March 18, 2011
Minutes #468

Minutes of the Board of Trustees' Meeting -1-

Call to Order: Chairman, Donald Pinard called the meeting to order at 10:17a.m.

Present: Trustees: Chairman, Donald Pinard, Richard Molan, Michael Woitkowski, and Dianne Mercier
MECRS Staff: Gerard Fleury, Sandi Aboshar and Suzanne Wilson

Absent: Trustees: Mayor Ted Gatsas, Paul Porter and Bill Sanders

In Attendance: Attorney John Rich of the McLane Law Firm
Sebastian Grzejka, Consultant and Doug Moseley, Partner, both of New England Pension Consultants
Ken Alberts, Consulting Actuary, Gabriel, Roeder, Smith & Co.

Approval of the Minutes of the Previous Board Meeting January 11, 2011:

A motion was made by Trustee Molan to approve the board minutes of January 11, 2011 seconded by Trustee Mercier 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 Mercier. Motion carried.

New Business:

Review and Acceptance of 2010 Actuarial Valuation –

Mr. Ken Alberts of Gabriel, Roeder, Smith & Co. was present to deliver the preliminary report of the 2010 valuation and to answer questions from the trustees.

Mr. Alberts introduced himself to new board members and began his presentation by directing the trustees' attention to page A-4 of the draft valuation results which had been included in the trustees' agenda packets. He noted that the MECRS rate of return on a market value basis of 13.1%, for 2010 had exceeded the earning assumption of 7.5% and he recapped the rates of return for 2009 and 2008 of 8.4% and -29.2%, respectively. He went on to explain that the funding value of assets did not recognize assumed investment income fully each year. Differences between actual and assumed investment income are phased in over a closed 5-year period. During periods when investment performance exceeds the assumed rate, funding value of assets will tend to be less than market value. During periods when investment performance is less than the assumed rate, funding value of assets will tend to be greater than market value. The funding value of assets is unbiased with respect to market value.

Mr. Alberts explained that in 2010 the MECRS experienced a 13.1% market rate of return which results in a $1.3 million base this year, but because of a $6.6 million loss from a couple of years ago, MECRS still has a loss on the assets of $1.3 million on a valuation basis. The valuation is recognizing a real rate of return of 6.6% compared to the assumed rate of return of 7.5%.

Mr. Alberts went on to explain that even though MECRS had a good year on a market value basis, because MECRS has not finished recognizing all the losses from a couple of years ago, this loss will have upward pressure on the System's contribution rate.

Mr. Alberts also stated that moving forward, we are expecting that in 2011 and 2012, before the market experience for those years can be known, the carry forward of sizeable losses will still have to be recognized.

For the benefit of the new board members, Mr. Alberts reviewed a Summary Statement of Resources and Obligations of the MECRS. He explained that performing a valuation results in an estimate of what the total cost of the program is by reviewing all the active, retired and deferred members and applying assumptions to those groups. The valuation therefore estimates in aggregate how much each member will receive in benefits over their expected lifetimes, given their salary and service. Aggregating those values provides the total present value of Future and Expected benefits. That number is broken down into two categories, benefits that have already accrued and benefits that will accrue in 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 accrued liability.

Mr. Alberts reported that as shown on page A-2 of the draft valuation, the total actuarial present value of expected future benefits is $291,168,298 for pensions and $19,186,226 for health benefits.

The trustees discussed hypothetical scenarios that may affect various cost components of the Plan, such as a decrease in payroll due to layoffs, termination of the Plan for future hires and also the affect it may have on the employer contribution rate.

Mr. Alberts referred the trustees to page 7 of the draft valuation and explained the breakdown of the total normal cost of the pension portion of the rate. He noted that 12.05% is the total normal cost of the pension and of that, the members pay 3.75%, leaving an employer obligation of 8.30%. The added Unfunded Actuarial Accrued Liability (UAAL) of 9.41% and the employer health portion of .87%, results in a total employer contribution rate of 18.58%.

Next, Mr. Alberts referred to the Contribution Rate Reconciliation Chart appearing on that same page of the draft valuation and commented on the cost associated with voluntary upgrades to the MECRS tiered plan where service with a multiplier of 1.5% earned prior to 1999 is leveraged to 2% like service rendered after 1999.

At that point Trustee Mercier asked Mr. Alberts for clarification regarding the 1.5% service time.

