

October 9, 2012
Minutes #486

Minutes of the Board of Trustees' Meeting -1-

Call to Order: Chairman Pinard called the meeting to order at 8:38 a.m.

Present: Trustees: Chairman Donald Pinard, Richard Molan, Paul Porter, Mike Woitkowski and William Sanders departed at 10:20 a.m.

MECRS Staff: Gerard Fleury, Sandi Aboshar and Suzanne Wilson

Absent: Mayor Gatsas and Dianne Mercier

In Attendance: Attorney John Rich of the McLane Law Firm, Kevin Leonard and Sebastian Grzejka, both from New England Pension Consultants

Approval of the Minutes of the Previous Board Meeting:

Previous board minutes of September 11, 2012 were deferred until the meeting of November 13, 2012.

Approval of the Immediate Meeting Agenda:

A motion was made by Trustee Porter to approve the immediate meeting agenda, seconded by Trustee Sanders, and passed unanimously by all those trustees present.

Chairperson Comments:

Chairman Pinard expressed his concern over the recent activity involving MECRS' Investment Consultant, New England Pension Consultants, and the Gottex Portable Alpha Fund. Chairman Pinard stated that during the September board meeting, at which the investment consultants were in attendance, he felt that NEPC should have informed the board about their concern over breaking developments with the Gottex Fund and should have told the board that they would be kept apprised of subsequent guidance on the portfolio.

Mr. Fleury noted that discussion had transpired at that meeting, specific to portable alpha investments where performance by Gottex was compared to Benchmark Plus. He had reminded the board that the decision to hire both managers had been made at the same time and funded for the same amount.

Subsequent to the September board meeting, Chairman Pinard stated that the trustees were advised by NEPC to file a redemption notice with Gottex, with no prior indication that there were concerns about the portfolio. Chairman Pinard took this opportunity to express his dissatisfaction and he stated that he expects a detailed explanation

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from NEPC on why the board was not forewarned of a possible recommendation for an expeditious redemption with Gottex.

Mr. Fleury noted that upon notification from NEPC, he had prepared the Gottex redemption forms, but upon careful review of the subscription agreement and after further consultation with counsel, he had determined that he did not have the authority to issue those forms without the board's consent. NEPC representatives had recommended a special meeting of the board to grant approval for the redemption notice to be issued, but again, after careful review of the rules and an examination of the calendar, there had been insufficient time to legally post and schedule a special meeting.

Report of the Executive Director:

Status Report of Investment Funding - Mr. Fleury reported that an installment on the funding commitment to PRISA from Morgan Stanley proceeds occurred as scheduled. PRISA called for only \$418,000 of the remaining \$1.4 million commitment which leaves MECRS still overweight in cash by \$982,000. In addition, he noted that September saw another capital call from private equity manager Lexington Partners, approximating \$149,000.

Conversion to VoIP – Mr. Fleury then informed the trustees that MECRS is now testing Voice over Internet Protocol, (VoIP) as a cost avoidance measure which simultaneously provides a number of operational efficiencies. A number of configuration refinements are customary with VoIP conversion and the organization continues to make these refinements as tests are conducted. So far, Mr. Fleury stated that the results are encouraging.

Unique Member Situation - Mr. Fleury explained that one of the System members meets the requirements for participation in the Plan resulting from employment with the City and again with the Manchester School District. The particulars for this individual have been examined and his service credit and final average earnings are being properly accumulated and reported. Details regarding this situation were discussed with the actuary, who confirmed that this dual employment does not result in an actuarial gain or loss and is not problematic for valuation purposes. MECRS staff will continue to track this case and to be on the lookout for others.

Special Election Notice Mailing Done to Retirees - Mr. Fleury stated that MECRS has traditionally depended upon State Street Retiree Services for the delivery of trustee election notices to retired members. This has generally been accomplished by providing a stuffer to State Street which is inserted with checks or non-negotiables on the first of October. Mr. Fleury reported that this year, staff became aware that the stuffers had not been inserted in an undetermined number of payroll mailings. Information coming from State Street on the magnitude and scope of the problem quickly proved unreliable and so to insure that notices went to all retired members, the MECRS staff generated more stuffers and did a direct mailing to the retiree population. This matter is being pursued with State Street.

