January 11, 2011
Minutes #467

Minutes of the Board of Trustees' Meeting -1-

Call to Order: Chairman, Donald Pinard called the meeting to order at 8:36 a.m.

Present: Trustees: Chairman, Donald Pinard, Richard Molan, Dianne Mercier, Michael Woitkowski, Bill Sanders and Paul Porter arrived at 10.00 a.m.
MECRS Staff: Gerard Fleury, Sandi Aboshar and Suzanne Wilson

Absent: Trustees: Mayor Ted Gatsas

In Attendance: Attorney John Rich of the McLane Law Firm
Sebastian Grzejka of New England Pension Consultants
Joseph Miletich, Managing Director and Timothy Conry, Vice President both of Mellon Capital Management
Also, Retirees, Tom Nichols, Joan Porter, Jay Taylor, Ken Pitman and Carolyn Michaud

New Business:

Board Organization – Chairman Pinard began the meeting by opening nominations for the MECRS Board Chairman pursuant to Article II, 2.01 of the MECRS By-Laws.

Trustee Molan nominated Donald Pinard to continue serving as Board Chairman, seconded by Trustee Woitkowski. Chairman Pinard asked if there were any other nominations. As there were no other nominations, Trustee Sanders moved to close nominations for Board Chairman. Pursuant to Roberts Rule of Order the Chairman cast a single vote for himself, to continue serving as MECRS, Chairman, for a two year term.

The next item of board organization, pursuant to Article 5.01 of the MECRS By-Laws, was the appointment of committee chairs for the three sub-committees, Investment, Administration & Accounting, and Benefits.

Mr. Fleury noted that in anticipation of his absence, Trustee Porter had verbally informed him that he was not unopposed to the re-appointment as Chairman of the Benefits Committee and that he would accept that nomination.

Chairman Pinard then re-appointed Paul Porter as Chairman of the Benefits Committee.

Moving on, Chairman Pinard nominated Trustee Molan to be Chairman of the Investment Committee and Trustee Molan indicated his acceptance of the appointment.

Chairman Pinard asked newly elected, Trustee Woitkowski and newly appointed, Trustee Mercier if either one would be interested in chairing the Administrative & Accounting Committee. Trustee Woitkowski expressed his desire to chair the committee and Chairman Pinard congratulated him on his new seat.

For the benefit of the new trustees, Mr. Fleury explained that Trustee Sanders, as the City Finance Director, is automatically on the Administrative & Accounting Committee, and that he is also presently on the Investment Committee. Vacant seats still remained on the Investment Committee, the A & A Committee, and the Benefits Committee.

Chairman Pinard asked Trustee Mercier if she would agree to fill the vacancy on the Investment Committee, she agreed to do so and was so appointed. Chairman Pinard then appointed Trustee Porter to the A & A Committee and Trustee Woitkowski to the Benefits Committee, thus filling all vacancies.

Chairperson Comments:

Chairman Pinard welcomed the new members, Trustees Mercier and Woitkowski, to the MECRS Board.

Citizens Comments:

Chairman Pinard asked if there were any citizens present who wish to address the board.

Retiree, Joan Porter asked to speak to follow up on her previous comments made at the October board meeting regarding the trustees annual decision on whether or not to grant retiree COLA's. She began by welcoming the two new trustees to the MECRS Board. She then reiterated her objective to make the trustees aware of factors which the retirees face during retirement such as rising cost of health insurance as well as the fact that they did not receive an increase in social security payments.

Mrs. Porter also reminded the trustees of the fact that last year city employees were afforded a 3% increase in January, an additional 1.5% increase in July, are expecting to receive a 2.5% increase in July of 2011, and in the following year as well. Retirees on the other hand are expecting no increase yet they are affected by increases in the cost of living.

Mrs. Porter went on the state that she understood that if the board had granted a retiree COLA last year, it would have cost $84,000 which she believed would have equated to less than one penny on the tax rate.

In closing her comments, Mrs. Porter asked each of the trustees to bear in mind all of her points before making the final decision on whether or not to grant the retirees a COLA and she thanked the board for their time and the opportunity to speak.

Next Retiree Ken Pitman commented that he was present to support Mrs. Porter's comments.

Also, Retiree Tom Nichols introduced himself and commented that he too was present to support Ms. Porter's comments.