Mr. Alberts explained that the service multiplier is a factor in the calculation of the benefit amount and he explained how a plan amendment in 1999 had changed the service multiplier prospectively to 2% and resulted in a higher normal cost. The adoption of SB402 a few years later allowed for members to upgrade their benefit multiplier under Chapter 159 from 1.5% to 2% per year of service rendered prior to 1999. He explained further that liabilities increased approximately $377,000 in 2010 as a result of members electing to upgrade their service multiplier for pre-1999 time. An additional $188,500 in member contributions was received as a result of these elections.

Mr. Fleury cited the possibility of City layoffs in July of 2011 and questioned the dollar value that the City is being asked to contribute in July and December of 2011. Would the City in essence be overpaying in the coming fiscal year if those dollar amounts were based upon the present population size and would that possibly result in an entitlement to a larger credit at the end of the year? Mr. Alberts replied that they could be a credit but whether it would be larger or small would depend upon what the city actually did. He pointed out that it is the city's desire to make installment payments based upon a projection rather than as a weekly percentage of payrolls which necessitates the calculation of semi-annual payment amounts. The actuary is careful in the computation of the "true-up" not to have those segments of the city which do pay weekly either charged or profit unfairly from the city's process. Chairman Pinard reiterated the question by referring to page A-9 of the draft report and asking if the $208,899 shown on that page might grow next year if the city actually did reduce a significant number of employees. Mr. Alberts cautiously replied that it could happen.

Chairman Pinard noted that MECRS has a funded ratio of approximately 64% and he asked whether that means that pre-funding the COLA therefore only 64% funded.

Mr. Alberts replied that the COLA was fully funded, not 64% funded. The pre-funded COLA basically is built into the liabilities. If it is assumed that no COLA's were to occur the liabilities would go down. The pre-funded COLA is "baked" into the valuation and the System is paying for future pre-funded COLA on a future basis in the normal costs. The System is paying for the past ad-hoc COLA which predated the prefunding process in the accrued liability and that amount is being spread over a 29 year period.

Mr. Alberts cautioned that with respect to COLA, experience should drive the assumption and assumptions should not drive experience. Mr. Alberts referred to page A-4, Development of Funding Value of Assets and explained that this year, because of losses in 2008 which are being spread over five years, despite a positive investment return for 2010; the experience was an asset loss of $1.3 million. Next year, the projection is for a $2.6 million loss and the following year a $3.5 million loss after which a $3.1 million gain and then $1.3 million gain is anticipated. Looking at the difference between the funded value and the actuarial value now, it only differs by $2 million. In an effort to exclude market volatility, Mr. Alberts suggested that the board might consider re-starting the 5-year smoothing in anticipation of less volatility over the next 4 years. The trustees would need to be comfortable that market volatility moving forward would likely to be less than that in the past 5 year cycle before making a decision to re-start the smoothing method. He further stated that there was no rush in making the decision and it could be deferred until next year. Furthermore, any decision to restart the smoothing would not impact the 2011 valuation.

Mr. Alberts went on to explain that if the board thinks volatility, in the next four years, is going to be greater than the volatility in the last four years then re-starting the smoothing method will introduce more volatility in the contribution rate.

Chairman Pinard entertained a motion to accept the draft valuation. I motion was subsequently offered by Trustee Molan to accept the 2010 draft valuation and to authorize the actuary to complete the full valuation, seconded by Trustee Woitkowski and passed unanimously by all those trustees present.

Having concluded his presentation, Mr. Alberts thanked the trustees for their time and departed the meeting.

New Business:

Chairman Pinard asked NEPC representative to come forward for a review of investment performance. NEPC Representatives, Sebastian Grzejka and Douglas Moseley began by distributing several informational booklets to the trustees regarding the MECRS allocation. Mr. Grzejka began with the Investment Performance "Flash Report" noting that January and February were both positive months overall. Every manager outperformed their benchmark with Mellon Global Alpha up 2.9%, with the last 12 months up 22.2%. Both large cap core managers had positive returns, Benchmark up 3.8% , Gottex up 4.3% since January, and Rothschild Small Cap was up 7.2% and for the one year, beating the benchmark of 6.3%. International and domestic equities reported positive results generally in line with their benchmarks.

