August 14, 2012
Minutes #484

Minutes of the Board of Trustees' Meeting -1-

Call to Order: Chairman Pinard called the meeting to order at 8:33 a.m.

Present: Trustees: Chairman Donald Pinard, Paul Porter, Richard Molan, and William Sanders. Trustee Dianne Mercier arrived at 8:40 a.m. and Trustee Michael Woitkowski arrived at 9:04 a.m.

MECRS Staff: Gerard Fleury, Sandi Aboshar and Suzanne Wilson

Absent: Mayor Gatsas

In Attendance: Attorney John Rich, accompanied by Intern, Matthew Whitehead, both of the McLane Law Firm, Mr. Ken Alberts of Gabriel, Roeder, Smith & Co. and Mr. Sebastian Grzejka of New England Pension Consultants

Approval of the Public Hearing Minutes of July 10, 2012 on MECRS Administrative Rule Part 7, Cost of Living Adjustments:

A motion was made by Trustee Molan to approve the public hearing minutes of July 10, 2012 on Administrative Rule 7, seconded by Trustee Sanders and passed unanimously by all those trustees present.

Approval of the Minutes of the Previous Board Meeting:

A motion was made by Trustee Sanders to approve the minutes of July 10, 2012, seconded by Trustee Molan 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, and passed unanimously by all those trustees present.

New Business:

GRS Five-Year Experience Study – Chairman Pinard called on Mr. Ken Alberts of Gabriel, Roeder, Smith & Co. to begin his presentation of the 5-Year Experience Study commissioned by the trustees at the May board meeting.

Mr. Alberts began by providing some background of the actuarial valuation process and he explained the wisdom of reviewing the assumptions after a time.

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Utilizing a power point presentation in conjunction with a presentation booklet, which had been distributed to the trustees, Mr. Alberts addressed the various economic and demographic assumptions associated with the valuation process. The charts and graphs provided a clear picture of the actuarial valuation model and the role of the actuarial assumptions.

Mr. Alberts explained that the Experience Study covers the period from January 1, 2007 through December 31, 2011 and was based upon the active, inactive and retired member data submitted by retirement system staff for the valuations conducted between December 31, 2006 and 2011. The study employed a file matching technique which allowed GRS to track individual member activity from one year to the next.

Mr. Alberts also explained that when the System's experience deviates from expected experience, a gain or loss is generated. The gain or loss is then amortized over a period of future years and applied as an offset or addition to the normal cost contributions. Over time, it is expected that the gains and losses will offset each other. If they do not, then one or more of the actuarial assumptions may need to be amended to reflect actual emerging experience. Identifying such variances from expected values was the purpose for conducting this study.

Next, Mr. Alberts noted that the actuarial assumptions are intended to be the best estimate of future experience of the System when they are adopted, but that conditions inevitably change over time. He went on to list each condition which was found to have changed by the study, as well as GRS's recommendation on whether to increase or decrease the presently assumed rates.

Having completed his review of the actuarial valuation process and explaining the objectives of the experience study, Mr. Alberts delivered the results of the study itself.

Mr. Alberts began by summarizing detrimental experience over the last five years, breaking it down by risk area for withdrawals, disabilities, normal retirements, early retirements and mortality. He also reviewed the history of pension gains and losses over the five year period.

Then, Mr. Alberts addressed the demographic and economic assumptions associated with the Plan. He provided a detailed explanation of service-based and age–based withdrawals between males and females as well as the actual experience for all other assumptions. He noted a very low experience associated with disabilities, which resulted in minor changes. Retirement experience was broken down between men and women, and between early retirement and normal retirement.

Trustee Sanders inquired as to the number of males in females making up the retirement system membership.

That information was not summarized in the study and Mr. Fleury replied that while he did not have that information in hand but that it is easily compiled and that he would send Trustee Sanders the requested information following the meeting.

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Mr. Alberts continued by stating that one of the more difficult assumptions to measure is the salary assumption. In order to determine the longevity increase you need to factor out inflation, which can be difficult. Unlike demographic activities, economic activities do not lend themselves to analysis solely on the basis of internal historical patterns because returns are more affected by external forces, namely inflation and general productivity changes, which defy accurate long-term prediction.

Mr. Alberts explained the rationale for lowering the salary assumption which prompted questions from the trustees. Discussion ensued during which, Mr. Alberts elaborated in order to further the understanding of the potential salary assumption change.

Moving on to economic assumptions, Mr. Alberts directed the trustees to a chart on page C-4 of the report entitled, "Historical Patterns of Investment Return, Pay Increase & Inflation." He explained that estimates of economic activity are generally selected on the basis of the expectations in an inflation-free environment and then both are increased by some provision for long-term inflation. If inflation and /or productivity increases are higher than expected, it will probably result in increases to both actual rates of salary increase and investment return which exceed the assumed rates.

