March 9, 2010
Minutes #457

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, Chuck Hungler and Richard Molan and William Sanders
MECRS Staff: Gerard Fleury and Suzanne Wilson

Absent: Trustees: Mayor Ted Gatsas and Paul Porter

In Attendance: Attorney John Rich of the McLane Law Firm
Mr. Ken Alberts of 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 February 9, 2010 board meeting, seconded by Trustee Molan and passed unanimously by all those trustees present.

Approval of the Immediate Meeting Agenda:

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

New Business:

Review and Acceptance of 2009 Valuation – Mr. Ken Alberts was present to deliver the preliminary report of the 2009 MECRS Valuation and to answer questions from the trustees.

Mr. Alberts began his presentation by noting that, effective with the December 31, 2009 valuation, the actuarial methods and assumptions were prepared in accordance with factors identified in the 2004-2008 experience study which was adopted by the MECRS Board.

Mr. Alberts listed the new assumptions as, increased longevity rates, lower mortality rates, and a change in wage inflation from 4% to 3.5%. Also, a fixed COLA assumption of 1.75% was used, turnover rates were increased, and revisions were made to the rates of retirement, all of which in the aggregate resulted in an increase in the employer contribution requirements.

Mr. Alberts asked that while reviewing this year's results, the trustees should keep in mind that the assumptions in place started on the valuation date and going forward are for 2010. Looking back at the experience for last year and addressing the gains or losses, Mr. Alberts noted, that that gain or loss is being compared with the prior assumptions because those were predicated on the 12/31/2008 valuation.

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Moving on, Mr. Alberts stated that MECRS had a positive market value investment experience and a negative asset value investment experience. The fact that there was no COLA last year caused a 0% gain. Also, the System had less members retire than expected, more members quit than expected and pay increases that were less than expected. He further noted that there were fewer deaths than expected and that a continued recognition of the prior year's investment losses offset other demographic gains. Liability gains were more than offset by investment losses from 2008 investment activity, recognized this year. In total, the System actually had a liability gain.

Mr. Alberts explained that running the valuation costs tries to estimate what the total cost of the program is by reviewing all the active, retired and deferred members and employing the assumptions, to figure how long the members will receive benefits as a result of their longevity. Calculating those values results in a total present value of Future and Expected benefits for the fund and approximates $279,000.000. That number is broken down into two categories, benefits that have already accrued and benefits that will accrue in the future. He continued to detail the development of funding values for all components in the valuation such as the actuarial accrued liability, actuarial value of assets, and the unfunded actuarial accrued liability.

Next, Mr. Alberts referred to a chart in the presentation booklet and provided the trustees with a more in-depth actuarial explanation of one segment of the valuation process. He noted that the board controls what the funding method is, which in turn results in how the normal cost is determined. There is more than one funding method and the MECRS board adopted a method known as the level percent entry age normal cost method. He explained that the calculation done by using that method resulted in a future normal cost of $57 million. The future normal cost is then subtracted from the present value which equals the accrued liability or, $222 million. In addition to the funding method, Mr. Alberts also noted that the board has the ability to change the amortization period for the present value of the future working lifetime of the current population.

Trustee Hungler asked Mr. Alberts to what extent the board can control the present value of present and future benefits amounting to$279 million.

Mr. Alberts replied that to some extent, the board can control that amount through the decisions it makes on retiree COLA's and on assumption settings.

Trustee Sanders noted that today, if members compared the pension plan being 60% funded to back in 2001 when the Plan was 105% funded, a big portion of the difference between 105% and 60% is the actuarial assumption. Aside from assumptions, severance payments which are factored into retirement calculations were not included by the previous actuary and legislative amendments to the Plan over the years also served to lower the funded ratio by driving up the present value of future benefits.

Chairman Pinard asked Mr. Alberts to what extent the future normal cost and the accrued liability had changed since last year.

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Mr. Alberts replied that the normal cost was $41 million, accrued liability was $201 million, which is an increase 10% from the previous period. Mr. Alberts also noted to Trustee Sanders' point that the funded ratios had never really been in excess of the 100% mark using the present assumption. The less conservative practices of the time had inflated the ratio so that it now appears that a much greater decline has occurred than if more realistic assumptions had been utilized back in 2001.

The board continued to discuss, at length, factors which drive the present value of future benefits.

