July 14, 2015
Minutes #515

Minutes of the Board of Trustees' Meeting -1-

Call to Order: Chairman Pinard called the meeting to order at 8:31 a.m.

Present: Trustees: Donald Pinard, Dick Molan, Bob Lynch and Mike Woitkowski
MECRS Staff: Gerard Fleury, Sandi Aboshar and Suzanne Wilson

Absent: Mayor Gatsas, William Sanders and Dianne Mercier

In Attendance: Attorney John Rich of the McLane Law Firm, Mark LaPrade and Tyler Butler of Berry, Dunn as well as Kevin Leonard and Sebastian Grzejka of NEPC

Approval of the Minutes of the Previous Board Meeting:

Chairman Pinard entertained a motion to approve the previous board minutes of June 9, 2015.

Trustee Lynch moved to approve the board minutes of June 9, 2015, seconded by Trustee Woitkowski and passed unanimously by all those trustees present.

Approval of the Immediate Meeting Agenda:

Trustee Molan motioned to approve the immediate meeting agenda, seconded by Trustee Woitkowski and passed unanimously by all those trustees present.

Approval of the Amendments to Administrative Rule, Part 7.3: Chairman Pinard entertained a motion to approve the amendments to Administrative Rule Part 7.3, which clarify the COLA Administrative Rules regarding when sufficient funds are available through earnings for the Trustees to consider granting a COLA. The amendments were presented at the Public Hearing prior to the start of the regular board meeting.

Trustee Molan moved to adopt the amendments to Administrative Rule , Part 7.3, seconded by Trustee Lynch. Motion carried.

New Business:

System Auditors, Mr. Mark Laprade and Mr. Tyler Butler of Berry, Dunn were present to deliver the results of the MECRS 2014 Audit. - Mr. Laprade began by distributing the Executive Summary of the audit results to the trustees and outlining his presentation.

Directing the trustees attention to page 3 of the Executive Summary, Mr. Laprade stated that the audit was performed in accordance with U.S. generally accepted auditing standards and Government Auditing Standards. He stated that it is Berry, Dunn's responsibility to obtain reasonable, not absolute assurance to express an opinion about whether the financial statements prepared by management are fairly presented in all material respects.

He noted that the audit does not relieve management of its responsibility.

Mr. Laprade explained that the audit includes examining, on a test basis, evidence supporting amounts and disclosures in the financial statements, assessment of accounting principles, assessment of estimates used by management and evaluation of overall financial statement presentation. Mr. Laprade stated that Berry, Dunn's audit opinion covers the basic financial statements and does not cover other information included in the CAFR.

Moving on to the qualitative aspects of accounting practices, Mr. Laprade reported that the Retirement System adopted the provisions Governmental Accounting Standards Board (GASB) Statement No. 67 during 2014 and the application of the existing policies was not changed during 2014.

Mr. Laprade stated that there were no transactions where there is a lack of authoritative guidance or consensus and all significant transactions have been recognized in the proper period.

Mr. Laprade identified the most sensitive disclosures affecting the financial statements as, the schedule of net appreciation (depreciation) in fair value of investment, reflected in Note 3 of the financial statements, the disclosures required by GASB 40 for investments held, found in Note 7 of the financial statements, and the funded ratio of the Health Trust, reflected in Note 8, as well as the net pension liability of the Plan, found in Note 9.

Next, Mr. Laprade listed the more significant accounting estimates that affected the financial statements as the calculation of actuarially determined contributions, actuarial accrued liability and the actuarial value of plan assets of the health trust as well as the total pension liability and net pension liability of the pension trust.

Mr. Laprade went on to address the fair value of investments valued on a basis other than quoted prices in an active market ($31.3 million at 12/31/14 compared to $25.2 million at 12/31/2013) as well as the allocation of financial statement amounts between the Pension and Health Subsidy Trusts. He reported that based on the audit, it is believed that management judgments used in developing the accounting estimates are appropriate.

From an audit adjustment standpoint, Mr. Laprade reported that there were not any adjustments to the financial statements as a result of the audit process. However, he listed the four unrecorded audit adjustments for 2014 which were similar to the prior year.

Requesting input from the trustees, Mr. Laprade asked, if any of them were aware of any instances or allegations of fraud within the System, to which the trustees responded that they were not aware of any instances.

Mr. Laprade then turned the presentation over to his colleague, Mr. Tyler Butler to summarize the Required Supplementary Communications, Yellow Book Report.

Mr. Butler explained that the Yellow Book Report is required by GASB and relates to internal controls over financial reporting and compliance, however, the key distinction to note is that Berry, Dunn is not expressing an opinion on the Required Supplemental Information (RSI).

