April 13, 2010
Minutes #458

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, Chuck Hungler, Richard Molan and Paul Porter
MECRS Staff: Gerard Fleury, Sandi Aboshar and Suzanne Wilson

Absent: Trustees: Mayor Ted Gatsas and Bill Sanders

In Attendance: Attorney John Rich of the McLane Law Firm
Mr. Kevin Leonard and Sebastian Grzejka 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 March 9, 2010 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 passed unanimously by all those trustees present.

Report of the Executive Director:

Security Test – Mr. Fleury began by reporting that a meeting with a vendor representative regarding computer security and intrusion testing was held on March 25th at the MECRS office, to review detailed findings of security tests performed. Risk Manager, Harry Ntapalis, City Auditor, Kevin Buckley, Info System Specialist, John Fortier, and Human Resource Representative, Ronald Robidas were also in attendance. Mr. Ed Barry of DSQ, Inc linked in Brad Hutson a DSQ technical specialist and detailed reports of the test's findings were discussed. MECRS received a very favorable report in which it placed in the upper 25% of organizations with risk exposure stemming from the operation of information systems. The report did identify areas of low risk but for which solutions could be implemented. The formal 33 page report is on file.

Passage of National Healthcare – 401(h) Subsidy Implications – Mr. Fleury informed the trustees that MECRS clients are already asking whether the passage of the National Healthcare Bill will have an effect on the 401(h) medical subsidy. Since the bill has a few thousand pages and is impacted by various amendments, a complete analysis will probably take considerable time. After discussing the matter briefly with counsel, it was agreed that taking a wait and see approach would probably make the most sense. In the mean time, Mr. Fleury noted that he will continue to monitor informational releases from the National Council of Public Employee Retirement Systems for any news on problematic aspects of the new law. The Board should also know that the System will be tracking these events for the purpose of ensuring continued compliance with federal mandates.

External Storage System Failure - In closing his report to the board, Mr. Fleury reminded the board that the main MECRS network storage drive had suffered a complete failure a month earlier. At that time MECRS operated in accordance with its emergency plan and was fully functional with only a few minor inefficiencies while it awaited delivery of a new external storage unit. Since then the new unit was received, loaded with data, tested and activated. Mr. Fleury noted that as previously reported, the entire event was transparent to clients and all repairs, technical assistance fees and replacement equipment were within planned budget parameters.

In regards to the security testing issue, Trustee Hungler asked Mr. Fleury if the top 25% of organizations includes all or only organizations of the MECRS size.

Mr. Fleury responded that the company that did the survey keeps records on all of their clients and focuses primarily on companies that do credit card business where security concerns would be paramount. The MECRS System finished in the top 25% of their clients in general.

Report of the Investment Committee:

Committee Chairman Hungler reported that the contracts of the newly hired investment managers, Newstone Capital and Wellington Investment Management have been executed and delivered and that Wellington had been fully funded.

Report of the Benefits Committee:

Committee Member Angell reported on the recent meeting of the Advisory Committee to MECRS held at the MECRS office. She stated that Mr. Fleury had been in attendance during the meeting and had reviewed preliminary valuations results with those in attendance. She also reported on the committee's interest in the Retirement System's procedures for manager selection and funding as well as interest in passive vs. active management styles.

Committee Member Angell, also reported on the positive discussions by the committee regarding MECRS luncheon seminars held at the request of the City Departments and about the upcoming Pre-retirement Seminar scheduled for the fall of 2010.

Moving on, Trustee Angell reported on the committee's interest with the national health care plan. She noted that the committee discussed the possibility of the City offering a high deductible health care plan including a medical savings account. No conclusions were drawn or action plans formulated and no specific date was set for the next meeting of the Advisory Committee.

Report of the Administrative & Accounting Committee:

Committee Chairman Angell, stated that the next A & A Committee meeting will be held May 11, 2010 @ 8:00 a.m. The retiree COLA for 2010 will be the topic of discussion.

Trustee Hungler directed the board's attention to a spreadsheet distributed at the beginning of the meeting regarding the Consumer Price Index history and the MECRS' retiree COLAs granted in those corresponding years.

Trustee Hungler explained that the Administrative & Accounting Committee plans to use the spreadsheet as a tool and to review the parameters used by the trustees for determining past COLA awards.

Attorney Rich provided a history of the regulations put in place by an earlier board, for granting retiree COLA, and he noted the importance of the rule because the statute does not give the trustees guidance on whether and when there should be a COLA. He explained that the trustees had adopted guidelines to provide structure of the process which would steer discussion and provide process documentation. That said, Attorney Rich further noted that now that the COLA is pre-funded to a certain level, the trustees may want to revisit and amend the regulation where appropriate.

Mr. Fleury reminded the board that the COLA regulation predates the establishment of the pre-funded formula. The trustees discussed the regulation in some detail and before concluding their discussions, agreed to take up the subject at the next Administration & Accounting Committee meeting scheduled for May 11, 2010, with the objective of presenting a recommendation to the full Board of Trustees at their meeting which would immediately follow.

