March 28, 2012
Minutes #479

Minutes of the Board of Trustees' Special Meeting -1-

Call to Order: Chairman Pinard called the meeting to order at8:32 a.m.

Present: Trustees: Chairman Pinard, Bill Sanders, Michael Woitkowski, Dick Molan, Dianne Mercier departed at 9:39 a.m. and Mayor Gatsas arrived at 8:38 a.m. and departed the meeting at 9:03 a.m.

MECRS Staff: Gerard Fleury, Sandi Aboshar and Suzanne Wilson

Absent: Paul Porter

In Attendance: Ken Alberts from Gabriel, Roeder, Smith & Co., Attorney John Rich of the McLane Law Firm andSebastian Grzejka, Consultant from New England Pension Consultants.

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.

Previous Business:

Review of Actuarial Valuation Results and Investment Earnings Assumptions –Mr. Ken Alberts of Gabriel, Roeder, Smith & Co. and Mr. Sebastian Grzejka from New England Pension Consultants were present to review the results of changes in the earnings assumptions postulated by the trustees' at their March 13, 2012 board meeting.

Mr. Fleury began by alerting the trustees to supplemental pages that were included in the draft valuations that had been distributed. Two of the pages existed in the normal version and also in an alternative version in order to allow the trustees to elect between a pair of assumptions prepared by the actuary Mr. Ken Alberts from GRS was in attendance and was prepared to address questions from the trustees regarding all aspects of the draft valuation results.

Mr. Fleury further noted that Representative Sebastian Grzejka, from NEPC was also prepared to answer questions regarding the composition of the MECRS investment portfolio and whether it was adequately dovetailed to the earnings assumption used in the valuation.

Mr. Alberts began by providing the trustees with background information in preparing various earnings assumptions, which are reviewed on a regular schedule. He explained that the entire assumption package is reviewed including mortality rates, inflation rates, rates of disability, rates of retirement, etc. He stated that if the trustees would consider moving up the 5 year Experience Study to the current 3-years mark, GRS could go through an analysis of historical rates of return and capital market assumptions would be obtained from the MECRS' investment consultant.

Looking back at the last Experience Study, Mr. Alberts stated, he feels that a reasonable earnings assumption would be in the 6.5% to the 8.5% range for public sector plans. Within the last year, many public sectors plans have elected to bring their assumption down to 7.5% or 7.25%, noting that the System's current assumption is set at 7.5%.

In the essence of time, Mr. Alberts informed the trustees that GRS had re-calculated the earnings using the assumptions at 6%, which represents a 1.5% drop from the current assumption of 7.5% and an alternative assumption of 7%, which represents a .5% step drop from the current rate. He indicated that the changes are dramatic, and he guided trustees through the numbers as reported on page 3 of the trustees' handout.

Mr. Albert stated that utilizing the proposed 7.0% return assumption, the City's obligation as of December 31, 2011 valuation would increase from 19.48% to 22.16% and for the proposed 6.0% assumption it would increase to 28.17%. This would also have an immediate impact on the MECRS funding status by causing it to drop.

Mr. Alberts went on to explain that a change in the investment return indicates that on average, (if the interest rate is changed to 7.0%), the System only expects their investments to earn 7%, therefore, less money will be coming in from the market and more money will need to come from the employer and employees in order to cover the costs of the Retirement System, which is reflected in the net present values. The estimated liabilities would increase and the funded status would decrease.

Utilizing his handout, Mr. Alberts addressed the measure of change in the funded status which would result for pension benefits if the earnings assumption were lowered to 7.0%. He estimated that the funded status would go from 62.5% to 58.9%. When recalculated using a 6% earnings assumption, the funded status would decrease to 52.0%.

With respect to the health subsidy portion of the Plan, Mr. Alberts explained that there is not quite as much movement there because it is such a new Plan and there is a lower funded percent to begin with.

Trustee Sanders asked Mr. Alberts if he was comfortable with the System adopting an assumed rate of return assumption between 6.5% and 8.5%.

Minutes of the Board of Trustees' Special Meeting -3-

Mr. Alberts replied that without doing any further analysis and pending the investment consultants' opinions, he is comfortable with that range. He also noted that the trustees should keep in mind that this rate of return is a long-term average.

Chairman Pinard asked Mr. Grzejka of NEPC about the Systems current asset allocation.

