March 10, 2015
Minutes #511

Minutes of the Board of Trustees' Meeting -1-

Call to Order: Chairman Pinard called the meeting to order at 8:32 a.m.

Present: Trustees: Donald Pinard, Robert Lynch, Mike Woitkowski, Bill Sanders, and Dianne Mercier
MECRS Staff: Gerard Fleury, Sandi Aboshar and Suzanne Wilson

Absent: Richard Molan and Mayor Gatsas

In Attendance: Attorney John Rich of the McLane Law Firm, Ken Alberts of Gabriel, Roeder, Smith & Co., Kevin Leonard and Sebastian Grzejka, both from NEPC and Mark Laprade of Berry Dunn

Approval of the Minutes of the Previous Board Meeting:

Chairman Pinard entertained a motion to approve the previous board minutes of January 13, 2015.

Trustee Lynch moved to approve the board minutes of January 13, 2015, seconded by Trustee Woitkowski and passed unanimously by all those trustees present.

Approval of the Immediate Meeting Agenda:

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

New Business:

Ken Alberts of Gabriel, Roeder, Smith & Co – Delivery of the 2014 Preliminary Actuarial Valuation Results - Before beginning with his presentation Mr. Alberts asked if the trustees had any questions after their initial review of the preliminary valuation results that they had received electronically.

In response to Mr. Alberts' question, Mr. Fleury asked him to elaborate on the percentage of utilization on the health sub-trust and the slight increase in the sub-trust costs. Mr. Fleury stated, that the traditional underutilization of the sub-trusts had changed, which would be attributed to the increased costs.

Mr. Alberts explained the difference between the sub-trust and the pension benefit funding obligations. The health sub-trust is not a pay related benefit, and because the payroll did not increase as much as was anticipated, the sub-trust rate increased in order to maintain the same contribution that is needed to meeting the funding obligation. Also, he stated that experience during the year was unique, with the System experiencing a much larger utilization of early retirements than in the past, which would add more people to the roles on the health side, and which also resulted in a slight increase. Mr. Alberts noted that the City is currently offering an early retirement incentive window, which may account for the early retirement experience.

Mr. Alberts then reported that experience during the year ending December 31, 2014 was less favorable than assumed resulting in a small experience loss. The primary sources of experience losses were early retirements (10 actual verses 5.1 expected) and benefits for new retirees larger than expected. Losses were partially offset by pay increases less than assumed and recognized investment gains greater than assumed (7.25% assumed versus 7.38% recognized). Overall, he stated that the experience loss was approximately 0.8% of the beginning of the year liabilities. The pension funding status increased from 63.5% to 64.3% during the year.

Working through the presentation booklet, Mr. Alberts referred to a demographic chart labeled, Active Members Added to and Removed From Rolls, and he detailed actual experience versus expected experience of plan participants.

Next Mr. Alberts asked the trustees to turn to page A-13 of the booklet, and he called their attention to the Comparative Statement, which indicated that in 2014, the System had 1200 active members and that average pay increased by 1.3%. He noted that the expected increase was 3% which produces a liability gain, and also caused the rate increase. Mr. Alberts elaborated that when there is an unfunded liability and it is amortized over a level percent of payroll, the payroll is expected to grow by 3% and did not. As a result, the rate increased.

Trustee Mercier asked Mr. Alberts for his future projection of the Ratio of Retired to Active members, to which Mr. Alberts responded, that due to the active group contracting, he estimated future ratios in the area of 1.4 versus the 2014 rate of 1.59.

Moving on to Summary of Current Asset Information, Mr. Alberts stated that reports indicate that future contributions may be less than the benefits which are being paid out over the next couple of years, which he explained is the purpose of the System prefunding.

Chairman Pinard stated that it was his understanding that Mr. Alberts' projection regarding contributions does not include investment revenue, to which Mr. Alberts replied that Mr. Pinard was correct.

Trustee Sanders expressed his concern regarding Mr. Alberts' comment on the contributions being less than the benefits paid- out, due to the System's 64 % funded ratio.

Mr. Alberts responded that the issue is being raised, so that the Board is aware of the situation, which is the natural progression of a maturing pension fund. As the Plan matures, the System has the pre-funding program in place and steps are being made to get to the 100% funding level.