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After brief discussion, the trustees directed Mr. Fleury to seek reimbursement for expenses incurred for generating and shipping the stuffers to State Street. Mr. Fleury indicated that it would be done.

Previous Business:

Report on Work in Progress – Indemnification Policy – Attorney John Rich of the McLane Law Firm distributed a hand-out to the trustees covering the proposed changes to the Indemnification Policy as well as materials on potential legislative amendments which had been previously discussed.

First, Attorney Rich stated that during review of the Policy in the previous month, there were concerns regarding the language suggesting that there might not be a Fiduciary Liability Insurance Policy at some future date. Attorney Rich noted that he had removed that language from the new draft of the policy.

Attorney Rich also noted that he added requested language that suggests that the Indemnification Policy should remain in effect, but with no ability to bind future boards. In addition, Attorney Rich amended the draft to document the intention of the trustees that the System would continue to purchase insurance to protect the personal liabilities of the trustees.

Another area of requested change included in this draft deals with the ability of trustees to approve, disapprove, or request specific counsel in connection with any claim against them that the Retirement System is paying for. The policy currently states that if an individual trustee is sued, the Retirement System is entitled to participate in the proceeding and the System can select counsel. Attorney Rich noted that a request was made that that provision be amended to provide the trustee with great say in the matter. He stated that upon consideration, he felt such an amendment was not necessary and that it makes sense as stated, so no change was made.

After brief discussion by the board, Attorney Rich explained that he would prepare a final version of a By-Law amendment to be posted for a 30-day period subsequent to a Public Hearing.

It was moved by Trustee Sanders to authorize Mr. Fleury to release the final version of the By-Law amendment for a 30-day period of public comment, seconded by Chairman Pinard and passed by all those trustees present.

Referring to the hand-out, Attorney Rich then briefed the board on the Comparison of Liability Protection between Chapter 218 and RSA 31:104, the Municipal Officials Statute. He explained that the principal difference between the two is that the municipal liability statute provides municipal executives and officials immunity from civil liability, not indemnification. He stated that the State Statute allows for protection from litigation for State officials and also allows municipalities to indemnify its officials.

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Attorney Rich briefed the trustees on an earlier meeting with City Solicitor, Tom Clark in which they discussed whether the municipal official statute would apply to the MECRS Board.

It is Attorney Clark's view that it was unlikely that the City would provide protection under the municipal statute if an issue were to arise because the Retirement System is considered a separate entity from the City.

Attorney Rich reiterated that an immunity statute means that a suit cannot be filed against an official whereas the Retirement System statute allows for a suit and the trustee is indemnified after the fact. Attorney Rich also described the requirement that the court hold a preliminary hearing within 90 days of a suit against a municipal official to determine whether immunity is available.

Trustee Porter suggested that an amendment to Chapter 218, mirroring the municipal statute, may be the best way to protect the board and to eliminate the procedural differences. Attorney Rich agreed and indicated that as requested by the trustees last month, he had prepared draft legislation.

Attorney Rich went on to explain his proposal to mirror the municipal statute RSA 31:104 and add similar language to Chapter 218. He provided justification for the proposed legislation, such as enhancing the ability to attract qualified candidates to the board, putting the Retirement System Trustees at the same level as municipal board members and also providing protection comparable to that of other trustees in other Systems across the country, who benefit from immunity.

Trustee Sanders asked if the board would still need Directors & Officers Insurance if the proposed legislation went through.

Attorney Rich responded by providing reasons why the board would want to maintain the D&O Insurance coverage despite and the existence of an immunity statute.

Attorney Rich addressed whether or not the statute can be amended by the legislature, without a referendum.

Mr. Fleury noted that during his tenure at the Retirement System, there have been two issues that went to referendum and both of them affected the benefit structure and had a cost factor associated with them. Cost neutral amendments had been enacted without the referendum step, but with the approval of a vote by the Mayor and Aldermen.

After discussing the justification for legislation as well as the arguments for and against legislation to enhance the Indemnification Policy, the trustees were in agreement that Attorney Rich should move forward only with the proposed By-Law Indemnification Policy.

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Trustee Sanders asked Attorney Rich if he would forward an electronic copy of the By-Law to his attention, to which Attorney Rich responded that he would do so.

