November 18, 2010
Minutes #465

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, Bill Sanders, Richard Molan, Chuck Hungler and Jenny Angell
MECRS Staff: Gerard Fleury, Sandi Aboshar and Suzanne Wilson

Absent: Trustees: Mayor Ted Gatsas and Paul Porter

In Attendance: Attorney John Rich of the McLane Law Firm and Kevin Leonard 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 October 12, 2010 board meeting, seconded by Trustee Angell and passed unanimously by all those trustees present.

Approval of the Sealed, Non-Public Session held September 16, 2010:

A motion was made by Trustee Molan to approve the sealed, non-public session meeting minutes, held September 16, 2010, seconded by Trustee Hungler 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 Sanders and passed unanimously by all those trustees present.

The trustees then handed in their copies of the approved sealed minutes of the non-public session of September 16, 2010 for proper disposal.

Report of the Executive Director:

Death Audit of Retiree Named Beneficiaries – Mr. Fleury reported that in late October, MECRS conducted its annual audit of named beneficiaries for retirees who chose a survivor option at retirement time. The audit discovered 2 retirees whose named beneficiary had passed away but had not been reported. This knowledge, Mr. Fleury continued, allowed the retirement staff to implement the retiree's "pop-up" option which becomes effective with the passing of the beneficiary and restricts retroactive pension adjustments to the current year.

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MECRS Receives PPCC Award for Seventh Consecutive Year - Mr. Fleury was pleased to report that for the last seven years the MECRS has applied for and received the Public Pension Coordinating Council's "Public Pension Standards Award". He explained that the PPCC is a confederation of the National Association of State Retirement Administrators, the National Conference on Public Employee Retirement Systems, and the National Council on Teacher Retirement. Last year the PPCC raised the requirement for qualification and spit the award into two categories, one for meeting funding standards and the other for meeting administrative standards. Applicants were allowed to apply for either or both awards. For 2010, the MECRS applied for and received the award for both categories for a second time.

Mr. Fleury noted that the award is given in recognition of meeting professional standards for plan design and administration as set forth in the Public Pension established by the confederation. To receive the award, plans must meet specific criterion related to funding, financial reporting, member benefits, and actuarial and audit practices. He noted that those practices would not be possible without the board's support and he commended the board for supporting the staff in their pursuit of these objectives.

Investor Conference Calls for Gottex and PRISA - Mr. Fleury also reported that he had participated in investor conference calls for both Gottex and PRISA which had been held on Monday, November 1st. Gottex reported a positive year to date but unfortunately that fund remains below the original investment value because of unfortunate timing in the entry to that asset class. PRISA, on the other hand, has already achieved the earnings assumption for 2010 and expects to achieve between 12 and 13 percent by year end. Requests for redemption in PRISA are down and leverage in the portfolio has also been reduced below the target originally established for 2010. Mr. Fleury indicated that presentation materials associated with both investor conference calls are on file and are available to interested trustees.

Court Subpoena Regarding Qualified Domestic Relations Order. (QDRO) - In concluding his report, Mr. Fleury gave an accounting on a series of events beginning in August of 2008, when MECRS had received a request from an attorney seeking a QDRO against an active member. Mr. Fleury replied on behalf of MECRS on August 15, 2008, by providing the monetary value of the member's account but citing the protective statute disallowing QDROs and refusing to honor the request. Then, in July of 2010, Hooksett Family Court took steps to implead MECRS in the continuing disagreement between the client in question and the former spouse. The matter was then referred to MECRS counsel who interceded by letter dated August 4, 2010 and the court issued a decision on August 17th calling for a hearing. Mr. Fleury informed the board that a subpoena was issued on October 14th for him to appear in court on behalf of MECRS and that a hearing was conducted on November 1st. Because one of the parties failed to appear, the case was continued to January 24th, 2011 at which time Mr. Fleury expects that he may be subpoenaed once again.