Retiree Jay Taylor commented that Mrs. Porter had expressed the concerns of all the citizens present and praised Mrs. Porter for a job well done.

Before the citizen group departed, Retiree Carolyn Michaud added that she also supports Mrs. Porters comments, regarding the factors that the trustees should consider in the upcoming COLA decision.

The trustees continued to discuss the COLA issue at length with Chairman Pinard reminding the board that MECRS has adopted guidelines which have to be followed and criteria which have to be met before granting a COLA.

When CPI calls for a COLA but the trustees determine that there are not sufficient Retirement System earnings to pay for it as described in Section 7.3 of the Administrative Rules, Chairman Pinard questioned who brings COLA request forward to the Board of Mayor & Aldermen seeking that they fund the measure?

Mr. Fleury replied that it was his belief that the trustees could provide documentation of such circumstances along with actuarially determined cost estimates and seek the approval of the BMA for a special appropriation in the ensuing City budget so that the retirees may receive a COLA.

For the benefit of the new board members, Mr. Fleury cited Chapter Law 218;20 which determines the board's obligation to look at COLA as well as Administrative Rule 7, which dictates how to calculate the amount of inflation for COLA purposes, as well as the earnings requirements for the board to grant a COLA from pension reserves.

Trustee Sanders pointed out that he understands all of the factors facing the retiree population however, he noted that the Plan closed last year 60% funded and to think that the System has excess funds sufficient to pay for COLA's is simply an illusion, it does not exist. Any approval of COLAs will increase the city's pension contribution rate and hence the tax rate. This reality will create a difficult situation for the board when the time comes for it to make its next COLA decision.

Approval of the Minutes of the Previous Board Meeting December 14, 2010:

A motion was made by Trustee Molan to approve the board minutes of December 14, 2010 seconded by Trustee Sanders and passed unanimously by all those trustees present.

Approval of the Immediate Meeting Agenda:

A motion was made by Trustee Molan to approve the immediate meeting agenda, seconded by Trustee Sanders, with Trustee Mercier abstaining, Motion carried.

Report of the Executive Director:

Status of Negotiations with RMK - Mr. Fleury reported that the System has been in contact with RMK regarding a formal response to his letter sent December 9, 2010. He indicated that a response regarding the EGF Evergreen Fund will be forthcoming and that he was given limited details on events in progress. He refrained from explaining them in public session as the minutes of MECRS Board meeting are widely read and such details could complicate negotiations.

Insurance Coverage Meeting – Mr. Fleury informed the trustees that a meeting was held on Wednesday, January 5th with Mr. Grady Crews of the Ferdinando Agency to review insurance coverage for MECRS. Worthy of notice is the fact that the carrier for Security & Privacy Coverage proposed to raise the renewal premium considerably. In response, MECRS pointed out that it had undertaken a security audit in 2010 and received high marks with one notable exception which was subsequently corrected. In bringing that to the insurance carrier's attention, the carrier reconsidered the proposed rate increase and rescinded most of it. Mr. Fleury noted that the actual increase in premium was $493 which was more than offset by a subsequent reduction of $1,196 in Fiduciary Liability Coverage leaving MECRS $703 under budget.

Trustee Sanders inquired as to the status of the Directors'& Officers Insurance concerns that had been raised the previous year.

Mr. Fleury replied that the issues were regarding coverage by AIG and concerns over their ability to pay claims. He went on to say that the System had been assured at that time that the State Insurance Dept. had demanded and received reserves adequate to cover liabilities and that the condition of AIG has since improved.

Trustee Mercier asked Mr. Fleury for copies of the D & O Insurance as well as the Fiduciary Coverage.

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Mr. Fleury replied that they would be forthcoming.

Progress on Audit of 2010 - Moving on, Mr. Fleury informed the trustees that a meeting was conducted on January 5th with Mark LaPrade and Tyler Butler of Berry, Dunn, McNeil & Parker regarding the audit schedule and to introduce Mr. Tyler who will be the primary on-site auditor this year. Mr. Fleury noted that he expects the audit to be uneventful.