Mr. Butler explained that certain tests were performed on the Retirement System's compliance with certain provision of laws, regulations, contracts and grant agreements where noncompliance would be direct and material to the financial statements. He informed the board that the audit did not detect any instances of noncompliance or other matters that would require reporting.

Chairman Pinard asked the auditors, if the tests performed while conducting the audit each year, are the same tests as the prior year.

Mr. Laprade responded that they are required to create an element of unpredictability and to mix it up a bit, as it relates specifically to the tests on compliance laws, regulations and contracts etc.

Moving on to the next page in the presentation, Mr. Butler summarized the statement of changes in the Fiduciary Net Position which correlates to page 29 of the CAFR. He reported that the net increase in Fiduciary Net Position for period ending 2014, is $7,773,000, driven partially by Net Investment Income.

Total contributions showed a slight increase which was sufficient to cover benefit payments of $12,885,000. Other deductions Mr. Butler stated, consist primarily of refunds and administrative expenses.

Mr. Butler then reported on the impact of the implementation of GASB Statement No. 67, noting the key change that the term "Plan Net Position" is now known as "Fiduciary Net Position".

Mr. Butler went on to explain that expanded disclosures can be found in note 10 of the CAFR, as well as significant changes to Required Supplementary Information (RSI) for Pension Trust as they relate to GASB No. 67.

Attorney John Rich, asked Mr. Butler if the new chart presenting the assumed rate of return by asset class was from the MECRS Investment Consultant, NEPC, to which Mr. Butler replied that NEPC had provided the data for the new table.

Mr. Fleury stated that the new chart from NEPC will be a crucial tool for future reporting from the actuarial point of view and the financial statement point of view because it relates directly to the effectiveness of earnings in comparison to the actuarially adopted earnings assumption.

In concluding the presentation, Mr. Butler detailed the schedule of funding progress regarding the health trusts, schedule of employer contributions for the health trusts, schedule of changes in net pension liability and related ratio, schedule of investment returns net pension liability, as well as the schedule of contributions.

Mr. Fleury thanked Mr. Laprade and Mr. Butler for their collaborative approach with the introduction of GASB 67. He noted his appreciation for the professionalism of the auditors in working through the audit process.

Mr. Butler acknowledged that Mr. Fleury and staff were also professional and helpful throughout the course of the audit.

Referring to page 4 of the Required Communications, Trustee Woitkowski asked for clarification on a deficiency in internal controls.

Mr. Laprade explained that the segment in the Required Communications is simply defining what a deficiency may be and that none were identified.

Mr. Fleury elaborated by providing the board with a recent example of what a deficiency might be and where a new control was implemented, regarding the deposit process of checks received by the System.

Trustee Lynch motioned to accept and place on file the 2014 MECRS Audit Results, seconded by Trustee Molan and passed by all those trustees present.

Mr. Laprade and Mr. Butler thanked the board for their time and Mr. Laprade stated that he would be submitting the final audit letter to the System.

Consent Agenda:

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

Report of the Executive Director:

Budget Estimate for COLA Study: First, Mr. Fleury stated that pursuant to instructions issued by the Board at the June 9, 2015 meeting, an estimate has been obtained from the actuary to repeat the 2006 COLA study commissioned by the Board. The actuary has estimated that repeating the study would cost $6,000. The study itself would be conducted following the next valuation and the study's result would be available for consideration in time for annual COLA deliberations in the spring of 2016.

Chairman Pinard stated that the current contract with the Gabriel, Roeder, Smith & Co. includes two studies at no additional costs to the System and he inquired as to why the pending study would not be included as part of the two analyses in the current contract.

Mr. Fleury responded that the magnitude of the requested engagement would be outside of the two analysis included in the current contract.

Chairman Pinard then requested the dollar amount of the two analyses included in the contract, to which Mr. Fleury responded that he was not certain, but that he would inquire of GRS and report back to the board.

Status of Cash Flow: Mr. Fleury reported that as a result of capital calls for commercial real estate in June, $1,000,000 was redeemed in shares of the S&P 500 Exchange Traded Fund in order to ensure that cash flow requirements would be met. This redemption was part of $3,000,000 which the board authorized shortly after the fund was established. He also noted that NEPC was notified of the redemption to further ensure that Flash Report will recognize the change for the end of the second quarter.

July Retiree Cumulative Service Credit: Mr. Fleury informed the board that at last month's meeting, the Chairman questioned whether the cumulative service credit for the 40 people retiring in July was known. At that time, he stated that the number was not readily available, but it was subsequently compiled and the total amounts to 953.65 years. That amount is divided between City employees who amassed 804.45 years and School District employees who accumulated 149.2 years.