In the fixed income arena, Mr. Grzejka reported positive returns for Income Research, Loomis Sayles and the Seix Credit Dislocation Fund, all finishing ahead of their indices year to date.

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The two Hedge Fund Managers were up through February and ahead of their benchmarks year to date. Despite that fact, Mr. Grzejka stated that he would be making a recommendation regarding Attalus Capital's later in the meeting. Moving on, Mr. Grzejka noted that Wellington, the diversified inflation hedge manager, performed well at 3.7% for the month.

Dropping back from year to date events, Mr. Grzejka reviewed final fourth quarter performance of the portfolio with the trustees. He noted peer comparisons for the eight and ten years periods with 9% ranking in the 10 percentile for the eight year average and 5.4% in the 23rd percentile over the past ten years. This, he indicated was a very good return.

Next, Mr. Grzejka transitioned NEPC's review toward education on emerging market debt opportunities. He opened with a commentary on capital markets, warning that investors face a lower than traditional market return environment but that NEPC sees opportunities in emerging market debt and he turned the presentation over to Mr. Moseley.
Mr. Moseley explained that local currency emerging market debt is a unique asset category that is separate from the US Dollar or Euro denominated EMD securities, mainly due to differences in components of risk and return. In general, fundamentals in emerging countries are strengthening while fundamentals in developed markets are weakening. Growth in emerging market countries continue to show promise and the debt obligations of the stable governments in developing nations is more attractive than that of heavily indebted developed countries.

After presentation and discussion of materials contained in NEPC handouts, Mr. Moseley stated that it is NEPC's recommendation that MECRS take advantage of the long-term opportunity in fixed income securities by liquidating funds from the Seix Dislocation Fund which is presently invested in high-yield and bank loans and shift it into emerging markets debt that is denominated in the local currency, in the primary markets identified in the NEPC materials.

Mr. Moseley indicated that if the board were so disposed, that NEPC would provide the trustees with a search booklet of potential EMD Managers to be reviewed at a future meeting, as well as with the Seix liquidation requirements.

Mr. Grzejka noted that revisions to the MECRS Asset Allocation model would be necessary to target the EMD asset class before proceeding with a manager selection. Referring to the Investment Performance Analysis, Asset Allocation Overview, Mr. Grzejka pointed out an anticipated drop of 90 basis points in the expected return between 2010 and 2011 if the same target allocations are maintained. By amending the target mix to include a 6% allocation to EMD, local currency, 20 basis points of the anticipated drop might be avoided. He further noted that the main change would be to eliminate the opportunistic credit line and replace it with EMD.

Trustee Molan moved to amend the Asset Allocation Model to eliminate the opportunistic credit line, include the EMD asset class and make other changes recommended by NEPC, seconded by Chairman Pinard and passed unanimously by all those trustees present.

Because of the notification time required for withdrawal from Seix, Mr. Fleury was authorized to begin the notification process with a target date at the end of the second quarter. He would also work with NEPC to schedule a review of potential managers by the full board and subsequent manager interviews by the Investment Committee, most likely in May.

Mr. Grzejka continued the NEPC presentation by addressing the ongoing question of migration of the Mellon portfolio from Mellon's GTAA product to their Expanded GTAA which includes exposure to commodities. Before opening discussion regarding the Mellon GTAA enhancement, Mr. Grzejka addressed recent developments at the leadership level at Mellon Capital Management. He informed the trustees of the departure of Michael Hoseley, a Strategic Analyst for the portfolio as well as the reassigning or departure of five other key people within the firm. Mr. Grzejka noted however that two of those key employees will transfer to working with the CEO to run the firm. A former employee, founder and developer of Mellon Capital, is moving back into the CEO slot and would be driving the research and the investment modeling.

Mr. Moseley noted that NEPC has schedule a site visit to Mellon in San Francisco to meet with the new team.

Mr. Grzejka stated that despite the management changes NEPC continues to recommend migration of the present GTAA product to an enhanced version which, in addition to including commodities, will also add an emerging markets component, a small cap component and an inflation hedge component while further diversifying the fixed income component.

Attorney Rich asked Mr. Grzejka if the leadership changes in the firm caused NEPC to have any concerns with Mellon maintaining the positive investment performance that they have had with the portfolio in light of these changes.

Mr. Grzejka replied that because Mellon is model driven and there should not be changes to the investment selection process.