Status of Legislation for 2011 – In closing his report, Mr. Fleury informed the trustees that progress continues on the MECRS legislative amendments for 2011. Advanced drafts of the LSR (Legislative Service Request) 11-0415.1 which will go public shortly have been reviewed and everything appears to be in order. Communications with the Legislative Budget Assistant's office continues on a regular basis and the MECRS board will be notified as soon as the LSR 11-415.1 is issued a senate bill number and released.

New Business:

December 31, 2010 Market Update – Mr. Sebastian Grzejka of NEPC, the Retirement System's Investment Consultant, was present to assist in explaining NEPC's recommendation to the MECRS Board on conversion opportunities to a new Mellon Product as well as to provide a market update as of December 31, 2010.

Mr. Grzejka distributed a preliminary "Flash Report" for period ending 11/30/2010 as well as a December 31, 2010 Market Update. He began with the Flash Report and for the benefit of the new trustees present, he explained the policy index, the allocation index as well as the composite, and noted how they measure and compare the return for the portfolio and the underlying assets.

Based on NEPC's strategy at the beginning of 2010, the policy index reveals that through year-to-date, November 2010, the optimal portfolio had a return of 7.5%. Because of active management of the portfolio, and some under and over weights to the various asset classes, value has been added with benchmarks returning 9.8% for the period.

Mr. Grzejka began a review of individual manager performance starting with Mellon Global Alpha I which is a Global Asset Allocation Manager. He noted that Mellon has the ability to move between stocks and bonds internationally and domestically and shift that allocation opportunistically. Mellon returned 9.5% for the period, exceeding to 4.4% benchmark.

Mr. Grzejka reported that the System's two portable alpha managers, Benchmark and Gottex, have done very well for the System's portfolio, up 12.7% and 9.5% respectively through November.

Large cap growth and value managers Pzena and Sands Captial, also did well with Pzena returning 9.6% and Sands returning nearly 24%.

He also noted, SMID Cap Manager, Rothschild Management's positive return of 20.2% for the same period.

Next, Mr. Grzejka reported on the International equity allocation which consists of three managers, Gryphon and Causeway, a growth and a value manager, and City of London as the emerging markets equity manager. All three had positive returns year to date and exceeded their benchmarks.

Moving on, Mr. Grzejka, provided a breakdown of the fixed income composite, alternatives composite and the real estate/real assets composite. Fixed income managers have all posted good year to date returns in excess of their benchmarks. The returns for Income Research, Loomis Sayles and Seix Credit Dislocation fund respectively were 8.2%, 11.5% and 13.5%. He explained that within the private equity portfolio, returns for Lexington and Newstone Partners were not yet available and that Newstone's first capital call being had just recently transpired in December. He indicated that the next "Flash Report" will be inclusive of returns for private equity investments.

Trustee Mercier inquired as to the funded amount in Newstone Investment.

Mr. Fleury responded that Newstone was funded in the amount of $196, 309 on December 10, 2010 and that commitments and funded amounts for both of MECRS' most recent private equity investments, Lexington and Newstone, are tracked on the Cash Flow Chart which is included in the trustee's agenda packets each month.

Mr. Fleury asked Mr. Grzejka about the status of Attalus Capital since that manager had been interviewed by the board earlier in the year and some questions had arisen regarding their structure and the levels of key person risk. Mr. Grzejka replied that as the year progresses the trustees may want to review their allocation with Attalus and that although NEPC continues to monitor the concerns, MECRS might wish to initiate a search of multi-strategy managers for comparative purposes.

Trustee Mercier noted that some pension funds are moving to an "Asset Liability Matching" strategy and she asked if the MECRS has considered or explored this option.

It was noted that the subject has been discussed but that a move to more conservative investment returns can result in large increases in the employer's funding obligation. Mr. Grzejka stated that

NEPC is available to work with the System's actuary to review the liabilities and assets, and followed up with a recommendation for future strategies.

Trustee Sanders felt that the ability to achieve MECRS's assumed rate of return of 7.5% consistently in the coming years will be challenging. If the earning rate declines over a long term, the cost associated with discounted liabilities will increase causing the funded status of the Plan to deteriorate and increase pension costs to the City. Should this scenario manifest itself, the a more detailed conversation on migration to "Asset Liability Matching" may become imperative.

Attorney Rich asked Mr. Grzejka what the investment return assumption might be if the board decides to go into a liability driven strategy.

