

November 10, 2009
Minutes #453

Minutes of the Board of Trustees' Meeting -1-

Call to Order: Chairman, Donald Pinard called the meeting to order at 8:34 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, Bill Sanders and Kevin Barry

In Attendance: Attorney John Rich of McLane Law Firm
Mr. Kevin Leonard and Mr. Sebastian Grzejka of NEPC

Approval of the Minutes of the Previous Board Meeting:

A motion was made by Trustee Hungler to approve the minutes of the October 13, 2009 board meeting, seconded by Trustee Molan 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.

Report of the Executive Director:

Update – Request From a Vested Deferred Member - Mr. Fleury began by reporting that the System has recently received new information from counsel causing MECRS to reverse their position on whether vested deferred members may elect to make additional contributions. In previous months, Mr. Fleury noted that he had reported that a vested deferred member had expressed interest in the Additional Contribution Program and that he had referred the eligibility question to counsel before proceeding. When pressed by the member for an answer, Mr. Fleury informed the board that he had issued a letter denying the request to participate based upon what was known of IRS restrictions at the time. A subsequent investigation by counsel discovered that key elements of Section 415(c) of the IRS Code which had been amended and now allow for additional contributions to be made. The key change was the substitution of the term “participant” in place of “employee” in the qualifying language. Since a vested deferred member was no longer an employee, they did not qualify, but since a vested deferred member is still a “participant”, they do. Another section of the Code which previously required current period earnings from the qualified employer was specifically exempted from the eligibility requirements and thus paved the way for additional contributions to be allowed. This discovery applies only

November 10, 2009
Minutes #453

Minutes of the Board of Trustees' Meeting -2-

to additional contributions and in no way impacts the limits imposed on the upgrade of service credit of time earned prior to 1999.

Reminder to Retirees of Pop-Up Provision – Next, Mr. Fleury informed the board that upon the recent passing of a retired member, it was discovered that the member's spouse who would have been eligible to continue receiving a monthly benefit under the chosen survivor option had actually passed away four years earlier. Because the retiree never notified us of the passing so that the System could adjust the benefit, he was underpaid until the time of his death. Mr. Fleury stated that while there is no specific statutory obligation to do so, in an attempt to prevent a repetition of such an unfortunate situation, Mr. Fleury is proposing to run a check for deceased beneficiaries annually at a cost of less than \$200 per year. He noted that a budget line is being requested in the 2010 MECRS budget to cover that new expense.

The trustees agreed to add the \$200 line item to the proposed budget for 2010, in the attempt to identify deceased beneficiaries.

It was then moved by Trustee Hungler to approve the retro payment to the estate of the deceased member, seconded by Trustee Angell and passed by all those trustees present.

7th Annual NEPERS Conference – Mr. Fleury stated that he and Trustee Angell attended the 7th Annual NEPERS Conference in Boston on October 27th. He noted that a number of topics covered at the conference were relevant to events at the MECRS. Two topics which seemed to have evaporated from the presentation list since last year were credit opportunities and portable alpha. The new focus appears to be on potential inflation and the use of commodities, real estate, tactical asset allocations and TIPS to posture for inflation which may possibly develop at some indeterminate time in the months or years to come. He also noted that by carpooling to the conference and because he volunteers to participate in presentations, the cost to the System for both to attend was reduced to mileage reimbursement. Also, Mr. Fleury opined that he sees great value in these seminars for public funds and encourages trustees to attend, especially when the events are in the local New England area.

Experience Study With GRS- Mr. Fleury reminded the board that at their August meeting, they had authorized an experience study by Gabriel Roeder Smith & Co., subject to a negotiated price to keep the engagement within budget limits. He reported that results of the study will be ready for the December meeting and printed materials will be received in time to be included in the December board packet. Mr. Fleury noted that this should allow sufficient time for trustees to review the results of the study and ponder its implications prior to the meeting when the actuary will be present to make a formal presentation and to answer any questions.

Status of Trustee Election – Mr. Fleury reported that the MECRS trustee election is on schedule for December 10, 2009. There will be one candidate on the ballot for the election of citizen

Minutes of the Board of Trustees' Meeting -3-

representative. Former Trustee Paul Porter submitted the necessary election forms and will appear unopposed on the ballot.