MECRS Website Problem Report: Mr. Fleury then reported that on July 7th, it was discovered that the MECRS website was inoperative. Technical support services at the hosting company were contacted and a diagnostic routine that they provide to clients, erroneously indicated that the site was up and operating normally. He explained that after several hours of investigation, it was discovered that our website had been migrated to another server and that the transfer had not been completed successfully. The hosting service made corrections and the website became operational once again. He informed the board that as a result of the website problem and earlier issues associated with the hosting service, replacement hosting has been added to the list of requirements as we collect proposals for a redesigned website.

Chairman Pinard asked Mr. Fleury if the System is able to view how many hits there are to the MECRS website, to which Mr. Fleury responded that the System has no way of knowing that information and that it is one of the obsolescence issues that MECRS is currently facing.

MECRS Security Review: In concluding his report, Mr. Fleury stated that as part of a review of security at MECRS, the efforts to obtain quotes for professional risk assessments has become bifurcated, with one focus placed on information technology related risk and a second focus placed on administrative and procedural processes and compliance. While this second focus is of lesser personal concern, due to confidence levels that controls are all they can be, for the board's benefit, a business focused risk assessment may make sense in that it would provide the

Board with a level of confidence that staff are maintaining adequate standards while acknowledging the possibility that a vulnerability may have been overlooked. Mr. Fleury informed the trustees he is in the process of researching firms and that he will be seeking proposals for business and computer security reviews.

Referring back to the earlier discussion regarding the COLA study from GRS, Trustee Molan moved to authorize the expense of $6,000 for the Systems Actuary, GRS, to perform a COLA Study, seconded by Trustee Lynch.

Mr. Fleury asked for clarification on the motion and whether Trustee Molan's motion added $6,000 to the existing budget or if he was requesting that a $6,000 expenditure be budgeted for next year in order to pay for the study.

Trustee Molan then amended his motion directing the Executive Director to include the expense of $6,000 to the 2016 budget for the COLA Study. Motion carried.

Trustee Woitkowsi expressed his concern regarding the GRS contract and that he would like to know the exact amount of the two analyses included in the actuarial contract with GRS. Chairman Pinard stated the he agreed with Trustee Woitkowski's concerns.

Executive Director Fleury assured the board that he will contact GRS to ask for clarification of the monetary value of the two analyses inclusive in the actuarial contract and to ensure that the COLA survey will be done within the 2016 MECRS budget. Mr. Fleury stated that he will report the results of his investigation on the matter at the Administrative & Accounting level with delivery of the DRAFT budget.

New Business:

Delivery of the Asset Liability Study from NEPC – Mr. Kevin Leonard and Mr. Sebastian Grzejka from NEPC were present to deliver the Board's requested Asset- Liability & Liquidity Study and to answer any questions or concerns that the trustees may have.

Mr. Leonard first explained that the Asset Liability Study examines how the System invests assets, that Liquidity Studies have been conducted by NEPC for the last 5-7 years, and that MECRS does have ample liquidity in the portfolio. On the Asset Liability Study side, Mr. Leonard reported that NEPC is not making any major change recommendations to the System's asset allocation, however, minor changes may be recommended within the existing portfolio.

Mr. Leonard informed the board that over the next 5-7 years, it could be a challenging environment for the System to earn the assumed rate of return of 7.25%, which could have a adverse impact on the funded ratio of the Plan.

Referring to the Executive Summary of his presentation Mr. Leonard stated the funded status of the System is projected to remain relatively level, slightly increasing over the next ten years from 64% to 68%. Current Plan liquidity is sound, but is subject to the continuation of participants and employers making the required contributions. He noted that all the information needed for the study was gathered from the System's actuarial firm Gabriel, Roeder, Smith & Co. (GRS).

Mr. Leonard explained that GRS is assuming that the System makes the 7.25% rate of return and NEPC is assuming that the System does not make the 7.25%, the differential is the expected investment return. After taking the target allocation and applying the 2015 assumptions, the 5-7 years return is coming in lower than the 7.25%

Chairman Pinard stated that the System has a strategy in place to get to 100% funded over the next 25 years, which includes the assumed rate of return of 7.25% and if the 7.25% is not met, the employer contribution rate increases, for which Mr. Leonard agreed that is a correct statement. Chairman Pinard then asked Mr. Leonard, why NEPC's study results indicate that the System is not on track.

Mr. Leonard explained that NEPC's projection is utilizing the current employer contribution rate, therefore, NEPC is assuming a 6.25% rate of return over the next 5 to 7 years with contributions being paid as expected. The trustees continued to discuss the difference between the actuarial assumption and the Investment consultant's assumption.

Mr. Leonard stated that the minor recommended changes in the asset allocation can be discussed further at the next Investment Committee meeting.