Mr. Grzejka replied that the return assumption would be much lower because of the greater role likely played by fixed income securities which potentially translates to 4% or 5%.

Mr. Grzejka continued his report by addressing the Investment Market Update through December 31, 2010. Focusing on the last column of the handout, he noted that all MECRS' portfolio sectors were positive with smaller cap stocks, REITS, emerging markets, commodities and large cap stocks leading the way. The international developed market had lower returns however, owing to two time periods during the year, May and November, when investors pulled out of those markets.

Having completed the performance review, Mr. Grzejka turned to his final handout regarding NEPC's recommendation that MECRS swap its current Mellon Global Alpha investment for units in Mellon's new Expanded Global Alpha Fund. He explained that Mellon's representatives has been scheduled to appear before the board but were held up in traffic so he was proceeding with a report on the subject..

He explained that the current Mellon Product is based on developed markets. The Expanded Global Alpha adds emerging markets equities to the portfolio which expands the opportunity set, adds diversification of alpha and beta exposure and also gives the manager more latitude in terms of opportunities and investments.

Before Mr. Grzejka could continue, Mr. Joseph Miletich, Managing Director of Global Investment Strategies and Timothy Conry, Vice President and Relationship Manager, both from Mellon Capital Management arrived and distributed their presentation booklets to the trustee's.

After brief introductions, Mr. Conry conducted a review of the current Mellon Product noting that the current market value of $22,049.436 is composed of 60% global stocks and 40% global bonds. The big difference between the existing portfolio and the expanded product they are

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suggesting to the board consists of beta components, not alpha. Year-to-date performance of the expanded fund is 16.09% compared to the benchmark of 8.7%

Mr. Conry turned the presentation over to his colleague, Mr. Joe Miletich. Mr. Miletich opened by thanked the trustees for their continuing support through the tough market times with Mellon Capital. He reiterated Mr. Grzejka recommendation and explanation of the expanded Mellon Global Alpha Fund I. Directing the trustees attention to page 33 of the presentation booklet, Mr. Miletich explained that the new fund's benchmark seeks to exhibit a similar risk profile as the existing benchmark while providing a more diversified opportunity set.

Utilizing pie charts to describe the expanded benchmark Mr. Miletich stated that current benchmark on government bonds would be reduced from 40% to 25%, exposure, adding 10% to the global inflation-linked bonds, (TIPS or linkers) and adding the US Intermediate Credit Index of 5%.

Moving on to the Global Equities the big change would be changing global equities from 60% to 55% and allocating 5% of the reduced equity allocation to the Russell 2000. In addition, a 5% allocation to commodities is being introduced which maintains the same level of risk while adding diversification and theoretically generating higher returns.

Mr. Miletich went on to explain that expanded alpha opportunities will include, but not be limited to commodities, emerging market equity and emerging market currencies.

Upon completion of his description of the recommended new product, Mr. Miletich provided the trustee's with a sample of the model portfolio with the Expanded Opportunity Set.

Trustee Sanders informed the trustee's that owing to a schedule conflict, he was compelled to leave the board meeting to attend another scheduled meeting. He apologized and departed at 10:10 a.m.

Mr. Grzejka asked Mr. Miletich weightings in the expanded product are expected to fluctuate over time. Mr. Miletich replied that the no fluctuate was anticipated at present.

Mr. Fleury asked the Mellon representative if they would provide copies of the contract agreement for the new product. Mr. Miletich agreed to do so.

The presentation materials having been covered and there being no further questions, the Mellon representative's thanked the board for their confidence and business and expressed their desire to hear back from the board with their decision.

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After further discussion between the trustees and their investment consultant, the board agreed to research the new product further and Mr. Fleury noted that the contract would be reviewed by legal counsel before making a decision as is standard practice.

Consent Agenda:

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

Chairman Pinard recessed the meeting at 10:23 a.m. to enter into attorney/client session.

Chairman Pinard reconvened the meeting at 10:44 a.m.

Motion to Adjourn:

Having completed all of the items of business for the day, Chairman Pinard entertained a motion to adjourn. Trustee Molan moved to adjourn at 10:45 a.m. seconded by Trustee Woitkowski and passed unanimously by all those trustees present.

Respectfully Submitted,

Gerard E. Fleury
Executive Director