Insurance Quote for Breach of Security Coverage – Before closing his report, Mr. Fleury noted that some months ago, Trustee Molan had brought Chapter 359-C Right to Privacy, Notification Laws and their requirements to the board's attention. After reviewing the intent and letter of the law and assessing the potential applicability to operations at MECRS, Mr. Fleury stated that while many of the typical vulnerabilities inherent in a breach of security scenario have been addressed and that the organization's data is reasonably secure, that the System cannot anticipate and guarantee prevention of every type of event which might occur. Given the potential in any organization for loss of data and the requirements of the law, Mr. Fleury informed the board that he had obtained a quote for Security & Privacy Insurance which would cover the cost of notifications and related expenses should any of the MECRS data become subject to the notification provisions of Chapter 359-C. A Security & Privacy questionnaire had been completed and submitted to MECRS Insurance Provider, Ferdinando Associates. A subsequent meeting had been held on October 30th to discuss the matter and to obtain details on coverage provisions. Mr. Fleury recommended that the board consider allowing him to add \$8,200 per year to the MECRS operating budget to cover premium expenses for such coverage and he noted that the amount had been included in the draft budget which had been provided to the board. While he believed that the risk of a security breach is low, the cost to comply with provisions of Chapter 359-C could be considerable and, in his opinion, the trustees should go on record as having reviewed and acted upon that insurance option.

Administrative Accounting Committee:

Due to Committee Chairman Barry's absence, Committee Member, Trustee Hungler reported that the MECRS draft budget for 2010 was discussed during the A & A meeting held the previous day. It was requested that the executive director fine tune some of the budget line items so that the committee would be able to present a draft budget for the full board's recommendation with a zero increase.

Trustee Hungler then referred to the revised budget distributed to the trustees at the beginning of the meeting, showing a 35 cent increase over the 2009 request. He commented that he would like to table the approval of the MECRS 2010 DRAFT budget, allowing the trustees sufficient time to review the changes and to come back with any other recommendations, at the December meeting of the full board. The trustees agreed to do so.

Next, Trustee Hungler referred to the second item for the trustee's consideration regarding an amendment to the MECRS's Personnel Policy, bringing the MECRS's staff in line with

Minutes of the Board of Trustees' Meeting -4-

employees of the City of Manchester on issues of sick and vacation time and the amounts of such time which can be paid out upon termination or retirement.

Trustee Hungler moved to accept the amendment to the MECRS's Personnel Policy to mirror the City of Manchester's policy, seconded by Trustee Molan.

For the record, Mr. Fleury stated that the Vacation and Sick Policy DRAFT had been reviewed by the System's legal counsel and included recommendations made by counsel.

Motion carried unanimously by all those trustees present.

The next item of business addressed was salary increases for the MECRS staff. Trustee Hungler indicated that Committee Member, Molan, had been provided with copies of the study commissioned by the full board a few years earlier which had resulted in the adoption of a salary schedule named after the firm which had been hired to conduct the study and which has since been referred to as the Condrey Report. There had also been discussion among the committee members about the rate of inflation and about the assumptions included in the Condrey Report. The committee did not take issue with the salary schedules in the Condrey Report for present day use but expressed concerns over the accuracy of correlation with salaries paid by peer plans for use in the coming years. Seeking to keep that peer relationship up to date for use in the future, the Committee requested that Mr. Fleury provide an update of salary data from the peer groups of comparative retirement plans which had been surveyed as part of the Condrey Report. Mr. Fleury agreed to do so.

Trustee Hungler moved to grant a step increase on the scale from the Condrey Report, adopted by the board, for the three staff members of the MECRS, seconded by Trustee Molan and passed unanimously by all those trustees present.

Executive Director Fleury, on behalf of the MECRS staff and himself, expressed his gratitude to the board for their continued support.

Benefits Committee:

Mr. Fleury reported that there had been a meeting of the Advisory Committee on October 15, 2009.

Several items were reviewed such as the status of the Plan, fluctuations in the market, changes in the investment portfolio and the asset allocation model, the pending study of actuarial assumptions, as well as the upcoming MECRS election for citizen representative.

Mr. Fleury informed the board that goals and objectives for the committee were discussed and that no requests for plan amendments were contemplated by the Advisory Committee for the 2010 session of the NH Legislature.

November 10, 2009
Minutes #453

Minutes of the Board of Trustees' Meeting -5-

Mr. Fleury also noted that the Committee had attended to organizational housekeeping issues for 2010 by nominating and subsequently electing a chair for the committee for 2010. Kim Desrosiers from Parking Control was nominated and re-elected in that process.

Committee Member Angell, also noted that the City HR Director, Ms. Jane Gile had been in attendance during the meeting and committee members had taken the opportunity to discuss aspects of the City's retiree health insurance coverage with her. Ideas that might make such coverage more affordable were discussed and pitfalls to some suggestions were identified. The group also expressed their desire to make the utilization of the health subsidy more flexible.