After a lengthy discussion and comparison of peer retirement funds and their funding status, Mr. Leonard suggested that the board may want to consider requesting an Asset/ Liquidity Study that will show liquid assets within the MECRS portfolio that can be sold, building in different investment earnings assumptions and income, which will also provide the board with a future liquidity profile.

Mr. Alberts turned the trustee's attention to page A-4 of the presentation booklet, Development of Funding Value of Assets. He explained that the 2014 market performance rate was about 3.6% net of investment expenses, versus the expected 7.25 % assumed rate of return. The funding value of assets for 2014 recognizes the assumed investment income which is $13,518,352 and the portfolio actually received $6,868,180, resulting in a $6,650,172 loss which will be phased in over the next 5 years. In 2014 he continued, 1/5 of that loss, $1,330,034, was added to the portion of gains and losses from the previous 4 years scheduled to be recognized this year, resulting in an overall gain of $250,000. Fast forwarding to next year, it is anticipated that there will be a market loss in total if the market rate of return is below 10% and the trustees should be prepared for upward pressure on contributions should the returns be disappointing. Two years from now, however, Mr. Alberts projected that the System is looking at a sizable gain which will create volatility in the contribution rate over the following few years, barring gains and losses in those years.

Next Mr. Alberts detailed the aggregate experience for 2014, which basically indicates that the assumption results were very reasonable and close to expectations. Gains and losses often cancel each other over a period of years, but sizable year-to-year fluctuations are common.

Moving on to the Contribution Rate Reconciliation Chart on page A-7 of the preliminary valuation booklet, Mr. Alberts detailed the miscellaneous factors which resulted in a slight increase in the employer contribution rate from 21.13% to 21.71%.

Mr. Alberts reported that 10 years ago the System had about 150 more employees than in 2014. If those employees had been replaced, the contribution rate would be about 1% less today.

The trustees continued to discuss the factors driving the employer contribution rate, relative to the percentage of payroll and the unfunded actuarial accrued liability. Trustee Sanders stated that the past actuarial calculations were extremely weak and that today, he believes the System receives a more quality valuation. He also noted that the unfunded accrued liability of 12.05% is a major problem and it will become very expensive due to the amortization period shortening. Trustee Mercier concurred with Trustee Sanders comment.

In response to Trustee Sanders concerns, Mr. Alberts stated that he is aware of other GRS clients, who have passed legislation that prohibits any changes to upward benefit increases, until their Plan is at a certain level of funding.

Minutes of the Board of Trustees' Meeting -4-

Attorney Rich asked Mr. Alberts, when the other GRS clients had passed their legislation, was it inclusive of COLAs to which Mr. Alberts responded no, because the COLAs were already built in before the legislation was put in place.

Mr. Alberts briefly touched upon an additional concept of layering the amortization period, which the trustees may want to consider, when they approach the 15-year range point on the amortization schedule.

Trustee Mercier stated that she is not confident in assuming a 7.25% assumed rate over time. She inquired as to how the trustees should be viewing these current numbers, so that the board can create a strategy or road map for future trustees.

Mr. Alberts said that the board could also consider a quicker amortization period or adopting a contribution that is higher, thus creating contribution stabilization reserve, in an effort to keep the contribution stable. The trustees continued to discuss all future options at length.

Mr. Leonard stated that lowering the assumed rate is a prudent thing and he noted the effects of lowering the rate. He briefly spoke about the possibility of using a pension obligation bond and explained their purpose. In theory Mr. Leonard stated, it's a way in which the board could take debt from one side of the balance sheet to the other, the board would become more conservative in its investment pool and the Plan would be in a much better funding position. He noted, however, that the downside risk would be greater. Mr. Leonard then provided the trustees with success stories of pension funds who have chosen the option of using pension obligation bonds.

Trustee Sanders stated that he was aware of another Pension Plan that has also utilized the option of the pension obligation bond and did not have positive results.

The trustees continued to have a lengthy discussion on the effects of lowering the assumed rate of return and their options in methods and assumptions, moving forward. Mr. Leonard reiterated his earlier offer by stating that a Liability Study would provide the trustees with a determination of risk parameters and which would give them the comfort level needed to adopt options for the Plan.

Trustee Sanders moved to direct NEPC representatives to conduct the MECRS Asset Liability Study, followed by a detailed review of the study, with a spectrum of outcomes.

Mr. Leonard stated that it is now a prudent time to conduct the study, noting that the service was part of the NEPC contract and that it would be done at no additional cost to the System.

