

March 12, 2013
Minutes #490

Minutes of the Board of Trustees' Meeting -1-

Call to Order: Chairman Pinard called the meeting to order at 8:35 a.m.

Present: Trustees: Chairman Donald Pinard, William Sanders, Mike Woitkowski, Richard Molan, Dianne Mercier departed at 9:45 a.m. and Robert Lynch arrived at 8:59 a.m.
MECRS Staff: Gerard Fleury and Suzanne Wilson

Absent: Mayor Gatsas,

In Attendance: Attorney John Rich of the McLane Law Firm and Ken Alberts from Gabriel, Roeder, Smith & Co.

Approval of the Minutes of the Previous Board Meeting:

Trustee Woitkowski moved to approve the board minutes of February 12, 2013, seconded by Trustee Sanders and passed by all those trustees present.

Approval of the Immediate Meeting Agenda:

It was then moved by Trustee Sanders to approve the immediate meeting agenda, seconded by Trustee Woitkowski, and passed unanimously by all those trustees present.

Chairperson Comments:

Chairman Pinard briefed the board on a meeting that he had attended on February 13, 2013, at the request of Mr. Garth Corriveau. Also in attendance were, MECRS Executive Director, Mr. Fleury, William Shaheen of Shaheen & Gordon as well as Peter Safirstein and George Pressley of Morgan & Morgan, Attorneys at Law.

Chairman Pinard explained that Morgan & Morgan is a Securities Class Action Law Firm with offices at Penn Plaza in New York City. Attorneys Corriveau and Shaheen acted in an introductory capacity while Attorney Safirstein delivered a presentation on services provided by Morgan & Morgan, of which the MECRS might avail themselves, at no charge.

Chairman Pinard briefed the board on Attorney Safirstein's presentation, where he explained that the goal of Morgan & Morgan is to work with investors to protect assets and assist in the fulfillment of fiduciary duties. One of the ways in which Morgan & Morgan helps public funds to satisfy their fiduciary obligations is to monitor class action securities litigation and to provide reports to ensure that MECRS and its agents are aware of an action whenever the Plan is eligible to participate. The reports also aid in determining critical dates in class action suits, so that the necessary forms are prepared and that filing deadlines are observed.

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At the present time, Chairman Pinard noted, some of MECRS managers and or the MECRS custodian, provide this function, with the MECRS's Executive Director filing claims when he becomes aware that the System is eligible to participate and that other agents have failed to act for any reason. Chairman Pinard also noted that MECRS received approximately \$21,000 in 2012 from its participation in class actions. If the service of Morgan & Morgan were obtained, they would be able to track class action cases and could advise or act upon those cases on behalf of MECRS if it were deemed appropriate.

Chairman Pinard went on to state that Attorney Safirstein had explained the importance of proxy voting, an area where MECRS currently does not have a policy, or any type of guidance in place for managers who may be voting those proxies on behalf of the System.

Mr. Fleury then explained that he has had the opportunity to review the contract with Morgan & Morgan, which essentially would grant them access to the MECRS trades at State Street Bank & Trust. Mr. Fleury further reported that he has been able to collect sample policies from other public funds which could be used as a template for MECRS policy advising its managers on the way that it would like them to vote on a multitude of issues routinely appearing on proxies. He stated that if it pleased the board, he would be able to provide a summary for a future meeting on how this policy structure might work. He suggested that establishing a proxy voting policy for MECRS might be in the best interests of the System.

Trustee Mercier asked what the motivation was for Morgan & Morgan to offer such services.

Trustee Molan replied that more than likely, Morgan & Morgan is hoping at some point to be named counsel in a class action suit by a plan willing to become a lead plaintiff.

At the conclusion of the discussion, there appeared to be sufficient interest to merit discussion at the next level. Morgan & Morgan had promised to provide a copy of their contract agreement for initial review and to return to Manchester and appear before the board, if there was sufficient interest.

Attorney Rich inquired whether the MECRS would have the option to opt out of a class action suit, to which Mr. Fleury explained that MECRS did not foresee itself as a lead plaintiff and did not anticipate playing an active role in a class action. He went on to explain that it would be the MECRS managers, filing on the System's behalf, through the custodian, State Street Bank & Trust, who would be doing most of the activity.