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.

New Business:

Request For a Motion - Mr. Fleury requested a transfer from the miscellaneous account in the amount of \$25 to the State Unemployment account, due to an increase in insurance premiums.

It was moved by Trustee Hungler to transfer the funds requested by Mr. Fleury, seconded by Trustee Angell and passed unanimously by all those trustees present.

Investment Committee:

Committee Chairman Hungler reported on the Investment Committee Meeting held the previous day with Investment Consultant, Mr. Kevin Leonard in attendance. Chairman Hungler noted the comparison by sector between 2009 year-to-date investment returns, and those for the whole of 2008. A quick comparison revealed that International Emerging Markets, High Yield, Bank Loans, Emerging Fixed Income and Muni Bonds have more than recovered losses recorded in 2008. For the remaining sectors however, additional gains would be needed in order to fully recover from losses in the fourth quarter of 2008 and first quarter of 2009.

Chairman Hungler stated that year-to-date, growth funds continued to outperform value funds as had been the case earlier in the year despite signs to the contrary throughout the summer months. He also noted that International Equity continues to look strong with the EAFE index up 29% year to date. International emerging markets lead the group in advances 64.7% for the year.

Committee Chairman Hungler reported that NEPC had briefed the committee on the notification by Eaton Vance, Credit Opportunity Funds, of its pending closure and distribution. He reported that the profit assumptions which Eaton Vance had foreseen to occur over a two to three year

Minutes of the Board of Trustees' Meeting -6-

period had already been achieved and that because limited further upside potential was thought to exist, the manager had elected to close the fund and return the profits to investors.

Mr. Fleury interjected that there will be two distributions, both in December. The System has already received the forms from Eaton Vance to process the distribution and State Street Bank & Trust has been notified to anticipate receipt of the funds.

Next, Committee Chairman Hungler reported that the committee had received a recommendation from NEPC to allocate some or all of the Eaton Vance proceeds to Mellon Capital Mgmt. for inclusion in the existing Global TAA. The committee discussed whether an allocation to Mellon Capital Mgmt. would necessitate an adjustment to the asset allocation model. They concluded that it would, and is recommending that a change in the asset allocation percentages is in order. The present target allocation for fixed income of 23% could be reduced to 20% with that change representing the distribution of Eaton Vance Credit Opportunities' Fund. The present target allocation of 12% to Global Asset Allocation Composite could then be increased by that same 3% to bring it up to 15%.

Chairman Pinard accepted a motion by Committee Chairman Hungler to increase the GAA target weight by 3% and reduce the fixed income target weight by 3%, seconded by Trustee Molan and passed unanimously by all those trustees present.

Chairman Pinard then accepted a motion by Committee Chairman Hungler to grant authority to Mr. Fleury to move funds to TAA from the cash account upon consultation with the System Investment Consultant, NEPC, seconded by Trustee Molan and passed unanimously by all those trustees present.

It was also reported that Mr. Fleury had participated in a conference call with NEPC and Income Research & Mgmt regarding the investment of excess cash in the IR&M Core Bond Fund. It appears that the liquidity requirements with IR& M would be well suited for the Plan rather than having a large amount in the Systems' cash account with State Street or other cash management options Mr. Fleury had investigated in September and October which simply failed to produce acceptable yields. Mr. Fleury informed the board that he would require their authority in order to invest amounts identified as excess to the operational needs to the Retirement System into the IR&M Core Bond Fund and to withdraw those amounts as needed.

Chairman Pinard accepted a motion from Committee Chairman Hungler to grant Mr. Fleury the authority to move the funds out of the cash account, as recommended by the System Advisors to get a better best return from Core Bonds and to withdraw said funds to meet liquidity needs of the System. The motion was seconded by Chairman Pinard and passed unanimously by all those trustees present.

Minutes of the Board of Trustees' Meeting -7-

Mr. Leonard of NEPC briefly reviewed his presentation made to the Investment Committee the previous day addressing the anticipated causes and possible timelines for inflation which is believed to be inevitable, and he spoke on the role of certain asset classes as effective hedges against inflation. Mr. Leonard made it clear that MECRS presently is invested in various asset classes such as real estate and timber which will help to posture it for inflationary times. Referring to charts and graphs in the presentation booklet, Mr. Leonard summarized the behavior of the economy over the past decade and how inflation, as measured by the consumer price index, oil, and commodity prices had moved in concert.

