too conservative then the computed contribution rate will decrease over time. If the assumptions are too liberal the estimated cost of the plan is too low then computed contribution rate will increase over time. In either case, this is not consistent with the level percent of payroll principle needed to establish contributions that will, over time, remain approximately level as a percent of payroll.

Mr. Alberts also noted that each assumption should represent a reasonable estimate of future experience. Even though a package of assumptions may produce results which are reasonable, it is important that each component of the package reflect actual expected experience. Estimated costs of benefit changes, for example, are highly dependent upon specific assumptions.

Referring to the Five-Year Experience Study Booklet included in the trustees agenda packets, Mr. Alberts listed the assumptions that drive the contribution rate as; rates of withdrawal, service-based rates of withdrawals, age-based rates of withdrawal, rates of disability, rates of retirement, post-retirement mortality rates, pre-retirement mortality, merit salary increases, economic assumptions, cost of living adjustments and lump sums payable at retirement.

Regarding the service based rates of withdrawal and age based rates of withdrawals Mr. Alberts noted that the actual rates of withdrawal are, on average, nearly twice the assumed rates. GRS is recommending that MECRS increase the assumed rates by approximately 50% to bring them close to the actual observed rates. This is a continuation of a pattern observed in the last experience study. In addition it is recommended that the select period be extended from 5 years to 8 years.

After expanding the select period, the rates of age-based terminations for males did not produce a regular pattern. GRS therefore, combined the male and female age based experience to produce blended results which more closely approximated expectations. Overall however, GRS is recommended increasing age-based withdrawal rates by approximately 50%.

Mr. Alberts asked that the trustees' focus their attention to charts and graphs for the remaining list of assumptions and past experience. He then proceeded to deliver a detail explanation of current trends experienced by the MECRS membership.

Regarding the rates of disability, Mr. Alberts reported that the rates of disability from active service with entitlement to a disability benefit were slightly lower than assumed over the 5-year period. Given the size of the group and the amount of disability occurrences, it is recommended that existing separate assumptions for the male and female rates be combined into one group.

Attorney Rich asked Mr. Alberts how the disability rate at MECRS compares with other Systems.

Mr. Alberts replied that the general overall trend was low for employees in the non-hazardous positions.

Regarding the rate of retirement, Mr. Alberts reported that the rate of retirement from active service with entitlement to an immediate benefit was lower than expected over the 5-year period. After the previous 5-year experience study, the 100% assumption at age 65 was extended to age 70. Recent experience indicated that the 100% assumption at age 65 should be extended to age 70. Also, recent experience indicates that the 100% assumption should be extended to even later ages. Referring to charts within the presentation booklet, Mr. Alberts indicated that many members are actually retiring after age 70, particularly females. Therefore, it is recommended that the retirement decrements extend beyond age 70 and assume 100% retirement at age 75 for males, and at age 80 for females. He also stated that GRS is recommending setting separate assumed normal retirement rates for males and females and adjusting rates toward experience. In addition to normal retirement rates, there are also rates for age based early retirement and "Rule of 80" early retirements. GRS also recommends revising the Rule of 80 assumptions, lowering the early age-based rates for females and not changing the early age-based rates for males.

Next, Mr. Alberts referred to graphs on early retirement experience for males and females. The males actually had 4 retirements with the expected retirement at 6 and he suggested leaving the proposed retirements at 6. The females had 8 retirements with the expected rate at 15 and he suggested changing the new assumption to 13.

Mr. Alberts stated that the next category to be reviewed was the Post Retirement Mortality assumption. He noted that the post-retirement mortality rates currently being used are from the 1994 Group Annuity Mortality (GAM) tables. Experience during the 5-year period was very close to the assumed rates, in total with 35 expected male deaths compared to 35 actual male deaths and 45 expected female deaths compared to 51 actual female deaths. In order to establish enough margin for future improvements in mortality as well as taking into account recent experience, Mr. Alberts recommended that the current male table be multiplied by 95% and that the current female table be maintained. Impaired mortality experience was not sufficient to produce credible experience. Therefore, it is recommended that MECRS maintain the current approach, which is to use the healthy mortality tables set forward 10 years for impaired mortality.

Focusing on merit salary increases, Mr. Alberts stated that merit salary increases are based on a correlation with service. GRS studied both age and service relationships for MECRS and continue to find a slightly greater correlation for service and merit salary increases than between age and merit salary increases. It was also found that current rates of assumed increase were lower than actual increases at later ages. Mr. Alberts noted that he is therefore recommending adjustments to the assumed salary rate increases, accordingly.