After further discussion, Trustee Molan moved to move ahead with the enhanced GTAA, subject to review and approval of the contract by legal counsel, seconded by Trustee Mercier and passed unanimously by all those trustees present.

Lastly, returning to performance issues, Mr. Grzejka provided a review of the two Hedge Fund managers. He reported that Archstone has provided significant exposure and focus to long short equities which helped the performance of the fund as this area of the market has rallied. Attalus Capital Management has a more balanced and diversified exposure, with event driven relative value and tactical trading strategies. Unfortunately, the fund held a defensive posture throughout most of 2010, avoiding directional as well as beta oriented strategies where performance was eventually realized. Mr. Grzejka, stated that while this posture helped protect during the down months, the portfolio was unable to capture the upside as markets turned positive, hurting performance for the year relative to the benchmark and he stated that NEPC was recommending that MECRS replace Attalus for a combination of reasons including poor performance.

Attalus came before the board in 2010 and concerns related to the concentration of its ownership had been identified at that time. After reviewing the trailing performance of both Archstone and Attalus , their five and seven year risk return, Trustee Molan expressed concern that the management problem could be significant for Attalus Capital

Trustee Mercier asked Mr. Grzejka if the asset allocation model would stay the same or if the allocation would change if the board elected to terminate Attalus.

Mr. Grzejka replied that the recommendation is to keep the hedge fund allocation at the same level, simply swapping out of Attalus Capital to a core type of manager, a more balanced allocation.

After brief discussion on the NEPC recommendation that Attalus Capital be terminated and the timetable and interviewing process of swapping out hedge fund managers, the trustees unanimously agreed to terminate Attalus Capital and move forward with a search for a replacement manager.

Chairman Pinard recessed the meeting at 12:24 p.m.

Chairman Pinard reconvened the meeting at 12:39 p.m.

Report of the Executive Director:

Status of Negotiations with RMK – Mr. Fleury reported that in a letter sent to RMK last December, a number of issues had been identified on which the existing timber management contract was silent. Because those issues were of concern, MECRS drafted language which would amend the contract with RMK to manage the EFG Timber Fund Portfolio. RMK has tentatively agreed to accommodate most of those concerns and has provided draft agreements to accomplish MECRS objectives. The process is ongoing and further reports will follow.

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Status of Private Letter Ruling - Mr. Fleury stated that for some time the board has contemplated the cost/benefit of updating the private letter ruling from the IRS initially granted back at the formation of the Plan in 1974. Because any such intention constitute a disclosure item, as MECRS prepared for the audit of 2010, that question was revisited with counsel and it was agreed not to move in that direction because MECRS had no legal obligation to do so and there is no limit to the amount which it might cost if the IRS elected to be less than cordial. As an alternative, Mr. Fleury stated, that with the permission of the board, a new Administrative Rule could be drafted, which would address the IRS requirements not specifically stated in our enabling legislation which might be in question if an updated private letter ruling were to be sought. Mr. Fleury indicated that if it meets the board's approval, a draft could be ready for initial review in a few months.

The board granted authorization to develop a new Administrative Rule which would address the IRS provisions.

CD of Manger Reports, Analysis and Newsletters – Mr. Fleury informed the trustees that reports for the 4th quarter of 2010 are now on file along with newsletters, market analysis and managers prognostications of the future. All of this information is kept in electronic format within sub folders for each manager. While the primary purpose for maintaining these soft copy records is business continuity, we also provide a copy to our outside auditor for their review. Mr. Fleury stated that if any trustee is interested in having a CD that he would be happy to send them one and that the information on the CD falls within the realm of public information so trustees do not need to be concerned about safe keeping the disk.

Member Complaint – Annual Member Statement – Next, Mr. Fleury notified the trustees that a complaint to the City Human Resource Dept. was relayed to the MECRS's office on January 12th regarding the accuracy of beneficiary information on a member's annual statement. The member had filed a change of beneficiary form with the System in May of last year which somehow was not updated in the computer system. Mr. Fleury noted that while the member's election was never at risk because the actual form was on file, this was understandably disconcerting and so a letter of apology was sent to the member which accompanied a revised Annual Member Statement.

Mr. Fleury further reported to the trustees, that after investigating how the problem may have occurred, changes to the beneficiary processes were implemented which should reduce the probability of reoccurrence of a similar event.