Looking toward the future, the size of the money supply needed to repay economic stimulus programs, demand for energy and commodities, and the potential drop in unemployment were all identified as catalysts for inflation in a 12 to 18 month timeframe. In response to those conditions, and in order to better posture the MECRS portfolio, Mr. Leonard stated that a redefined asset allocation class for real assets should be created. The recommended components to this allocation class would be real estate, treasury inflation protected securities, (TIPS) and commodities.

Mr. Leonard explained that of the three components in an inflation protection portfolio, TIPS would be the least volatile, followed by real estate and then commodities being the most volatile of the three. He noted that investments such as the SSGA Real Asset Fund could provide the sought after exposure to such a class of investment.

Mr. Leonard indicated that a search book had been completed by NEPC for this investment category and was ready for use. A review of potential managers could be conducted with the objective of identifying managers in the search book who would be called for interview at a subsequent meeting.

The trustees continued to discuss the different options before them in order to better posture the Systems asset allocation.

After lengthy discussion the board requested that NEPC issue a real asset manager booklet for the boards review for the December board meeting when all the trustees are present.

The board also agreed to table the issue of investment on Private Equity Fund of Funds with a Mezzanine Focus until the December board meeting when all the trustees are present.

Next, Mr. Leonard referred to the Active vs. Passive Management booklet included in the trustees agenda packets. He stated that NEPC is a firm that does believe that there are opportunities to add value through active investment decision-making and that over time, there will exist opportunities to improve performance through superior strategy, structure, and implementation.

Minutes of the Board of Trustees' Meeting -8-

Mr. Leonard referred to a chart, on page 28 of the booklet, Active vs. Passive – Summary by Asset Category. The chart provided an asset class list, active constraints, excess return expectation and NEPC's comments on each asset class.

Mr. Leonard stated that NEPC believes in seeking to add value at every step in the investment management process. It is critical for plan sponsors to focus resources on the highest value added components of investment management process. Active management is less likely to add significant value in more efficient areas of capital markets. He provided an analysis of each type of management noting that analytical challenges include universe selection, survivorship bias and time period sensitivity.

The trustees were then provided a comparison of rankings and rolling periods of U.S. Large Cap Core Equity, Growth Equity, and Value Equity to the rankings of U.S. Small Cap Core Equity, Growth Equity and Value Equity.

Mr. Fleury observed that the breakdown of Mr. Leonard's statistics, whether it be large cap or small cap, seems to favor the manager's ability to outperform the index in growth over value.

Mr. Leonard responded that Mr. Fleury's observation is correct. Growth managers outperform the benchmark due to technology which tends to give the managers the ability to outperform.

Mr. Leonard stated that it is NEPC's recommendation, that in this next market cycle, that active management should be part of the System's portfolio of large cap stocks.

Mr. Leonard explained that NEPC differentiated large cap active managers between those that had a more pronounced stock selection bias toward the specified discipline, the so called "deep value" and "deep growth" managers versus those that did not have as profound stock selection bias, the so-called "relative value" and "relative growth" managers. Mr. Leonard stated that if a client was inclined to utilize active management, his preference was to use a manager pairing of "deep value" and "deep growth" in order to maximize the value added by the active manager.

Moving on, Mr. Leonard referred to the Large Cap Value Equity Manager Search booklet, distributed to the trustees at the start of the meeting. Mr. Leonard narrowed the selection of Large Cap Value Managers for consideration down to four; Barrow, Hanley, Mewhinney & Strauss, Dodge & Cox, Pzena Investment Mgmt, LLC and Westwood Management Corp.

Next, Mr. Leonard referred to the Large Cap Growth Manager Search booklet, distributed to the trustees at the start of the meeting. Mr. Leonard narrowed that selection of Large Cap Growth Managers for consideration down to four as well including; Rainier Investment Mgmt., Sands Capital Mgmt, Turner Investment Partners and Wells Capital Mgmt.

November 10, 2009
Minutes #453

Minutes of the Board of Trustees' Meeting -9-

After brief discussion by the trustees and NEPC it was moved by Trustee Molan to interview the two Large Cap Deep Value managers, Barrow, Hanley, Mewhinney & Strauss and Pzena Investment and two Large Cap Deep Growth Managers, Turner Investments and Sands Capital, at the next scheduled meeting of the Investment Committee on Monday December 7, 2009 at 8:30, seconded by Chairman Pinard 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 Hungler moved to adjourn at 11:01 a.m., seconded by Trustee Molan and passed unanimously by all those trustees present.

Respectfully Submitted,

Gerard E. Fleury
Executive Director