Next, Mr. Alberts explained how the employer contribution rate is computed and provided a comparison of the current amortization and a 30-year amortization. He explained that the Unfunded Actuarial Accrued Liability, (UAAL) for pensions is currently financed as a level percent of payroll over a period of 24 years. For each 1% ad-hoc COLA increase above the assumed COLA, UAAL will increase by approximately $895,000 and the employer contribution rate will increase by approximately 0.11% (based on current payroll and a 24-year amortization period). In developing these costs for the ad-hoc COLA increase, it was assumed that the increase would be a one-time permanent increase to all members retired as of 12/31/2009 and the additional liability would be amortized over 24 years. It was also assumed that the increase would be effective on 1/1/2010.

Mr. Alberts reminded the Board of his comfort a year earlier with the idea of changing the amortization period to 30 years, but that it would be in the best interest of the MECRS to hold off as long as they could. He stated that if the trustees felt that more economic losses were inevitable from another down turn that they might want to wait longer to restart the current amortization. Conversely, if they believe that we are entering a more stable economic time, this may be a good time to consider the 30-year amortization.

Trustee Sanders stated that he would be extremely supportive of adopting a 30-year amortization after going through the recent Experience Study and adjusting the assumptions. Re-setting the amortization of the UAAL is a reasonable alternative, resulting in an 18.50% contribution rate, rather than a 19.87%

Trustees Sanders also noted that adjusting the amortization period would lower the health contribution from 18.94% to 17.65%.

Reflecting back upon wage assumptions for the City for 2009 which had been too conservative, Trustee Sanders requested that the actuary provide a reconciliation of the true-up of the employer contribution still owed for 2009 which had been estimated to be $157,000 plus interest.

Mr. Alberts agreed to provide such schedule.

Trustee Sanders also agreed to provide a more accurate 2010 projected payroll for Mr. Alberts.

Attorney Rich asked Mr. Alberts what would be likely to result if the board changes to the 30-year amortization period and the Fund subsequently experiences a rate of return that is less than anticipated.

Mr. Alberts replied that once the amortization period is changed, if there is another loss, it would cause an increase in the employer contribution rate, which is why he made the earlier comment of waiting as long as the Board could to change the amortization period.

It was moved by Trustee Sanders to approve the preliminary valuation as proposed but including the resetting a 30-year amortization for the unfunded liability, seconded by Trustee Hungler and passed unanimously by all those trustees present.

Mr. Alberts asked the Board's indulgence so that he might explain a spreadsheet developed by GRS which trends up payroll, liabilities, adds the smoothing method along with the market value of assets, calculates the funding value of assets, and the projected funding status and contribution rate. The assumptions and salary scale are not changed. What is being measured, Mr. Alberts stated, is what the impact of actual investment experience could have in any given year, plugging in the different values. The working spreadsheet allows for future projections, is a great tool, and would provide the board with planning ability.

Mr. Alberts and the trustees discussed the fee for the proposed spreadsheet and agreed to further discuss the benefits of such a tool.

Attorney Rich asked Mr. Alberts how long the spreadsheet's results would continue to be valid.

Mr. Alberts explained that the spreadsheet is good for one year.

Attorney Rich expressed his opinion that the spreadsheet would be a valuable tool because it would allow stakeholders to know what the future holds at various investment return points.

Mr. Fleury requested that Mr. Alberts provide the System with a quote for the spreadsheet tool which the Trustees could then consider at a future meeting.

Mr. Alberts agreed to provide such a quote.

Report of the Executive Director:

Security Test - Mr. Fleury reported that a meeting with a vendor representative regarding computer security and intrusion testing was held on Feb. 19th in the MECRS office. City Risk Manager, Harry Ntapalis and City Auditor, Kevin Buckley were also in attendance. Mr. Ed Barry of DSQ, Inc. linked in Brad Hutson, a DSQ technical specialist by telephone and a variety of issues related to computer security testing were discussed. As a result of the meeting, MECRS authorized the security tests on March 2nd and results are expected in time for the Board's review at its April meeting.