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:

First Quarter Review of Investment - Mr. Kevin Leonard and Mr. Sebastian Grzejka of NEPC were in attendance to review preliminary results of first quarter 2010 investments and to elaborate on future developments in private equity and commercial real estate allocations.

Mr. Leonard referred to the Investment Performance "Flash" Report distributed to the trustees and began his presentation with the March Market Update. He indicated that the chart is ranked by the highest to the lowest with the highest asset class for the first three months of 2010 being small cap value, which was up 10% and with the lowest being commodities which was down 5%. The S&P 500 for the first three months was up 5.4%. The market continued to move positively with small cap stocks outperforming large cap stocks.

Mr. Grzejka directed the trustee's attention to the year-to-date column in the "Flash Report" beginning with Mellon Global Alpha I which was up 3.6% for the year-to-date and up 44.8% for the last year. Moving on to portable alpha managers, he noted that the performance numbers for Benchmark were not yet available but that they would likely be comparable or slightly higher than the performance figures for Gottex. Gottex is up 7% year-to-date, well above the S&P benchmark of 5.4% used to gauge portable alpha managers. Mr. Grzejka then noted that Pzena was funded right at the beginning of the year, is doing quite well, and has outperformed its year-to-date value benchmark by a three and one half percentage points. The other new manager, Sands Capital, although slightly behind the benchmark for the year-to-date, is still up 3.4% for the calendar year. SMID cap manager Rothschild also is up 7.6% for the year but trails the benchmark of 9.2%. The one year return for Rothschild was 41.3% but again behind the benchmark of 65.7%.

Mr. Grzejka went on to explain the track record of quality stocks versus non-quality stocks over the past year, with non-quality leading the market place in terms of performance. He expressed the opinion that quality stocks will outperform the non-quality over time. Given the nature of the rally in the last year of non-quality stocks, managers like Rothschild had a hard time beating the benchmark but he predicted that as we get to a 3-year cycle with Rothschild, that we should see better performance.

Mr. Leonard interjected that he had received an email from Mr. Fleury stating his concern that another NEPC client is looking at potentially replacing Rothschild. Mr. Leonard reassured the trustees that NEPC has not recommended terminating this manager to any of their clients. He noted that the particular client in question is concerned with Rothschild's performance, has a longer track record Rothschild than MECRS and is simply evaluating Rothschild's performance. Mr. Leonard reiterated that if NEPC was concerned with this manager then the System would have received a recommendation from NEPC to address the issue.

Moving on to the next item of concern, Mr. Fleury stated that he recalled when NEPC recommended that MECRS pursue active management vs. passive because of imperfect markets and the ability to outperform an index at the small and mid cap levels. That recommendation had resulted in the hiring of Rothschild to replace a Vanguard index fund. More recently, when faced with replacing two of its domestic equity managers, NEPC extended their recommendation for active management and MECRS hired Sands Capital Management and Pzena Investment Management. It now appears from published press releases that NEPC has recommended the opposite to the New Hampshire Retirement System. Mr. Fleury asked Mr. Leonard to explain the circumstances of this seemingly contrary recommendation.

Mr. Leonard explained that the press articles were not necessarily accurate. NEPC recommended that the NHRS have some level of passive management within their large cap given their risk tolerances and it was also recommended that they have some active management within their large cap. The NHRS Investment Committee, however, chose to implement 100% passive in their large cap space. NEPC's preference would have been a blending of passive and active management.

Trustee Hungler referred to an article published by NEPC which states that there is no one answer regarding active vs. passive management. Trustee Hungler read from the article stated that "The decision depends on an assessment of 1.) The specific attributes of an investment program including government structure and available resources. 2.) Individual asset classes and 3.) The market environment." Trustee Hungler then asked Mr. Leonard if those assessments were discussed with Mr. Fleury, because he did not recall them being discussed with the MECRS Board of Trustees.

Mr. Leonard replied, "Yes, those items were discussed" and he continued to compare the NEPC's active vs. passive management recommendations made to the NHRS and the MECRS in detail.

Minutes of the Board of Trustees' Meeting -6-

A further discussion ensued concerning the long term performance of some of the System's managers including some that had been added to the portfolio in recent years for which there has been no regular reporting of performance versus the benchmark for periods prior to inclusion in the System's portfolio. During the discussion, Mr. Fleury reminded Mr. Leonard that he and the Trustees had requested performance data including performance versus the benchmarks for certain investments prior to the time the investments had been utilized by the System. During the discussion, Attorney Rich expressed caution in putting too much emphasis in evaluating a manager based on performance data for periods prior to the time at which the System decided to employ the manager. There could be any number of reasons why that manager's performance could be positive or negative over a long period of time that may or may not be relevant to performance while subsequent to the System's date of hire. Mr. Leonard replied that they had provided the trustees with results of the due diligence process in place at NEPC when the Board considered hiring managers. That included providing their clients with all reports and track records needed in deciding to employ an investment manager. Thus, the information that had been requested had been made available initially when the Trustees decided to hire the manager.