Moving on to the MECRS asset portfolio, Mr. Alberts pointed out that the portfolio is a diversified mix of equity and fixed income investments. Real market returns (the spread between recognized net investment return and wage inflation) for balanced portfolios have averaged approximately 4.2% for the last 59 years. He noted that only hindsight will tell whether a particular combination of economic assumptions is optimal.

Mr. Alberts informed the trustees that the study includes a forward looking analysis and a historical analysis. The forward looking analysis compares the expected returns of the asset allocation based on the capital market assumptions of eight investment consultants. Referring to a chart on page C-3 of the study, Mr. Alberts explained the arithmetic average return is 7.34 and the geometric average return is 6.77%. It is believed that the geometric return provides a reasonable range. That range is 5.16% to 8.41%.

Attorney Rich asked Mr. Alberts what the geometric average of 6.77% represents.

Mr. Alberts responded that the 6.77% is based on the capital market assumptions of the 8 consultants which is an average return over the 20 year period.

Regarding wage inflation, Mr. Alberts reported the average rate of increase in National Average Earnings (NAE) over the last 59 years is higher than the current MECRS assumptions. However, both regional and national average salaries have risen at a slower pace since 1990. He further noted that any differences between the long-term national averages and MECRS' more recent experience is related to the excess rates of price and wage inflation during the 1970's and

1980's which most observers do not expect to see repeated. Mr. Alberts indicated that the reasonable range for this assumption was between 3.0% and 4.0% per year.

Although the current wage inflation assumption of 3.5% appears to be in line with the NAE over the past decade, wage inflation experience over the 5-year period for MECRS is closer to 3.00% and most economists and consultants believe inflation will continue to trail historic averages in the short.-term. Mr. Alberts stated that GRS is recommending that the board adopt assumptions contained on one of the option packages listed on page B-4 of the study, with a slight preference for alternative 3.

Mr. Alberts pointed out that the historic analysis also supports the range of the forward looking analysis.

Mr. Grzejka agreed with Mr. Albert's prediction for the future outlook for inflation.

Mr. Alberts stated that the next step is to look at valuation results under each of the assumptions.

Trustee Sanders asked Mr. Alberts if he finds all the alternative assumptions reasonable.

Mr. Alberts replied that all alternatives are reasonable and GRS is simply providing a range of choices.

Trustee Sanders asked Mr. Grzejka, for his assessment of the study after reviewing the investment return assumption based on the MECRS current investment profile.

First, Mr. Grzejka noted that the NEPC Asset Liability Study booklet which was also provided to the board for this meeting will be reviewed and explained in detail at their September meeting in the interest of time. He further stated that this bifurcated receipt of study results will afford the trustees time to read and better understand each of the studies.

In responding to Trustee Sanders inquiry, Mr. Grzejka referred to page 8 of NEPC's Asset Liability Study, Potential Asset Mixes. The chart included MECRS current target as well as Mix A and B, the difference being the inclusion of more alternatives, and more private equity. He noted that the chart did not include any assumption for active management so that the values shown all represented beta returns. Mr. Grzejka felt that it was a fairly safe assumption that over the next 5 to 7 years, active management is expected to add around 40 basis points and that the expected rate of return would be 7.1%. The chart also highlighted the results of the 30-year expected return and the projected returns for Mix A and B.

Mr. Alberts asked Mr. Grzejka if the returns shown in the chart were gross or net of administrative and investment expenses.

Mr. Grzejka replied that they are net returns of investment expenses.

Mr. Alberts stated that the trustees should keep in mind that Mr. Grzejka is comparing the process of pulling out the investment expenses, and that administrative expenses are not included in reaching a net return.

Trustee Sanders asked Mr. Grzejka if he would be comfortable with 7.5% assumed rate of return based on Mr. Alberts report.

Mr. Grzejka replied that based on NEPC's experience, that 7.5% assumed rate is more conservative relative to other public funds and that the average is 7.7%. He did note however, that he believes the 7.5% assumed rate is achievable given MECRS current portfolio.

Mr. Fleury pointed out that the decision to adopt assumption changes is not required immediately; the trustees do have the luxury of time to further review the proposed assumptions before making a decision.

Trustee Sanders commented that he is interested in alternative #4 with an investment rate of 7.10%.

Mr. Alberts then employed the use of a Contribution Projection tool based on the 2007-2011 Experience Study, which allowed plugging in variables of investment return, wage growth and COLA's for varying amortization periods. The trustees were able to see the results of individual assumption changes as they were introduced into the equation and Mr. Alberts explained that he could provide printouts of the results for any combination the trustees desired.

Trustee Sanders requested a Contribution Projection analysis utilizing a 7.00% investment return, and alternate #4 to which Mr. Alberts replied that he would generate the requested projection and provide it to the board.