Trustee Woitkowski seconded the motion to move forward with the Asset Liability Study and the motion passed by all those trustees present.

It was moved by Trustee Sanders to accept the preliminary valuation, inclusive of the set of assumptions and to move forward with the valuation, seconded by Trustee Woitkowski and passed by all those trustees present.

Referring to SB 402, Service Credit Upgrade and the actuarial effect to the fund, Attorney Rich inquired as to the number of members who are eligible for SB 402 and have not upgraded their pre-1999 service.

Mr. Fleury responded that he will generate a report of participants who remain eligible to update their pre-1999 time and will submit the results as an informational item as part of the MECRS April Agenda.

New England Pension Consultants – Investment Performance Analysis – Kevin Leonard and Sebastian Grzejka were in attendance to present the performance analysis and to answer questions regarding the earnings assumption and the funded ratio of the Plan.

Before Mr. Grzejka began his presentation he stated that as a result of the earlier directive from the board, asking NEPC to conduct an Asset Liability Study, he would refrain from presenting his planned discussion on the energy market opportunities, due to the possible changes in the MECRS asset allocation which might result from the study.

Referring to the handout, January 2015 Flash Report, Mr. Grzejka reported that the MECRS portfolio finished at roughly $201 million, attributing a large portion to US Equities.

Mr. Grzejka reported that after a period of poor performance, Mellon Capital has come back strong with 3.4% for the month of January and up 14% for 2014. Mr. Grzejka systematically provided the trustees with performance results of domestic equity managers as well as other market sectors.

Regarding the Global Asset Allocation Composite, Mr. Fleury asked Mr. Leonard if he felt that Mellon Capital, would be mutually exclusive from the Asset Liability Study.

Mr. Leonard responded that NEPC in not recommending that MECRS discontinue global asset allocation, just possibly a modification to the Global Asset Allocation strategies moving forward. Mr. Fleury, on behalf of Investment Committee Chairman Molan who was unable to attend the meeting, asked Mr. Leonard if NEPC thought there would be a need to schedule reviews for any of the MECRS managers or to consider a replacement. He noted that if there was cause for such meeting, that a timeframe would need to be set.

Mr. Leonard responded that the most important thing, at this time, is to review the MECRS asset allocation as well as the risk within the sectors. There is not a current manager that NEPC is recommending for review at this time.

Moving on to the International Equity Composite, Mr. Leonard stated that managers in this sector take advantage of volatility in international equities and hedge part of the exposure to the US dollar. Mr. Grzejka reported that in January, both International Equity managers outperformed their benchmark.

Mr. Grzejka provided the trustees with performance results on Fixed Income and the real estate composite/real asset composite. He reported that following the pending Asset Liability Review, NEPC will have a recommendation on whether to retain fixed income manager, Standish, Emerging Market Debt, and whether or not to invest in a blended type of currency, therefore, reducing the effect of currency volatility on the portfolio.

Mr. Fleury inquired as to the poor performance with Wellington Diversified Inflation Hedge to which Mr. Grzejka responded that the poor performance is attributed to decline in oil prices, over 55% of the portfolio is natural resource equities.

Mr. Fleury asked if Wellington was caught unaware of what was happening in the markets and may have been improperly postured for the decline.

Mr. Grzejka responded that Wellington's strategy was on target and they are fully invested at all times, there is a reasoning behind their strategy, which, in theory, poses an opportunity.

Referring to the final page within the Total Fund Performance Detail, Mr. Grzejka reported positive returns within hedge fund composites as well as the private equity composite.

Mr. Fleury asked the NEPC representatives for their insight on events within Private Advisors and a seeming delay in their issuance of capital calls.

Mr. Leonard responded that their performance is attributed to the J curve impact and there should be a pick-up in the future capital calls.

Before departing Mr. Leonard stated that NEPC will begin the process of the Asset Liability Study which will be followed by a detailed review with the MECRS Board. He also mentioned the upcoming NEPC Annual Conference scheduled for May, 19th and 20th at the Boston Convention Center, and he urged all trustees to attend.

<u>Request For Motion –</u> Mr. Fleury requested the transfer of previously approved and budgeted funds for 2014, in the amount of $25,589.27, from areas with a surplus appropriation to areas

which ran a deficit. He informed the board that the transfer is simply a common annual event, prior to the 2014 Audit observation.