Consent Agenda:

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

Previous Business:

Continuation of Asset Liability Study - Mr. Kevin Leonard and Mr. Sebastian Grzejka of New England Pension Consultants were present to discuss the Asset Liability Study and also to explain NEPC's sudden recommendation that MECRS reconsider ongoing investments with portable alpha manager, Gottex Funds.

Chairman Pinard opened the session by expressing his concern over the series of events associated with NEPC's recent recommendation and specifically in the way the matter was handled. He asked Mr. Leonard to explain the reasoning behind the sudden action, when only days before at the September board meeting, and while NEPC representatives were present, no issues or concerns were reported regarding the investments with Gottex.

Mr. Leonard began by explaining the working of NEPC's dedicated research group and senior committees on Traditional Due Diligence and Alternative Due Diligence. He noted that those committees are responsible for client recommendations, and that which Gottex would fall under those committees. He then explained that at the September Board of Trustees Meeting, NEPC's committee had not completed their assessment on Gottex and it would have been premature for NEPC representative to have speculated on the outcome at that time. Mr. Leonard further noted that NEPC is a SEC Registered Investment Advisor, which requires them to provide their opinion on managers to all clients at the exact same time.

Mr. Grzejka confirmed Mr. Leonard's explanation and stated that he is on the Alternative Due Diligence Committee, which meets every two weeks.

Mr. Leonard went on to say that NEPC recommended submitting an immediate redemption for the products in which MECRS is invested, in advance of a review of the issue by the MECRS board in order to comply with notification deadlines for fourth quarter redemptions. If, after reviewing the matter with MECRS board, it is decided that MECRS wished to continue its investment with Gottex, the redemption could be rescinded.

Mr. Leonard explained that there are three recommendations which NEPC issues to its clients; to take no action, to review the agreement, or to immediately terminate the agreement. He further explained that Gottex has had a change in CIO, and while NEPC is comfortable with the replacement and Gottex performance has been strong, their outflows of assets under management

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has been a concern and NEPC believes that it may cause Gottex to struggle in the future. In light of turnover at the senior leadership in conjunction with outflows in the investment portfolio itself, NEPC believes the best course of action would be a client review.

Trustee Sanders stated that while he has the highest regard for NEPC as a consultant, he felt a degree of personal frustration over how the Gottex issue was handled. He explained that without receiving any background on the situation, the trustees had been asked to take immediate action by placing a redemption notice.

Trustee Sanders stated that he is aware of the NEPC Senior Committees and that in the future, if a similar situation were to arise, like the Gottex issue, that there would be some formal way that options would be presented in a timely manner so that clients could respond from a more informed position.

He stated that other concerns with Gottex had been going on for some time, but there had been no communication from NEPC, with the MECRS Executive Director or Investment Committee, regarding their performance. Trustee Sanders informed the NEPC representatives that he was not pleased with their service and the uncertainty that the trustees experienced associated with this recent Gottex matter.

Mr. Grzejka reiterated Mr. Leonard's earlier remarks on why the trustees were not notified sooner and apologized for the way the Gottex matter had been addressed. The main focus and intent, Mr. Grzejka stated, was to get clients on the queue for redemption and closely watching the Gottex Fund.

Mr. Fleury stated that when he was first contacted on the matter, he had been advised to file a redemption form before the close of business the following day. Knowing that he lacked the authority to take such action without prior board authorization he consulted with counsel and determined that it would not be possible to convene an emergency meeting of the board in the limited time available. He also reviewed language in the Gottex Subscription Agreement, and confirmed that MECRS was constrained to quarterly exits. NEPC suggested that he file the redemption with the knowledge that it could be rescinded at a later date if the board failed to subsequently approve the action. Mr. Fleury again cited language in the agreement which stated that Gottex has the right to allow redemption notices to be rescinded, but it's not a guarantee and so he was not disposed to act upon the recommendation. Furthermore, Mr. Fleury pointed out that the Most Favored Nations Status included in the agreement provides MECRS with preferentially receiving cash in the event of a redemption, but after reviewing the contract carefully, and in the event that too many clients departed simultaneously, Gottex could still distribute assets in kind and does not have an obligation to liquidate investments and return cash if it deemed such action to be in the best interests of the fund.