When it comes to economic assumptions, Mr. Alberts stated that there is no best single combination of assumptions. However, there is a range of reasonableness. GRS believes that the current set of economic assumptions (7.5%) interest; 4.0% wage inflation) provides for a fairly neutral set of assumptions (neither conservative nor liberal). Based on the historical pattern of investment return the recent investment market and predominant public sector activity, an investment return of 7.5% appears to be a good "middle of the road" assumption.

Mr. Alberts noted that MECRS does not have a provision for granting automatic cost-of-living adjustments (COLA) after retirement. However, they do have a history of granting ad-hoc COLA's. Pursuant to the previous experience study, a COLA assumption was phased-in during recent valuations. Phase-in ended December 31, 2008 with a 1.78% COLA assumption. However, given that the fund now has a policy in place to help determine when to pay COLA's and that policy in combinations with the recent market downturn will likely decrease the occurrence/amount of COLA's over the short term, GRS believes that a 1.5% or 2.0% assumption is reasonable. The results shown on page B-5 of the report (as of December 31, 2008), show separate results based on a 2.0% and 1.5% COLA assumption.

Mr. Fleury reviewed his understanding of Mr. Alberts' presentation at this point, noting that the nature of the study is to provide GRS and MECRS with an assessment on whether the assumptions to be used in the upcoming valuation and to set the future contribution rate, need to be amended. Even if any of those assumptions are changed, assumption changes are prospective; and would have no bearing on the upcoming valuation in which GRS will forecast the contribution requirements for the coming year. That valuation for the year just completed is still based on the assumptions that were in effect for the previous year and revised assumption would only be applied at the end of 2010.

Mr. Alberts responded that Mr. Fleury's comprehension was correct.

Mr. Alberts continued his presentation and addressed the lump sums payable at retirement. He commented that currently, normal and early retirement costs are adjusted by 2% to recognize lump sum severance payouts at retirement. He referred to a chart in the report booklet which indicated an increase for each year of 11%. GRS is recommending that the adjustment be increased from 2% to 8% to reflect experience.

Attorney Rich noted that as Mr. Alberts addressed each assumption change, he had not been indicating any level of magnitude on the costs to the System.

Mr. Alberts responded that GRS does not break the study down for each component and that it will be done for all the demographic assumptions at once.

Mr. Alberts explained that moving forward; the trustees will need to make decisions on the demographic and economic assumptions. If the trustees decide to adopt the demographic assumptions, one of the changes is in the mortality table. The mortality table will have an effect on a couple of different things outside of the valuation process, option factors and the additional contribution calculator. Mr. Alberts provided the trustees with a detail explanation of each assumption and a timeframe in which the decisions should be made by the trustees.

The trustees discussed their upcoming schedule in adopting the GRS 5-year study.

Mr. Alberts referred to page B-5 of his presentation booklet, Contribution Calculation Comparison, using assumptions for the pension only, not including health, and with assumed rates of 7.50% as the Interest rate, 4.00% as the wage inflation, and 1.88% as the COLA assumption. Using the same valuation data, he presented five different alternatives, resulting in contribution rates ranging between 17.33% and 19.95%.

Mr. Alberts stated that GRS would be comfortable with the five alternatives presented.

Mr. Alberts added that the results are as of 12/31/2008, however, and do not take into account the fact that the System is not done recognizing the 2008 four million dollar loss and that it is not known to what extent it might be offset by other gains. He also noted that the three variables pushing the contribution rate up are, the change in merit and longevity, the change in the end of career payment load and the mortality rate.

The trustees continued to discuss the adoption of the study and requested that Mr. Alberts prepare an additional combination of assumptions with the interest rate at 7.5%, the wage inflation at 3.5% and the COLA assumption at 1.75%, for the January board meeting. They thanked Mr. Alberts for his presentation and he departed.

Report of the Executive Director:

Funding of Mellon Capital Global Global TAA - Mr. Fleury reported that as directed by the board at the November 10th meeting, $3.3 million in cash was invested in Mellon Capital Mgmt. Global TAA as of December 1, 2009. That amount will approximate the total allocation to GTAA of 15% also approved by the board at the November meeting.

Annual Meeting Excerpt From Lexington Partners – Moving on, Mr. Fleury reported that MECRS has received the first capital call from Lexington Partners VII which was made on December 2, 2009. He also received was a CD of the Lexingot6n Partners Annual Meeting conducted on November 12, 2009, where reports were made on the various Lexington Funds. Selected pages on the status of Fund VII have been extracted from the CD and included in the agenda packets as an informational item.