Previous Business:

Executive Recommendation on Replacement Pension Administrative System – At the suggestion of MECRS legal counsel, Mr. Fleury cited RSA91-A:3 II (d) to proceed into non-public session at 8:40 a.m. in order to discuss a contract matter.

Roll Call Vote:

Ayes: Messrs. Pinard, Angell, Molan, Hungler and Sanders

Nays: None.

Motion carried unanimously.

Chairman Pinard called for a roll call vote to come out of non-public session at 8:50 a.m.

Roll Call Vote:

Ayes: Messrs. Pinard, Angell, Molan, Hungler and Sanders

Nays: None.

Motion carried unanimously.

It was then moved by Trustee Molan that the MECRS send out a letter of intent to negotiate a contract with the Pension Technology Group, subject to review by MECRS legal counsel and availability of necessary funding for the contract, seconded by Trustee Angell and passed unanimously by all those trustees present.

Chairman Pinard entertained a motion to seal the minutes of non-public session pursuant to RSA-91A:3 III

Trustee Molan moved to seal the minutes of non-public session, seconded by Trustee Sanders and passed unanimously by all those trustees present.

Consent Agenda:

Trustee Sanders moved to accept the Consent Agenda, seconded by Trustee Molan and passed unanimously by all those trustees present.

New Business:

RMK Request for an Extension of the EFG Timber Portfolio – Mr. Kevin Leonard of New England Pension Consultants was in attendance to counsel the board on RMK Timberland Group's request for an extension of the Evergreen timber partnership for another year.

Mr. Leonard began by commenting that Mr. Fleury has researched this issue in depth on behalf of MECRS and the other investors in the Fund. He noted that Mr. Fleury had corresponded by email and telephone conference call with NEPC, as well as with the System's legal counsel, RMK and the other two investors, Wells Fargo and the University of Alabama Pension Fund. Mr. Leonard noted that NEPC is in agreement with Mr. Fleury's assessment of the situation which he subsequently delivered.

Mr. Fleury chronicled events with RMK's contract which was extended a year ago, for one year. The original terms of the ten year investment called for it to be liquidated at the end of the term, however, he expressed concern that the timeframe for liquidation called for in the original agreement is not realistic and might result in deeply discounted forced sales which were not in an investor's best interest.

Attorney Rich clarified Mr. Fleury's reference to the timeframe for liquidation in the existing contract. The language in the agreement requires that liquidation which must be complete within 180 days, however if current market conditions dictate, then RMK has up to one year to complete the liquidation process.

Mr. Fleury resumed by reporting that a review of reports prepared by independent appraisers, hired by RMK, cited the value of the properties with a caveat that a period of liquidation in access of a year could be necessary in order to achieve the estimated market values contained in the appraisals.

Mr. Fleury continued by stating his concern that paying RMK 1% of market value to manage the properties based on possibly inflated market values was undesirable. He also noted that the concept of paying fees on market value rather than on invested capital was a concern to one other investor who had expressed interest in seeing concessions on the management fees as a condition in any extension.

Expressing concern over the system's investment return, Mr. Fleury raised the possibility that if the System were forced to witness a liquidation by RMK within a year's time, that it might be at fire sale prices, and he reminded the board that that sentiment had been the rationale for the first extension a year ago. Acting on authority given him by the board, Mr. Fleury reported that he had issued a counter proposal on MECRS' behalf, requesting fee concessions, a formal exit strategy from RMK, and a variable term for the balance of the portfolio's duration to insulate investors from the fire sale scenario. RMK had declined.

Mr. Fleury informed the board that on November 9, 2010, the System received a letter from RMK stating that they would make their best effort to liquidate the properties although they wanted a bonus if the properties sold for more than the appraised value and if the liquidation of the properties could not be concluded within one year, RMK would accept a reduced management fee for the remainder of the management period.

Mr. Leonard and the trustees continued to discuss the strategy for liquidation of the Timberland properties at length.