Moving on to the Liquidity Study, Mr. Leonard explained that investment programs can benefit from a portion of assets in illiquid investments, but that investing in illiquid assets adds another dimension to liquidity management. He reiterated his earlier comment that the overall Plan liquidity is sound, but subject to making the actuarially required contributions.

Mr. Fleury reminded the trustees of the Cash Flow Schedule that they receive as part of their agenda packets. That report identifies all funds coming into the Plan and all disbursements from the Plan, thus, providing a snapshot of liquidity adequacy and trend.

Mr. Leonard briefed the trustees on circumstances encountered by other Public Plans, who had experienced liquidity shortages.

In summary, Mr. Leonard stated that the MECRS funded position is projected to improve from 64% to 68% over the next 10 years and the Plan's liquidity is healthy enough to support the portfolio's allocations to less liquid alternative investments.

Mr. Leonard reported that NEPC continues to recommend the current asset allocation target with a potential for some enhancements and that the Plan continue to maintain commitments to private equity and private real assets and to review its pacing plan to commit to further real assets strategies.

Directing the trustees attention to the Liquidity Profile on page 11 of the presentation, Mr. Leonard stated that approximately 84% of total assets are available on at least a monthly basis to meet regular liquidity needs, with an additional 10% of assets available on quarterly or annual bases and the remaining 6% are in illiquid assets. He reported that the asset base has sufficient liquidity to meet projected cash needs.

Attorney Rich asked Mr. Leonard if the 84% of total assets is based on the current allocation to which Mr. Leonard replied that the 84% is as of the period ending April 30, 2015.

Working through the presentation booklet, Mr. Leonard provided the trustees with the Liquidity Analysis, and a Comparison of Asset Mixes.

Next, Mr. Leonard referred to the chart entitled, Asset Mixes Modeled: the Current target and actual allocation and two additional allocations, which were presented only for comparison purposes.

Referring to the chart, Mr. Fleury asked if the assumptions for the managers shown, associated with the allocations, are meeting their benchmark.

Mr. Leonard responded that it is a net of fees return and that they are meeting NEPC's expectation on the asset classes with a standard deviation of return. Mr. Leonard continued to provide the trustees with a detailed explanation of the asset mixes.

Mr. Fleury reiterated his concern regarding the chart projections for the managers not meeting their benchmark.

Mr. Grzejka moved on to address the Asset Liability Projections and the information that the Systems' actuary, GRS, has provided. He stated that despite lower than expected asset performance in 2014, funded position increased at 12/31/2014 as well as 12/31/2015. The Actuarial Value of assets currently lags market value as past gains remain to be recognized in future years. He noted that actuarial value is expected to surpass market value in 2017 as gains are realized and future losses become unrecognized. Mr. Grzejka noted that small losses are expected in each year as the current expected return of 6.2% is less than the assumed return of 7.25%

Mr. Fleury asked how the Study is expected to act as a tool that the board can use to set direction for future investment decisions.

Mr. Grzejka stated that the key part of their presentation asks the question of whether the portfolio's current structure is prudent for what NEPC is trying to achieve over the long term, and that the answer is "Yes." The second question would be, "Is the Plan's portfolio taking on liquidity obligations that they cannot meet?" and that answer is, no.

Mr. Grzejka acknowledged that the Plan is structured appropriately and the current target allocation is prudent. but not perfect. He added that enhancements can be made, which will be addressed at the next MECRS Investment Committee Meeting.

Attorney Rich referred to page 24 of the presentation and asked Mr. Leonard to explain the reference to the Median Public Fund.

Mr. Leonard responded that the Median Public Fund is defined as the average allocation of all Public Funds as reported by the consulting industry.

Mr. Fleury stated that as the System's Executive Director, he wanted to take the opportunity to express his concerns regarding the poor performance of Wellington Management and the hedge fund allocation. He also called attention to other issues within the portfolio which he felt that the Investment Committee and NEPC should be addressing.

Investment Committee Chairman Molan agreed with Mr. Fleury and stated that the Investment Committee will address the asset classes in question at the next scheduled meeting.

Mr. Leonard agreed with Mr. Fleury and reported that the Plan has an Investment Policy and noted that overall, the portfolio has outperformed the policy index.

Trustee Lynch moved to accept the Asset –Liability and Liquidity Study and place on file, seconded by Trustee Molan and passed by all those trustees present.

Next Meeting Schedule:

The next MECRS Board of Trustees Meeting is scheduled for August 11, 2015 at 8:30 a.m.

Motion to Adjourn:

Having conducted all the business of the day, Trustee Molan moved to adjourn the meeting at 10:40 a.m. seconded by Trustee Lynch and passed unanimously by all those trustees present.

Respectfully Submitted,

Gerard E. Fleury
Executive Director