Trustee Hungler indicated that he recalled asking for performance numbers before and that in his opinion, NEPC does have a problem showing it because we don't have it. He indicated that last month was the same way, last month we had asked for it again and last month we were told that NEPC was going to do it.

Mr. Grzejka replied that they had brought the investment report for the composite data as of 12/31/2009 with them today, so the entire history including calendar years and everything else that had been asked for should be present.

Moving on with the presentation, Mr. Grzejka focused on the International Equity Composite consisting of, Gryphon, Causeway and City of London. He stated that those managers that have been part of the MECRS portfolio for a long time and have done very well. He noted that in the three year line, which includes 2008, Gryphon is once again in the positive. Causeway, while still negative for three year return, is ahead relative to the benchmark by nearly two full percentage points. Finally, City of London is doing phenomenally well, 7.9% vs. 5.2% on the benchmark for the three year return and up over 85% over the last year.

In regards to the Fixed Income Composite, Mr. Grzejka informed the trustees that Income Research & Management and Loomis Sayles have had a very good year-to-date returns with 2.2% and 4.3% respectively and with both reporting well ahead of their benchmarks. Mr. Grzejka noted that NEPC was unable to report on Seix Credit Dislocation Fund because its performance numbers were not available in time to be included in the report. As the results become available, Mr. Grzejka promised to provide a finalized "Flash" Report for the first quarter.

Mr. Grzejka concluded his report by reviewing the alternative composite citing that Archstone is up 2.5% for the year and Attalus up 1.2%. Lexington had another capital call in March in the amount of $29,367 while Boston Millennia had a distribution of around $25,000 for the same period.

Mr. Fleury added that the traditional scarcity of information on happenings at Lexington Capital have been mitigated by the use of periodic online investor seminars and investor meetings. He noted that he is being informed of these events in advance and is making an effort to participate. He promised to continue to monitoring information provided directly to investors and will also keep the board up to date on the portfolio as information becomes available.

Mr. Leonard addressed the board regarding the current Real Estate Asset Class that is part of the MECRS portfolio. He recommended that the MECRS Board bring in their two real estate mangers, Morgan Stanley and Prudential, to deliver a portfolio review and investors update. Mr. Leonard explained that the pure real estate portfolio is slightly under target, while the Timber portion of the portfolio is above target. He noted that portfolio diversification is limited and that the current real estate allocation is illiquid. He went onto report that Morgan Stanley currently has a queue for withdrawals by other investors of $639M as of 12-31-2009. Prudential currently has a similar queue of $1,105 M for the same period while RMK Timber has recently extended for another year as selling in current markets would have had a significant negative impact on the value of the portfolio.

After completing a review of characteristics about the existing real estate portfolio and working from a handout distributed to the trustees, Mr. Leonard recommended that the board begin to plan the next steps in the portfolio's management. Step one would be to evaluate the current portfolio by bringing in the managers as he suggested. That could be followed by looking at other investment options, probably fund of funds, and that NEPC would provide the System with a plan on how much to invest in Core and how much to invest in Value Added.

After briefly discussing the MECRS real estate allocation, the board agreed to invite Morgan Stanley and Prudential to May 11, 2010 board meeting for review.

Returning to a list of NEPC issues gathered from press releases, Trustee Hungler questioned a report on an NEPC Client, City of Brockton, which had $25 million to invest and split between five difference managers. Recalling that NEPC had counseled MECRS to consolidate managers as opposed to maintaining a stable of competing managers for the same asset class, he asked Mr. Leonard if the selection of five managers by Brocton had been a recommendation by NEPC.

Mr. Leonard replied, "No, it was not the recommendation of NEPC."

There being for further questions or presentation materials to be reviewed, Mr. Leonard and Mr. Grzejka thanked the board for their time and departed.

Mr. Fleury spoke on Committee Chairman Angell's behalf and reminded committee members that there were two items that were discussed at the Administration & Accounting Committee meeting held on March 29, 2010 that need to come before the full board. One being a housekeeping measure regarding Chapter 218:16 II which will simplify the language on the "in service" death benefit and the other regarding Administrative Rule, Part 6, which would introduce new language and disqualify vested deferred members from making additional contributions. Permission of the full board was necessary for work to progress on these two issues.

Moved by Trustee Hungler to continue working on revisions identified by Mr. Fleury, seconded by Trustee Molan and passed unanimously by all those trustees present.

Motion to Adjourn:

Having concluded all of the items of business for the day, Chairman Pinard entertained a motion to adjourn. Trustee Molan moved to adjourn at 10:28 a.m. seconded by Trustee Hungler and passed unanimously by all those trustees present.

Respectfully Submitted,

Gerard E. Fleury
Executive Director