Mr. Fleury noted that the new pronouncement, GASB 67, could have an impact on the City's expense to the Fund beginning in 2014 and he asked if the elimination of the 5-year smoothing would introduce volatility to the employer contribution rate from year to year.

Mr. Alberts replied that it will introduce volatility, in the financial statements but not necessarily in the funding obligation.

Trustee Molan inquired whether changes to the amortization period would have an impact on the valuation.

Mr. Alberts explained the difference between an open ended 28-year amortization period and a closed end amortization period, with the former taking a longer time and approaching the target more slowly. With a closed end amortization period, you theoretically meet your goal, but greater volatility occurs in the contribution rate as a result of the introduction of gains and losses.

Mr. Alberts ended by explaining in detail how the use of the smoothing method reduces the effects of volatility introduced by wide swings in investment gains and losses.

After the brief discussion, the trustees agreed that the 5-year Experience Study presentation was well done and very informative. It was also agreed to further research the Study and to address additional concerns which might arise at the September board meeting.

The trustees thanked Mr. Alberts for his presentation and he departed.

New Business:

Request for a Motion – 2011 Annual Report on Gainful Occupation - Trustee Molan moved to accept the 2011 Report on Gainful Occupation, seconded by Trustee Sanders and passed unanimously by all those trustees present.

State Street Bank & Trust, Request for Custodial Rate Increase - Mr. Fleury reported that the custodian has announced an upcoming rate increase but he noted that the rate has not been increased in over a decade. He explained that he was just informed of the increase and that in his consultation with NEPC on the magnitude of the change, it had been seen as fair.

Trustee Sanders asked about the past service issues with the custodian, previously reported by Mr. Fleury and he asked if those issues have been resolved.

Mr. Fleury responded that the issues have not been entirely resolved, but are now manageable.

It was then moved by Trustee Molan to accept an increased fee schedule requested by State Street Bank & Trust for custodial services, seconded by Trustee Sanders and passed unanimously by all those trustees present.

Consent Agenda:

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

Report of the Executive Director:

Receivable Collected from Attalus Capital - Mr. Fleury recapped the trustee's decision to terminate participation in the Hedge Fund of Funds operated by Attalus Capital a year earlier. He reported that, at that time, funds in excess of $335,000 continued to be held by the manager pending completion of a financial audit as allowed by language in the original subscription agreement. Mr. Fleury reported that the audit process has been completed and that MECRS is now in receipt of the holdback amount plus interest.

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Status Report on Commercial Real Estate Activities – Mr. Fleury's last report to the BOT indicated that 90% of proceeds from Morgan Stanley had been received with the balance due later in July. Mr. Fleury informed the trustees that the balance was received and the amount reconciled with the asset value at market prior to the close and the initial redemption amount. As of this date, Mr. Fleury indicated that no capital call has been made by TA Associates, but an estimate of the funding dates was requested and received. MECRS remains overweight in cash pending one or more capital calls from TA Associates which are not expected until late in the fourth quarter of 2012.

Status of PIMCO Subscription – Next, Mr. Fleury reported that as of the end of July, $9,440,000.00 was transferred from Mellon Capital Management GTAA to the PIMCO All Asset Fund, ticker symbol PAAIX pursuant to actions taken by the board at the July 10th meeting.

Review of Public Funds Summit – Mr. Fleury reported on his attendance of the 2012 Public Funds Summit in Newport, RI conducted by Opal Financial. He summarized the sessions which covered subjects relevant to both large and small public funds, and noted that copies of many of the presentations are available to interested parties.

Informational Items of Interest – Referring to the informational items included in the trustee's agenda packets, Mr. Fleury explained that he had come upon these articles and thought them worthy of the trustee's attention.

In concluding his report, Mr. Fleury was pleased to announce that the Pre-Retirement Seminar, scheduled for September 11, 2012, currently has 100 members, registered to attend. He also thanked the Board of Trustees for re-scheduling the September meeting which would normally have been held on September 11th to September 18th, to accommodate the seminar.

Previous Business:

Non-Public Session Pursuant to RSA 91-A:3 II(d) For Discussion of Contract Negotiations - Chairman Pinard then entertained a motion to go into Executive Session pursuant to RSA 91-A:3 II(d) at 10:56 a.m.(Consideration of the acquisition, sale, or lease of real or personal property which, if discussed in public, would likely benefit a party or parties whose interests are adverse to those of the general community.)

Roll Call Vote:

Ayes: Messrs. Sanders, Woitkowski, Pinard, Porter, Molan

Nays: None

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Following the conclusion of the Non-Public Session, Chairman Pinard then entertained a motion to seal the minutes of executive session pursuant to RSA 91-A:3, III.

Trustee Molan moved to seal the minutes of executive session, seconded by Trustee Porter and passed unanimously by all those trustees present.

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 11:03 a.m., seconded by Trustee Molan, and passed unanimously by all those trustees present.

Respectfully Submitted,

Gerard E. Fleury
Executive Director