Mr. Fleury reminded the board that if no action is taken to come up with an alternate agreement before the current extension expires on December 17th; RMK will continue to collect potentially inflated fees and will be obligated to begin liquidation. Mr. Fleury recommended that the board grant the chairman authorization to sign an alternate extension with more favorable terms if one can be negotiated and to allow the executive director to work with the System's advisors and counsel toward a compromise agreement. If this cannot be completed in time, the recommendation is that the trustees allow Mr. Fleury to monitor the sale of the property and to do everything possible to ensure that RMK is marketing the properties in such as was as to ensure the best price and to avoid a fire-sale situation.

Attorney Rich expressed his opinion that it is in all the investors' best interest to get some sort of an extension tied to a program of marketing the property. Also, he felt that Mr. Fleury should be allowed to seek an extension on favorable terms with respect to liquidation and with some fee concessions.

It was moved by Trustee Molan to move in the direction suggested by legal counsel and the executive director to negotiate as best they can with RMK and to request a detail of RMK's liquidation procedures in the past, seconded by Trustee Hungler and passed by all those trustees present. Motion carried unanimously.

New Business:

Investment Performance Analysis - Mr. Leonard was called upon to deliver the MECRS Investment Performance Analysis, year-to-date.

He began his presentation however, by referring to a letter from Mr. Richard Charlton, CEO of NEPC, to Mr. Fleury which had been included as an informational item in the board's meeting packet. The letter addressed the marking of NEPC's 25th anniversary as an important milestone and it spoke of NEPC having become one of the country's leading independent investment consulting firms.

Mr. Leonard noted that the letter was also an announcement of Mr. Charlton's decision to step down from the active management of NEPC, effective March 31, 2011. He provided the trustees with a chronology of Mr. Charlton's achievements throughout his career, and explained how a succession plan was in place to ensure continued quality service following Mr. Charlton's retirement.

Returning to the matter of investment performance, Mr. Leonard began with the Total Plan Asset Allocation as of September 30, 2010. He explained three charts showing the System's target allocation, where the actual allocation was as of September 30, 2010 in a second chart and the break out the global asset allocation mandate in the third. He reported that the actual allocation at the end of September 30th was in line with the target allocation at the macro level. Therefore the portfolio should not require rebalancing at the end of December.

Mr. Leonard then addressed the universe rankings which take the System's portfolio composite return and compares it to a universe of other public funds. For the third quarter of 2010 the MECRS total composite was up 9.8% with a ranking in the 14th percentile, and the policy index and the allocation index were both up 8.3%.

Mr. Leonard also reported that Mellon, MECRS' Global Tactical Allocation Manager was up 12.6% for the quarter, outperforming their benchmark return of 9.1% and ranking them in the 20th percentile. Year to date the Fund is up 9.7%, significantly outperforming its policy index, ranking in the 57th percentile, exceeding the trailing one year and two year returns, and substantially outperforming its benchmark.

Mr. Leonard summarized the two portable alpha managers, Benchmark Plus and Gottex with Benchmark up 11.9%, ranking in the 18th percentile of the large cap core universe and Gottex up 12.5%, ranking in the 13th percentile.

Regarding U.S Equity Large Cap Value manager Pzena, Mr. Leonard reported that they were up 11.6% for quarter, ranking in the 22nd percentile, and year-to-date up 6.7% ranking in the 11th percentile.

Moving on to page 29 of the analysis booklet, Mr. Leonard reported strong results for Large Cap Growth Manager, Sands Capital, up 17% for the quarter, outperforming the Russell 1000 Growth benchmark by 400 basis points, ranking in the 10th percentile year-to-date.

Mr. Leonard also noted that SMID Core Manger, Rothschild, had a very strong quarter, up 13.8% versus the Russell 2500 benchmark of 12.2%, ranking in the 19th percentile, and year-to-date, outperforming their benchmark by 300 basis points.

International Manager Gryphon slightly underperformed the EAFE by 30 basis points but Causeway was up 17.6% versus 16.5% for the MSCI EAFE and ranked in the 19th percentile. Mr. Leonard noted that the international portfolio is doing well with these managers complimenting each other, Gryphon being more growth oriented and Causeway being more value oriented.