Mr. Grzejka referred to the chart on page 8 of his handout, entitled, 2012 Asset Allocation Review. He explained that the chart indicates a 5-7 year outlook as well as a 30-year outlook, based on what NEPC believes the portfolio should result in based on current market opportunities. Mr. Grzejka noted that NEPC has seen stated return expectations of 8%, but has seen some clients lowering their rates, more towards the 7.5%, 7.25%.

Chairman Pinard asked Mr. Alberts if the assumption rate is often changed on a 5-year average or a 7-year average.

Mr. Alberts replied, "No, but these are not normal times," and he elaborated further.

Mayor Gatsas asked Mr. Alberts, if the Manchester Retirement System was a brand new Plan, what GRS would recommend for an assumed rate of return.

Mr. Alberts responded that the best approach would be to actually use 2 different rates, one would be 8% which would be effective through the participants' active membership and the other would be 5% or 6% which would take place upon retirement.

Mayor Gatsas asked for just one rate to which Mr. Alberts responded that GRS's recommendation would probably be in the 7% range.

Mayor Gatsas then asked Mr. Alberts why this proposed assumption rate change was not suggested to the MECRS trustees back in 2008.

Mr. Alberts responded that it was in fact brought to the trustees' attention and there had been discussion to consider dropping the assumed rate of return to 7.25%.

Trustee Sanders expressed his concern of the funded status of the Retirement Plan.

Mr. Alberts reported that if the board decided to leave the return assumption at the current 7.5% and the Fund actually earned 7.5% on average every year for the next 10 years, the pension funded status would be about 73%, not a real big movement, in ten years.

Minutes of the Board of Trustees' Special Meeting -4-

Trustee Sanders stated that while the demographic profile of the pension Plan is aging, little tweaks to the assumptions appear to have only a minor impact on the funded status.

Mr. Alberts elaborated further on Trustee Sanders comment and provided the trustees with different scenarios on setting various assumptions.

Mr. Alberts indicated that shortening the amortization period would raise the employer contribution rate and it would accelerate the funding. He went on to say that there are more ways to get more money in the Plan then just changing the assumed rate of return.

Trustee Sanders noted that Mayor Gatsas has appointed a Sustainable Benefits Committee to review the current benefit structure of the MECRS, offered to city employees, and to make specific recommendations for the Board of Mayor and Aldermen's' consideration. He noted that he and Mr. Fleury will be attending a meeting of the committee later in the day and he also noted that he disagrees with Mr. Alberts on the funding of the retiree COLAs and that the System is in fact funding the COLAs. He stated that when COLA increases are granted to retirees they are calculated using a 7.5% discount rate. When the 7.5% discount rate is missed, there is an unfunded prior service cost. The trustees will soon be faced with the tasks of determining whether the retirees will receive another COLA increase and Trustee Sanders felt that they should keep this issue in mind during this very challenging time.

Mr. Alberts pointed out that the System is not in danger of not having enough money to pay the current retirees their benefits for the rest of their lives. If the current 7.5% assumption were to decrease then market value of assets would still be in excess of the liabilities.

Mayor Gatsas departed at 9:03 a.m.

Mr. Alberts stated that one of the things that needs to be balanced is the City's resources with the contribution requirement. During the downturn, the amortization period was reset from 25 years to 30 years to keep the City's contribution rate from increasing significantly, which had the effect of lowering the contribution rate. He explained that the trustees could again consider resetting the amortization period to a lesser period of time which would bring the City's contribution rate up. He noted that the trustees have many options to consider.

Chairman Pinard asked Mr. Alberts, if the assumption rate were to be lowered to 7.0% and the Fund actually realized 8.0%, would that have the effect of lowering the City's contribution rate?

Mr. Alberts replied that that is correct in theory, however, in practice it would take a couple of more years due to the booked losses. The trustees continued to discuss the lowering of the assumed rate of return and the affect it would have on the employer contribution rate and the funded status of the Plan.

Trustee Sanders expressed his belief that the employees of the City of Manchester are receiving a rich benefit, which has to be paid for by the City.

Mr. Fleury inquired as to the health subsidy portion of the benefit to which Mr. Alberts replied that the health benefits are tracked separately and changing the rate of return assumption will only have a slight impact on the health contribution portion. The trustees continued to discuss the health insurance subsidy and its utilization rate.

Attorney Rich asked Mr. Alberts about his earlier comment regarding if the assumption of 6% was met for 10 years the Plan would be 73 to 75% funded and his statement that if the assumption of 7.5%, was similarly met for 10 years, the Plan would be funded at the same percentage.