Progress Report – Pension Administration System Upgrade - Mr. Fleury informed the board that new price quotes have been obtained from our existing pension administration software provider as they continue to express interest in providing us with a replacement version of our administrative software. While initial price estimates were based upon a system housed and operated by MECRS staff, more recent estimates cover the option of having the application housed by an outside service provider. These estimates are from the same company which has

experienced great difficulty correcting social security number suppression issues on annual member statements and their ability to actually deliver on either proposal is still in question. As a result, discussions with an alternate vendor were undertaken and details along with cost estimates are expected in time for a general review by the board's A&A Committee when it meets on March 29th.

Retirement Related Legislation for 2010 - Next, Mr. Fleury reminded the Board that although MECRS does not have any legislation introduced in the current legislative session, many retirement related bills with possible implications to MECRS have been introduced and are therefore being tracked. One such bill, (HB1530) attempted to redefine "earnable compensation" which impacts the employer's pension costs when sick and vacation time combined with special duty pay, inflate the benefit, and result in an actuarial loss which must then be made up. That bill was deemed "inexpedient to legislate", (ITL) and so similar approaches to MECRS would probably meet the same fate if they were ever contemplated.

Another bill, (HB1682) attempted to change the method for determining retirement system contribution rates for the State System. That bill was also deemed ITL, possibly because of the present constitutional provision which spells out how such a rate is to be determined.

External Storage System Failure - Moving on, Mr. Fleury explained that during the month of February, the main MECRS network storage drive suffered a complete failure. The information stored on the failed unit was recovered to an alternate temporary drive while we await a permanent replacement storage unit. No information was lost as a result of the equipment failure and total costs associated with recovery are within budget parameters.

In closing his report, Mr. Fleury announced that NEPC Client Conference is scheduled for May 12th and 13th. As more information comes into the office regarding the conference, Mr. Fleury stated that it will be forwarded to the trustees. He also stated that all trustees are urged to attend.

Also, Mr. Fleury mentioned that the Annual Opal Conference in Newport, RI has been scheduled for July 21 – 23rd. Mr. Fleury requested the boards' permission to attend both the NEPC Conference as well as the Opal Conference.

The board unanimously granted Mr. Fleury's permission to attend the two conferences.

Trustee Hungler asked the status of the Wellington Management contract for Real Assets as well as the status of Newstone Private Equity contract.

Mr. Fleury replied that it was discovered that Wellington was engaged in securities lending with State Street with their Real Asset product and that given the substantial turmoil in securities lending following the subprime issues of 2008 and ensuing liquidity and volatility problems which had affected securities lending in the time that followed, that MECRS was working with counsel to access the level of magnitude of risk that might be associated with any ongoing securities lending activities. He noted that this is the first time that a MECRS manager has disclosed the use of securities lending to add incremental return to the portfolio and so caution was being exercised. A conference call has been scheduled with NEPC, the system's investment consultant, to address questions regarding the risk level associated with securities lending. Once those concerns have been addressed, the plan is to proceed with the funding which is tentatively scheduled for an April, 1, 2010, in the amount of $6 million.

Regarding the Newstone contract, Mr. Fleury reported that there are a number of issues that need to be addressed which are associated with the limited partnership structure of the investment. A meeting at the McLane Law Firm is scheduled for Wednesday, March 10, 2010 at 2:30, to address those issues. The target to sign agreements and participate in the fund is also tentative set for April 1, 2010.

Administrative & Accounting Committee:

Committee Chairman, Angell noted that a meeting of the A & A Committee is schedule for the March 29, 2010 at 8:30 a.m.

Consent Agenda:

Prior to voting on the Consent Agenda, Chairman Pinard asked the trustees if anyone wished to remove any item for discussion. Trustee Molan requested the removal of Consent Item #C1. It It was moved by Trustee Molan to approve the remaining Consent Agenda, seconded by Trustee Sanders and passed unanimously by all those trustees present.

Regarding Consent Item #1, Retirement Office Expenses, Trustee Molan referred to a Local Government Center expense in the amount of $2,992.51. He asked if that number was associated with a health insurance premium expense for MECRS staff. Mr. Fleury responded that that is correct.

Trustee Molan then asked what vendor provides the workers compensation insurance for the members.

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Mr. Fleury replied that Local Government Center also provides MECRS with workers compensation coverage.

Trustee Molan then moved to accept Consent Item #1, seconded by Trustee Sanders 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 at11:05 a.m. seconded by Trustee Hungler and passed unanimously by all those trustees present.

Respectfully Submitted,

Gerard E. Fleury
Executive Director