Trustee Sanders moved to approve the requested transfer of previously approved budgeted funds, seconded by Trustee Woitkowski and passed unanimously by all those trustees present.

Consent Agenda:

Trustee Lynch moved to approve the February and March Consent Agendas, seconded by Trustee Sanders and passed unanimously by all those trustees present.

Report of the Administrative & Accounting Committee:

Administrative & Accounting Committee Chairman Woitkowski reported that the A&A Committee met in a scheduled session on March 9, 2015 to discuss the performance of the Executive Director**.** The committee was provided with a copy of comments from Board Chairman Pinard, reviewed and discussed the self-assessment portion of the review process which was completed by Mr. Fleury, and provided feedback to Mr. Fleury on his performance to date. The subject of Mr. Fleury's continued tenure with the organization came up, at which time, he expressed an interest in continuing in his role, in the absence of any specific retirement plans and pledged to provide a year's advance notice should his intentions change. Committee members expressed satisfaction with Mr. Fleury's performance and voted to bring the matter to Chairman Pinard's attention at a session of the full MECRS board. He stated that upon signing by the Executive Director and the Chairman of the board, the performance evaluation will be placed on file.

Next, Committee Chairman Woitkowski reported on the review of the draft changes to Administrative Rule 7. The committee reviewed draft revisions to the COLA rule which would add language to address the treatment of COLA for retirees who elect to return to active service and eventually retire again. Committee Chairman Woitkowski listed three important issues for which the rules are presently silent. 1.) Are COLAs awarded while a member is retired, automatically reinstated when a retiree returns to active service and then retires again, 2). Are COLAs awarded to retirees, applied to a previously retired member who has returned to active service, once that member retires again, and 3) When does a previously retired member, who elected to return to service again, become eligible for COLAs after retiring once again ?

The new sections drafted by staff and refined by counsel, provided several options which allowed the committee to choose the practice they thought most appropriate. After lengthy discussion by the A&A Committee, Committee Chairman Woitkowski stated, the committee voted to recommend Part 7.7 and 7.7.1 as drafted along with Option 1 of Part 7.7.2. The committee also voted to recommend Option 1 of Part 7.7.3, with a provision that further discussion on the fairness of the practice called for by that language, be conducted at the full board level. The rule should then be released for 30 days of public comment and a public hearing. Mr. Fleury elaborated further on the committees' discussion of the amended draft presented to the board.

It was moved by Committee Chairman Woitkowski that the proposed additions to Administrative Rule 7.7 be released for 30 days of public comment, followed by a public hearing and subsequently voted upon at a regularly scheduled meeting of the full MECRS Board. Trustee Mercier offered a second to the motion and the motion passed unanimously by all those trustees present.

In addition, Chairman Woitkowski reported on the review draft changes to By-Law 18 Regarding Election Notifications. The committee reviewed draft amendments to Sections 18.02, 18.04 and 18.09 of the MECRS By-Laws, which address election notifications.

Mr. Fleury pointed out that three separate mailings are required under the present procedure and that a more cost effective way of accomplishing the task was available in two out of three of those steps.

Committee Chairman Woitkowski noted that the loss of the courier service formerly provided by the City Clerk's office, was the single proximate cause of a lack of awareness by active members of election events.

Committee Chairman Woitkowski moved that the proposed amendments to Sections 18.02, 18.04 and 18.09 be released for 30 days of public comment, followed by a public hearing and subsequently voted upon at a regularly scheduled meeting of the full MECRS Board. Trustee Mercier seconded the motion and motion passed unanimously by all those trustees present.

Before the meeting was adjourned, Mr. Fleury noted that the Labor Department has released the CPI numbers for 2014 and the inflation rate is .75. Armed with the valuation information, he stated, the board can now populate the formulas for the pending COLA review to be discussed at the next Board of Trustees meeting.

Report of the Executive Director:

Due to the lengthy nature of the meeting, the board elected to forego the verbal presentation of Mr. Fleury's monthly report. Trustee Mercier noted that she had read his report and was comfortable with foregoing the presentation.

Minutes of the Board of Trustees' Meeting -9-

Motion to Adjourn:

Having conducted all the business of the day, Trustee Lynch moved to adjourn the meeting at 10:37 a.m. seconded by Trustee Sanders and passed unanimously by all those trustees present.

Respectfully Submitted

Gerard E. Fleury
Executive Director

9020745_1.docx
April 14, 2015 10:03:35 AM