Status of Legislation for 2011 – Mr. Fleury stated that SB-127-FN passed the Senate and is scheduled to be introduced in committee of the House. Mr. Fleury plans to attend the hearing and testify on behalf of the bill.

Trustee Mercier asked Mr. Fleury to elaborate further on the SB 127-FN.

Mr. Fleury explained that SB 127-FN is a housekeeping bill on the MECRS Death Benefits provisions clarifying the intent of the death benefit payments to the survivors of members who die in service.

Significant Changes in Federal Withholding Tables for 2011 – Moving on, Mr. Fleury informed the trustees that tax withholding tables for 2011 required that withholding commence at a lower threshold beginning with payment made in 2011. As a result, many retirees saw an increase in the withholding from their pensions as of January and staff began to receive calls from individuals who had never experienced withholding before but were seeing it now. Mr. Fleury explained that on average, cumulative tax withheld for our retirees as a group, increased by 10.5%. The MECRS administrative response to those who called, was to mail them a 2011 W-4P, to recommend that they complete the "Personal Allowances Worksheet" which is part of the form, and to seek assistance from tax preparers or financial consultants if they are unsure of their actual withholding obligations.

Informational Materials from Gabriel, Roeder, Smith & Co.- Mr. Fleury explained that included in the trustees' agenda packets were two informational items from Gabriel, Roeder, Smith & Co. The first item focuses specifically on the pending Public Employee Pension Transparency Act presently before congress while the second publication addresses a few issues which are not germane to MECRS but include articles on IRS Determination Letters and on a GFOA Advisory regarding Responsible Management Design Practices for DB Plans. Mr. Fleury suggested that the later might be very important and quite relevant.

Change in D&O Policy Coverage Period - Mr. Fleury reported on a change in the term of coverage for MECRS's Director's & Officers insurance coverage. The term of the D&O Coverage was made at Mr. Fleury's request so that it would fall into sync with the end of the budget year and come due at the same time as Fiduciary Coverage. By placing the D & O and Fiduciary Coverage, both on a calendar year basis, the System can bid out the policies to the same company to obtain package rates and possibly to eliminate redundancies in coverage and which will in turn result in a lower insurance premiums.

Request to Attend NEPC Client Conference & Opal Conference on Public Funds in Newport, RI
Mr. Fleury requested permission to attend the 2011 NEPC Client Conf. on May 18th or 19th in Boston, and also to attend the 2011 Public Funds Summit in Newport, RI from July 18th to the 20th. He also extended the offer to register any of the trustee interested in either event and can provide details on either or both events to anyone interested.

Chairman Pinard expressed his recommendation that the Board grant permission to Mr. Fleury to attend both conferences. The Board agreed.

In concluding his report, Mr. Fleury indicated that during 2010 appropriation levels were set so as not to exceed 2009 actual expenditures. As was expected, some budget lines ran over while other lines generated a surplus. In order to close the 2010 operating budget with all lines in the black before the commencement of the annual audit and without increasing the gross amount originally authorized for the year, Mr. Fleury referred to a handout distributed to the trustees, detailing the requested transfer of administrative budget appropriations. He stated that the net effect o his request is to show that the year was finished with all budget categories in the black, having no affect on the total amounts that were spent, increasing the approved budget's bottom line.

Mr. Fleury requested that the transfer $24,158.91 from budget lines identified on the handout to other corresponding lines in the budget for a net change to total appropriation of zero.

It was moved by Chairman Pinard to grant Mr. Fleury's appropriation transfer request, seconded by Trustee Woitkowski and passed unanimously by all those trustees present.

Previous Business:

Contract Extensions with RMK Timber Fund – Mr. Fleury updated the trustees on the progress of the contract amendments with RMK which will provide better reporting and controls over the closure process of this investment vehicle. The System is currently waiting for approval of contract amendment language from co-investors and will likely have the final contract in time for the April Board Meeting.

Consent Agenda:

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

Trustee Molan moved to accept the Consent Agenda for March, seconded by Chairman Pinard and passed unanimously by all those trustees present.

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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 Woitkowski moved to adjourn at 12:59 p.m. seconded by Trustee Molan and passed unanimously by all those trustees present.

Respectfully Submitted,

Gerard E. Fleury
Executive Director