Regarding the emerging market manager, City of London, Mr. Leonard reported that emerging market equities continue to perform very well and that NEPC remains bullish on emerging market equities.

Mr. Leonard turned his attention to fixed income and informed the board that Income Research & Management, its core bond manager, is up 8.6% year-to-date versus 7.9% for the BC Aggregate and ranking in the 47th percentile. Loomis Sayles also beat their benchmark returning 7.3% for the quarter and 11.1% year to date.

Seix, which is MECRS' credit opportunities fund, has rewarded the portfolio with a 6.9% return for the quarter and 12.4% year to date.

Turning to Hedge Fund of Funds on a year-to-date basis, Archstone was up 2.9%, while Attalus remained flat. On the real estate side, Morgan Stanley was up 9.9% year-to-date, ranking it in the 30th percentile, while Prudential was up 11%, ranking it in the 25th percentile. Mr. Leonard stated that, in total, year-to-date performance for the System's portfolio is strong and that the managers are all doing well.

Mr. Leonard then directed the trustee's attention to the Mellon Overview segment of the Investment Performance Analysis booklet, Mr. Leonard explained that Mellon has come out with a new product know as the Expanded Global Alpha Fund. MECRS' present investment in the Mellon Global Tactical Asset Allocation Fund is meant to be an overlay to the balance of the MECRS portfolio, and its role is to lend flexibility to the portfolio. Mellon's Expanded Global Alpha Fund described in the handout expands the opportunity set by allowing emerging market equities and commodities to be introduced into the mix. He noted that beta exposure inherent in this Mellon product could better replicate the present MECRS portfolio. The Expanded Global Alpha Fund, through its additional diversification, could result in better risk-adjusted returns over time with no increase to the existing management fees. He did note however, that there would be a onetime charge of 20 basis points to migrate from GTAA to EGAF which is a rate that NEPC believes is reasonable.

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Mr. Leonard expressed NEPC's belief that this new product would be well suited for MECRS portfolio and recommended that the board consider this migration to the new product.

After brief discussion and questions posed by the trustees Mr. Fleury suggested that a logical step would be to invite Mellon Capital representatives to address the board on their new product. Trustee Angell suggested that the presentation wait until at least the January meeting at which time the composition of the board should be known, before making the decision to alter the portfolio.

The trustees and Mr. Leonard agreed to schedule that presentation with Mellon Capital and to plan on a January presentation..

Mr. Leonard thanked the board for their time and departed.

Summary Recommendation on the Application for Disability Retirement – Lucy Correa - It was moved by Trustee Hungler to approve the application for disability retirement for Lucy Correa, seconded by Trustee Angell and passed unanimously by all those trustees present.

Request for a Motion – Chairman Pinard cited a request by Executive Director Fleury to transfer previously appropriated funds between lines in the budget in order to end the year with all budget categories in the black, and he signaled his willingness to entertain a motion to that effect.

Trustee Hungler moved to transfer the funds as listed on the written request, seconded by Trustee Angell and passed unanimously by all those trustees present.

Trustee Sanders noted that all City Department Heads are currently preparing budgets at 92 % of their current budgets and felt that he would also like to see a lower budget appropriation request from the Retirement System.

Mr. Fleury replied that compliance with that request based upon approved budget levels would be unfair because the city is able to sell bonds to fund capital expenditure projects while the retirement system must include cash flow requirements for capital expenditures such as the replacement pension software in its operating budget. Trustee Sanders conceded the point but Mr. Fleury indicated that he understood the objective and could prepare a version of the budget which includes only one year's worth of amortization for capital expenditures.

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Motion to Adjourn:

Having completed all of the items of business for the day, Chairman Pinard entertained a motion

to adjourn. Trustee Sanders moved to adjourn at 10:31 a.m. seconded by Trustee Hungler and passed unanimously by all those trustees present.

Respectfully Submitted,

Gerard E. Fleury
Executive Director