Mr. Alberts replied that he did in fact make that statement and explained that he was implying that the funded percent in 10 years would be more heavily related to the amortization period than the interest rate.

Attorney Rich then asked Mr. Grzejka if the Plan's asset allocation would change significantly if NEPC were to amend the asset allocation for an assumed rate of 9%.

Mr. Grzejka responded that it would depend on the status of the Plan. If the Plan was in the current state, at 6% or 7.5% return assumption, the asset allocation recommendation for the next five to seven years would not change. If the assumed rate was 9% then it would change more towards illiquid securities. The MECRS portfolio would probably resort to a 15% to 20% allocation to private equity in order to get to the return target.

Attorney Rich then inquired about other Plans with heavy liability driven investment strategies and their assumptions, to which Mr. Grzejka explained, it would depend on a number of different factors and he provided the trustees with different scenarios.

Trustee Sanders stated that he is persuaded by Mr. Alberts' earlier comments that changing the assumed rate of return would not dramatically change the funded status of the Plan.

Trustee Molan then stated that he would like to see the 5-year study moved up to 3years.

Trustee Sanders suggested that Mr. Fleury work with Mr. Alberts and Mr. Grzejka to put material together that encompasses the scope of discussion relative to a 5-year study inclusive of deliverables which were discussed.

Trustee Mercier expressed her desire to have the advisors report back with recommendations to achieving a funded status of 80% to 85%, within ten years. Such a recommendation could provide a legacy strategy to take the Plan beyond 80% and transform it into a liability driven portfolio.

Trustee Molan agreed that this issue needs to be an ongoing discussion.

It was then suggested by Trustee Sanders, that Mr. Fleury draft a formal motion to be reviewed at the May board meeting.

Mr. Alberts reflected upon the essence of the discussion focused on performing a Five Year Experience Study and since it has not been five years since the last study, this exercise would include the last three years of data which would also include the last two years which were included in the last study.

The issues associated with performing a Five Year Experience Study at this time were discussed and the trustees made it clear that the deliverable in this case would need to be somewhat of a departure from studies in the past. They understood that under the usual circumstances, there are limits to what they can do because of limits to their authority.

For this proposed study, the board was clear in its desire to have the deliverable focus on identifying possible outcomes and to expand the scope of actions needed to achieve those outcomes to those normally beyond the boards' control. As examples, they expect the study to go beyond confirming the Plan's present status and general direction and to provide target outcomes which will result in improvements to the Plan's funded status, the reduction/elimination of unfunded liability, and a transition toward a liability driven model. The study's results should, therefore, include action plans to move the System over a prescribed timeline to a funded status in the area of 80 to 85 percent.

In order to achieve the objectives identified in this study, the board sensed that it may need to seek changes to the Plan's provisions which would facilitate movement toward those objectives and they appeared interested in moving in that direction, while simultaneously taking action within the scope of their authority to leverage those larger efforts. Ideally, this would also dovetail the composition of the Plan's asset allocation model to improve the likelihood of an acceptable earnings experience more often than not. It was also noted that having the actuary work collaboratively with the System Advisors at NEPC would be imperative to a comprehensive and meaningful plan for the MECRS organization.

Mr. Fleury informed the trustees of his two administrative concerns. The first was regarding the cost of the study. He noted that currently the budget allows for actuarial services, but it may not be sufficient to fund the cost of the study and he might need to request a budget addition.

Mr. Fleury's second concern was with the urgency of setting the employer contribution rate for the period beginning July 1, 2012.

It was moved by Trustee Sanders to accept the 2011 actuarial report, with an employer contribution rate of 19.72%. He also stated that he did not want to use the alternative allocation model which serves to reduce the employer contribution rate and he would prefer to continue using the smoothing method.

The motion was seconded Chairman Pinard.

Mr. Alberts stated that there is nothing operational that he is aware of that prevents the trustees from adopting a higher rate.

In regards to the budget, Trustee Mercier requested that Mr. Fleury review the budget, to perhaps transfer the funds needed, from an area of surplus, rather than adding to the budget.

Motion passed unanimously by all those trustees present.

Mr. Grzejka stated that NEPC is prepared to work with Mr. Alberts as well as NEPC's in house actuary, to take information from Mr. Alberts and interrelate it into an asset liability study, which will then show an asset allocation overview on what can be done to get to different levels of funded status.

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 9:44 a.m., seconded by Trustee Sanders, and passed unanimously by all those trustees present.

Respectfully Submitted,

Gerard E. Fleury
Executive Director