Mr. Grzejka explained to the trustees that similar language is also in most traditional manager contracts. If a redemption request is made and the manager can't sell securities, they will give

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securities in kind. The language is not exclusive to hedge fund managers and is included purposely because, at the time of a redemption request, the investment manager may not be able to provide full redemption, it is not a guarantee.

NEPC had operated under the premise that Gottex had made certain verbal assurances, that MECRS would be able to get cash and that the redemption request could be rescinded.

Mr. Leonard stated that NEPC had contacted Gottex and that they would be notifying all of NEPC's clients of the issue.

Since the initial recommendation was issued, NEPC has issued a more formal client review recommendation, spelling out the concerns with Gottex. The options are to place MECRS on the queue effective December 31, 2012, or to invite Gottex to a MECRS board meeting for review. Mr. Leonard noted that this is not a sell recommendation. Short-term performance had done well and NEPC continues to believe in portable alpha as an asset class, however, there are major concerns with this manager.

Mr. Leonard noted that Gottex has reached out to NEPC and would like to be able to come to a MECRS board meeting to discuss their fund.

Mr. Fleury informed the board that he has the necessary forms prepared to move forward with the redemption request if the board so directs it. He also noted that if the board chooses to redeem its investment with Gottex, the matter of where the proceeds would be reallocated would need to be addressed.

Trustee Molan moved to schedule an Investment Committee Meeting for the purpose of reviewing investments in the Gottex Fund with Gottex Representatives and NEPC. He further indicated that he was not in favor of executing a redemption notice at this time. The motion received a second from Trustee Sanders.

Attorney Rich questioned the effect of the NEPC Investment Committee's September 25 guidance on the Gottex portable alpha product. He asked Mr. Leonard whether having a large percentage of NEPC clients in the Gottex fund, all making redemptions at once, negatively impacted the remaining investors in the fund. He further questioned whether NEPC considered the possibility of their recommendation becoming self fulfilling.

Mr. Leonard replied that only the portable alpha product was affected by NEPC's recommendation and that Gottex still had other investment vehicles in other asset classes which would not be impacted by NEPC's guidance. Furthermore, Mr. Leonard asserted that NEPC was cognizant of its client base and of the percentage which that entire base constituted of the larger Gottex portable alpha fund. He declined to speculate beyond a point but opined that he did not believe that Gottex would be severely affected by the loss of NEPC clients.

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Chairman Pinard called for the vote and the Motion carried.

After brief discussion the trustees agreed to schedule the Investment Committee meeting for Thursday, November 8, 2012 @ 8:30 a.m.

Moving on to the Asset Liability Study, Mr. Leonard began by reviewing portions of the study which had been discussed at the September board meeting. Those discussions had centered on the current and projected financial status of the pension plan over the next 5-10 years. In addition, assessing whether the current asset allocation is appropriate in light of expected trends in liabilities and cash flows had also been covered.

Turning to page 8 of the study entitled, Potential Asset Mixes, Mr. Leonard addressed Expected Returns, Expected 30 Year Returns and Standard Deviation of Asset Returns for MECRS's current target asset allocation. He noted a range of results for potential Mix A and Mix B option, with the results slightly increasing with Mix A and Mix B.

Mr. Leonard stated that if the Board does not feel that they can afford greater illiquidity in the portfolio, then that belief may dictate whether changes can be made to the asset allocation. He noted that NEPC is comfortable with the current asset allocation. If the board feels that they would like to achieve a higher rate of return or a better risk adjusted return, then given the current profile, in order to do that, the Board would need to consider private investments, particularly private equity or private debt.

Chairman Pinard asked if the assumed rate of return of 7.5% is based on short-term or long-term.

Mr. Leonard responded that the MECRS Actuary is utilizing 30-year assumptions.

Chairman Pinard noted that with the current asset allocation, the expected return over a 30-year period is shown in the NEPC study to be 7.9% and he questioned whether his interpretation was correct. Mr. Leonard answered, that it is.

Mr. Grzejka explained that with the 5-7 expected return assumption, the board can expect more volatility.

Chairman Pinard asked if the assumed rate of return should be based on 5-7 years or on a long term.