The board continued to discuss the pros and cons of participating in a class action contract with Morgan & Morgan and after lengthy discussion, it was moved by Trustee Molan to table the matter for further discussion and consideration by the trustees, and to seek a recommendation from MECRS legal counsel, seconded by Trustee Sanders and passed unanimously by all those trustees present.

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Report of the Executive Director:

Status of Administrative Cost Saving Measures - Mr. Fleury reported that in an attempt to realize cost reductions in any aspect of administrative operations which do not result in diminished service, MECRS moved the office electric service to ENH, from PSNH, some time ago and the transition still has not occurred. This measure is expected to cut the Systems electric bill by 20% once transition is accomplished. In addition, he noted that FairPoint is no longer carrier for the MECRS phone service. Voice over Internet Protocol is currently being used to provide voice telephone communications and the anticipated reduction in phone expense will eventually amount to approximately 80%.

Mr. Fleury announced that registrations are now being accepted for the 2013 Public Funds Summit East in Newport, RI on July 22 – 24th and he urged the trustees to consider attending. He stated that he has attended this conference each year, has found it informative and valuable, and he respectfully requested the board's permission to attend the summit.

The board was in full agreement to approve Mr. Fleury's request to attend the summit in Newport, RI.

In closing his report, Mr. Fleury announced that the MECRS 2012 audit conducted by Berry, Dunn, is scheduled to begin Monday, March 18th and that he did not anticipate irregularities for 2012.

Report of the Investment Committee:

Committee Chairman Molan reported that the Investment Committee met with representatives from NEPC to discuss the System's investments in portable alpha and to hear recommendations for the future of that asset class. Representing NEPC were: Kevin Leonard, Sebastian Grzejka and Richard Pszenny.

During that meeting, Committee Chairman Molan noted that NEPC provided a historical review of the asset class, highlighted the original purpose of the class within the asset allocation model, explained the difficulties which faced the two managers hired for the mandate, and culminated with NEPC's assessment for portable alpha in the future.

Committee Chairman Molan stated that while NEPC still believes that there is a place for Portable Alpha in the asset allocation model of large public funds, who can manage a portfolio themselves; it has sufficient concerns about the availability of group funds to now rule them out as advisable investment vehicles for smaller plans such as MECRS. Given that the Board has already acted to terminate Gottex Funds as one of its portable alpha managers, NEPC believes that it would be appropriate to also terminate the remaining Portable Alpha manager, Benchmark Partners, and to reallocate the proceeds between an S&P 500 Index Fund and other existing

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MECRS managers in various asset classes, at a ratio to be determined by a future meeting of the Investment Committee.

In summary, Committee Chairman Molan reported that the Investment Committee had voted to recommend the adoption of NEPC's recommendation to the full board. He explained that such a motion would terminate the management agreement with Benchmark Partners, at the earliest opportunity, with the determination of how best to reallocate the proceeds, to be left to a future meeting of the Investment Committee with NEPC.

Discussion ensued on the timing and purpose behind the change. Mr. Fleury explained that the purpose for utilizing an S&P Index Fund, would be to capture potential returns in excess of those presently associated with cash investments while providing daily liquidity. He noted however, that there would be some exposure to volatility in the S&P and that the strategy would not be risk free.

Trustee Mercier asked if the MECRS offered any retirees, a lump sum payment in lieu of a retirement annuity.

After brief discussion on that subject, Mr. Fleury replied, that there is no provision under which an employee can avail themselves of the employer contribution or of the earnings of the fund. When an individual retires, they have the option of taking an annuity or a lump sum of only the employee contributions and interest that they had made to the Plan. The lump sum option is almost never selected because the employer contributions and cumulative investment earnings become an actuarial gain for the plan and of no benefit to the retiree.

Returning to the report of the Investment Committee, Trustee Molan offered a motion to terminate Benchmark Partners and to reallocate funds at the earliest possible date, with the reallocation to be determined by the System's investment consultant at a future Investment Committee meeting. The motion received a second from Chairman Pinard and passed without objection.