Option for Board Material on CD - Next, Mr. Fleury followed up on informal discussion by board members at last month's meeting regarding elimination of paper and receiving board packet materials on CD. A review of the materials and identification of logistical problems associated with such a concept were explored. The conclusion reached was that paper reduction could be achieved but that paper could not be completely eliminated. The board would also need to be receptive to having packet materials projected on a screen at the meeting rather than working from packets. This could be tried once to determine if it is practical using existing equipment and at essentially no cost.

After brief discussion by the trustees, the board agreed to have Mr. Fleury research the proposed elimination in the distribution of agenda items and report back to the board at the January meeting for further discussion and consideration.

Trustee Hungler recommended that in the future, financial information provided individually by investment managers no longer be copied and provided to the trustees since similar information is consolidated and reported regularly by NEPC.

Mr. Fleury agreed.

Investment Committee:

Committee Chairman Hungler reported on the Investment Committee meeting held the previous day and noted that RMK Timber Fund requested a 2-year contract extension. MECRS is a 16.67% co-investor in the RMK Fund along with Wells Fargo and the University of Alabama Pension Fund who each own 41.67%. A conference call had been held on December 1st between Mr. Fleury, representatives at NEPC and representatives at RMK to discuss terms of the tentative agreement. While NEPC had pressed for fee reductions, RMK remained steadfast resistant to that suggestion and was seeking a two year extension with an additional two years for liquidation.

Moved by Committee Chairman Hungler to grant authority to Mr. Fleury to negotiate the contract extension with RMK Timber Fund with the assistance of the Systems' Advisor, NEPC, seconded by Trustee Angell and passed unanimously by all those trustees present.

Mr. Fleury then reported that following the Investment Committee meeting the previous day, RMK has agreed to amend the contract extension to a one year period as opposed to two years as originally requested. The liquidation period was extended from the present 90-days to 180 days, with a 1-year extension for extenuating circumstances, and subject to RMK's ability to request an additional renewal of those terms a year from now. Mr. Fleury stated that this amended contract appears to satisfy the interests of Wells Fargo and the University of Alabama Endowment Fund and that he would attempt to close the agreement under those terms.

Committee Chairman Hungler continued his report by stating that four large Cap Managers had been interviewed the previous day, two Value Mangers and two Growth Managers to replace the Systems existing large cap managers; State Street Global Advisors and Cadence Capital Management.

Based on the previous day interviews and the recommendation of the Investment Committee, Committee Chairman, Hungler moved to grant Mr. Fleury the authority to liquidate Cadence Capital Mgmt., in the amount of approximately $9 million, to hire Sands Capital Mgmt. as the replacement value manager, and to liquidate approximately $9 million under management with, State Street Global Advisors to be replaced with Pzena Investments Management as the system's large cap growth manager. These actions would be subject to a review of subscription agreements by legal counsel. The motion was seconded by Trustee Angell and passed unanimously by all those trustees present.

Moving on, Committee Chairman Hungler reported on the committee's "Real Asset" Manager Search which had been recommended by NEPC. Committee Chairman Hungler stated that three Investment Advisors have been chosen to make presentations before the full board in January. They are DB Advisors, State Street Global Advisors, and Wellington Mgmt. Before hiring a real asset manager, the board would need to amend their Investment Objectives & Guidelines which Mr. Fleury would have ready with the assistance of NEPC.

Lastly, Committee Chairman Hungler reported that three mezzanine fund managers had been interviewed back in September. One of the managers had been eliminated immediately and there was a difference of opinion between the remaining two managers.

The trustees discussed the remaining two presentations and how their funds were managed, but were unable to reach a decision on which one to hire. They agreed to table the hiring of a Private Equity Fund of Funds Manager until the January board meeting.

Minutes of the Board of Trustees' Meeting -8-

Previous Business:

MECRS 2010 Administrative Budget – Mr. Fleury referred to the revised budget distributed to the trustees at the beginning of the meeting. He commented that the budget information included in the trustee's agenda packets was overstated by $1,600 in the 2009 budget column. The error has been corrected and amended budgets distributed with an end result with a 0% increase.

Moved by Trustee Hungler to approve the amended budget, in the amount of $966,560.35, seconded by Trustee Molan and passed by all those trustees present.

Consent Agenda:

It was moved by Trustee Hungler to approve the Consent Agenda, seconded by Trustee Molan and passed unanimously by all those trustees present.

Having concluded all of the items of business for the day, Chairman Pinard entertained a motion to adjourn. Trustee Molan moved to adjourn at11:17a.m., seconded by Trustee Hungler and passed unanimously by all those trustees present.

Respectfully Submitted,

Gerard E. Fleury
Executive Director