Mr. Leonard stated that the MECRS' expected rate of return recognized by the actuary and set by the board, should correlate somewhat to the way that assets are allocated, which is why NEPC publishes the 30-year expected returns. The trustees continued to discuss short-term expectations and long-term expectations to get a better understanding of potential mixes and the expected rates of return.

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In light of potentially new asset classes listed in the NEPC study which might be considered, Chairman Pinard asked Mr. Leonard for a greater definition of private debt category.

Mr. Leonard replied that MECRS currently has some private debt exposure within its private equity portfolio, but that those investments are not categorized as purely private debt. He stated that NEPC sees further opportunity within an illiquid private debt space should the board care to investigate such opportunities.

Moving toward a closure on the day's presentation, Mr. Leonard stated that the Asset Liability Study is a formal exercise completed every three years for their clients. The studies allow clients to recognize their cash flow trends, the outlook for their portfolios, and their current asset allocations.

Chairman Pinard asked Mr. Leonard to elaborate on the cash flow projections for MECRS.

Mr. Leonard asked the trustees to turn to page 6 of the study entitled Deterministic Projections – Cash Flow. He gave a detailed explanation of the chart inclusive of Employer contributions, employee contributions and outgoing annual benefit payments.

Mr. Leonard noted that the chart does not take into account any investment returns.

Chairman Pinard requested a liquidity projection assuming a new asset allocation mix inclusive of expanded alternative investments.

Mr. Leonard agreed to provide the board with the requested study.

Moving on to manager performance as of the close of the most recent period, Mr. Leonard distributed Investment Market Update materials and reported that as of September 30, 2012 the S&P 500 is up 16.4% with large cap growth stocks as the best performing asset class year-to-date and with emerging market equities up 12.0%.

Mr. Grzejka delivered a class by class review of the other categories in the Market Update and reported positive returns for all of the sectors.

Mr. Fleury noted that MECRS had been questioned about possible impact from the Libor scandal. He stated that he was uncertain whether MECRS had any degree of exposure since Libor provided a benchmark for some investments, but not a guaranteed return.

Mr. Leonard replied that Libor affected everyone to some extent and he explained that Libor can be tied investment decisions, to loans, alternative investment and performance hurdles. Mr. Leonard opined that measuring the impact of Libor is impossible, but that NEPC will keep the trustees apprised of any new developments as it pertains to their portfolio.

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Mr. Fleury informed the trustees and the NEPC representatives of notification from the custodial bank, State Street Bank & Trust, that certain foreign currency deposits no longer paid interest and that there is actually a fee assessed monthly on cash portfolios. He questioned the NEPC representative if this was a situation where MECRS should be concerned.

Mr. Leonard responded that MECRS, non-US exposure, is in pooled funds which should, therefore, result in minimal impact on the portfolio.

Before departing, Mr. Leonard stated that he appreciates the trustees' honesty in expressing their displeasure in how the Gottex Fund recommendation was handled and he stated that NEPC will take a more formal course of action in the future. Following that statement, Mr. Leonard and Mr. Grzejka departed.

Chairman Pinard then questioned Mr. Fleury about the effect on the fund if City positions are eliminated, and he specifically asked whether the actuary needs to be notified of such events.

Mr. Fleury responded that there are two components to the Chairman's question, the normal contribution and the unfunded accrued liability. He explained that the normal contribution is an employer obligation related to the service earned by a member for the period just completed, while the unfunded accrued liability is attributed to events which impact benefit entitlements earned by which were not funded at the time service was earned. Changing the normal retirement age from 62 to 60 was an example of how the accrued liability was accumulated and it is paid off over a period of time and is expressed as a fixed dollar value and translated as a percentage of wages for each active member. When a position is eliminated, it ceases to incur normal cost, but the portion of the accrued liability which had been allocated to that position is simply divided among all remaining positions such that the same fixed dollar obligation is collected.

To the second part of the Chairman's question, Mr. Fleury noted that the actuary receives annual data from the System regarding the number of active employees, retired employees and deferred members. From that data set, it is a small matter for the actuary to recognize any permanent reductions in force.

Motion to Adjourn:

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

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to adjourn. Trustee Woitkowski moved to adjourn at 10:33 a.m., seconded by Trustee Molan, and passed unanimously by all those trustees present.

Respectfully Submitted,

Gerard E. Fleury
Executive Director