Consent Agenda:

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

New Business:

Retiree Request – A MECRS retiree is requesting that the board consider a plan amendment which would allow an individual designated as a beneficiary at the time of retirement, to voluntarily waive that status.

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Mr. Fleury explained that when members retire, they are told the election of a beneficiary is an irrevocable act. The reason the election is irrevocable is because the benefit is based on joint lifetime probabilities at the time of the calculation. The age

of the named beneficiary determines the amount of the reduction factor, over the straight life option.

The System actuary, Mr. Ken Alberts interjected that in this particular case, the member would simply be removing his beneficiary, therefore, popping back up to the straight life annuity option, not adding another beneficiary.

Chairman Pinard stated that this request by a retiree would require an action by the State legislature.

Owing to the complexity of the issue, Mr. Fleury then recommended that the retiree request be handed down to the MECRS Benefits Committee for further study. He stated that it is his understanding that it is too late to get a piece of legislation in for the current legislative session. Referring the question to the Benefits Committee would afford sufficient time for continued research of this issue and for the committee to report its findings and recommendation to the full board.

After further discussion, Trustee Molan moved to refer the matter to the Benefits Committee, seconded by Chairman Pinard and passed by all those trustees present.

Presentation and Review of the Annual Actuarial Valuation – Mr. Ken Alberts from Gabriel, Roeder, Smith & Co., was present to deliver the draft, actuarial valuation results for 2012 and to answer questions that the trustees may have, prior to approval of the valuation.

First, Mr. Alberts began by explaining the purpose of the preliminary, 2012 Annual Actuarial Valuation, which is to review experience during the year, determine the computed employer contribution rates under alternate economic packages and to provide the board additional information (subsequent to the recent Experience Study done earlier in 2012) on which they will formally adopt economic assumptions to be used in the valuation.

Mr. Alberts explained that demographic assumptions were adopted by the board pursuant to an Experience Study completed in August, 2012. Final economic assumptions were not adopted by the board as part of the August study and still need to be addressed. The preliminary valuation builds upon the assumptions which were adopted by the board in August and provides two additional economic packages subsequently requested by the board in a format which allows them to choose variables which they deem to be preferable. The final valuation report will be completed using the economic assumptions selected by the board from options included in the preliminary report.

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Chairman Pinard noted that the draft valuation appears to suggest that changes in wage inflation assumptions have a bigger effect on funding obligations in the valuation results than the fluctuations in the investment return.

Mr. Alberts responded by calling the trustees attention to page A-7 which showed a summary of the results. While acknowledging Chairman Pinard's observation, he cautioned that there was another variable also at work in the comparisons and he reminded the board that under the current set of assumptions a 1.75% COLA assumption is used. In both alternative sets of assumptions, a 1.25% COLA assumption was utilized which exacerbated the trend which Chairman Pinard had observed. He explained that a post retirement COLA affects the liabilities as well as the wage inflation and assumed rate of return. Mr. Alberts cited a general rule of thumb which states that a .25% change in the interest rate is approximately equivalent to a .5% change in the wage inflation, in terms of the liabilities.

Based on the Experience Study, Mr. Alberts explained that they anticipated recognizing about a 6 million dollar loss on the assets due to the cumulative smoothing of investment returns. In addition, there was approximately a \$2.1 million difference between market and funding value, which when combined with the cumulative investment losses, raised the contribution estimates slightly.

Mr. Alberts addressed alternative 2, which lowers the current return assumption to 7.25%, lowers the estimates of the increase in benefits due to the increase in wages, and lowers the estimates on the increase in benefits due to post retirement COLA increases, which combine to result in a 20.96% employer contribution rate if this alternative were to be adopted.

Chairman Pinard asked in what dollar amount would the city contribution rate increase, to which Mr. Fleury responded that it would increase \$107, 215 from last year based upon simple calculations comparing 2012 actual amounts with 2013 projections.

Trustee Sanders asked Mr. Fleury, if alternative 2 excluded the true-up.

Mr. Fleury explained that the true-up accounts for the difference between the actual salaries paid during the year and estimated payroll values used to develop the contribution rate for that year in the preceding period. The total equates to the difference between what the contribution would have been if the City had been making contributions on a payroll period basis and the amount estimated by the previous year's valuation. He cited to Chairman Pinard, the true-up amounts listed in the valuations for this year and for last year had been taken into consideration and the true-up amount is independent from any of the alternatives presented in this valuation for the coming year.

The trustees continued to discuss the valuation results and the impact of including the true-up.

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Chairman Pinard asked Mr. Alberts, whether employee contract language was taken into consideration when formulating future obligations of the Plan.

Mr. Alberts replied that to the extent information is available, that information would be taken into consideration, however, when the Experience Study was conducted, he was not provided with any contract language.

Chairman Pinard informed Mr. Alberts that moving forward, vacation and sick leave payouts, under the AFSCME contract, have been significantly reduced for employees starting with 2010 and extending to include new hires.

Mr. Alberts explained the valuation process for projecting future liabilities and he noted that it isn't important what the provisions are when people become employed, it's important what the provisions are when the employees retire.

Next, Mr. Alberts addressed the Contribution Rate Reconciliation Chart which indicates that the contribution rate would be going from 19.72% to 20.96%. Breaking down the assumption results, Mr. Alberts explained that for each 1% ad hoc COLA increase above the assumed COLA, the UAAL will increase by approximately \$1,083,500 and the employer contribution rate will increase by approximately 0.13% (based on current payroll and a 27-year amortization period).

Trustee Sanders stated that his objective is to get the employer contribution rate up and keep it at a level and get a discount rate that will give the System some chance of generating gains moving forward. He noted that the last four years have been very volatile.

Breaking the valuation down to its component pieces, Mr. Alberts stated that gains and losses often cancel each other over a period of years, but sizable year-to-year fluctuations are common. Mr. Alberts provided details of the experience gains and losses, along with a year-by-year comparative schedule.

Mr. Alberts explained that experience during 2012 was less favorable than expected, resulting in experience loss of \$10,411,358 for pension benefits. The primary source of this loss was the difference between the 7.5% investment return assumption and the cumulative 3.8% return resulting from five year smoothing. In addition to the investment return loss, there were liability losses due to mortality and reserve transfers. The liability losses were partially offset by gains due to pay increases and turnover. It is important to note that experience is measured against the assumptions from the December 31, 2011 valuation. Overall, the pension funding status remained the same at 61.6%.

After continued discussion on the DRAFT valuation and the alternate methods, Trustee Sanders moved to adopt the economic assumptions using the proposed alternate method which lowers the

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investment rate of return to 7.25%, the wage inflation of 3.0% and the 1.25% COLA, seconded by Trustee Molan.

Chairman Pinard asked Mr. Alberts if he was comfortable with the trustees' motion to which Mr. Alberts replied that he agreed with the motion and expressed his belief that the method covers price inflation, plus real wage growth.

Trustee Sanders stated that he felt that the proposed alternate method, and in particular, lowering the assumed rate of return to 7.25%, was an appropriate decision.

The trustees voted unanimously to adopt the 2012 actuarial annual valuation, using the proposed method, lowering the assumed rate of return to 7.25%, lowering the wage inflation to 3.0% and lowering the COLA to 1.25%, resulting in a 20.96% employer contribution rate.

The trustees thanked Mr. Alberts for his presentation of the 2012 valuation and he departed.

Mr. Fleury reminded the trustees of the upcoming NEPC Client Conference on May 14, 2013 and that they had agreed to reschedule the regular BOT meeting that month in order to avoid a scheduling conflict. He noted that the registration for the NEPC Conference begins today, for those trustees interested in attending and that he would forward information on conference registration to them. Mr. Fleury also offered to have staff handle the registration process for any trustee who wished to attend, but did not care to handle registration themselves.

Mr. Fleury then asked Investment Committee Chairman Molan to select a date in which to hold an Investment Committee meeting.

After reviewing his calendar, Committee Chairman Molan scheduled a meeting of his committee on April 8, 2013 at 8:30 am.

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 10:10 a.m., seconded by Trustee Molan, and passed unanimously by all those trustees present.

Respectfully Submitted,

Gerard E. Fleury
Executive Director