

April 12, 2016
Minutes #521

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, William Sanders, Bob Lynch, Dianne Mercier and Dick Molan
MECRS Staff: Gerard Fleury and Sandi Aboshar

Absent: Mike Woitkowski and Mayor Gatsas

In Attendance: Representative, 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 March 8, 2016

Trustee Molan moved to approve the board minutes of March 8, 2016, seconded by Trustee Lynch and passed unanimously by all those trustees present.

Approval of the Immediate Meeting Agenda:

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

Report of the Executive Director:

Status Report – Request for IRS Determination Letter –Reaffirmation as a Qualified Plan: Mr. Fleury began by addressing the status, regarding the MECRS's Board's decision back in the fall of 2015, to pursue a Determination Letter from the IRS, in keeping with a recommendation from counsel. Mr. Fleury reported that in January of 2016, the application and all of its respective supporting documents were filed with IRS and on March 9, 2016 a letter of acknowledgement was received from the IRS. He stated that the process is expected to take between 60 to 150 days to complete and the board will be kept informed of any developments.

Website Development Status Report: Next, Mr. Fleury informed the board that work on a replacement website continues on schedule. MECRS staff has held meetings with the vendor to review progress and the project is moving as planned. He noted that the project completion date is late May or early June of 2016.

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MECRS IT Security Audit Completed: Moving on, Mr. Fleury informed the board that an Information Technology Security Audit, which began on February 25, 2016, has been completed and reports on the results are now in hand. RSM conducted the audit and MECRS staff and third party affiliates will be reviewing the findings in the coming weeks. The reports are generally favorable and do not contain any unpleasant surprises but there is at least one observation which missed the existence of internal controls and which needs to be addressed with RSM. Mr. Fleury stated that a formal presentation of the final results will be made to the board at a future meeting, and that there were no immediate action items which need to be addressed.

MECRS Audit in Progress: In closing his report, Mr. Fleury stated that the auditors from Berry Dunn have begun the audit of MECRS for 2015. All of the required materials have been provided to the auditors, and staff does not anticipate observations or findings which might be of concern. The board may expect a report on the audit by June or July as is customary.

In closing his report Mr. Fleury informed the board that after a lengthy review of contract negotiations with real estate manager, Brookfield Asset Mgmt. Company, NEPC consultants and the MECRS's legal counsel have recommended, not to pursue the real estate allocation with Brookfield.

Before moving on with the next agenda item, the trustees briefly discussed more efficient and cost effective procedures, for use by MECRS when it explores future investment opportunities. The objective would be to avoid sunken costs associated with subscription agreements if prohibitive constraints were included in the language.

Trustee Sanders asked Mr. Fleury when the next MECRS Retirement System Seminar would be scheduled, to which Mr. Fleury replied that pending availability of the guest speakers, it would be scheduled sometime between September and November of 2016.

Report of the Administrative & Accounting Committee:

Due to the absence of Committee Chairman Woitkowski, Committee Member Lynch delivered the results of the A&A meeting held, April 7, 2016.

Committee Member Lynch reported that the committee reviewed the inflation measurements for 2015 and the COLA related information contained in the most recent valuation, which is used in Administrative Rule 7, in consideration of whether or not to award cost of living adjustments. After the committees' deliberation on the COLA question, Committee Member Lynch stated that he had offered a motion that the A&A committee make the recommendation to the MECRS

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Board, to forego any COLA for 2016. The motion received a second and passed without objection. The primary reasons for the motion were low inflation, tight cash flow resulting from record retirements and the disappointing earnings on investments. After discussion by the board, Trustee Lynch offered a motion, not to grant a COLA for 2016, seconded by Trustee Molan and passed unanimously by all those trustees present.

Report of the Investment Committee:

Status of Past Decisions - Committee Chairman Molan began by explaining that although the MECRS Investment Committee has not met since the March Board of Trustees' meeting, that he would provide the trustees on the status of board decisions, which were based on the Investment Committee's recommendation.

Real Estate Investment: Committee Chairman Molan reported that the board decision to expand investments in Real Estate, with the hiring of three new managers has progressed. Subscription agreements have been signed with Blue Vista and the DSF Group, with both funds awaiting capital calls.

Investment with Blackrock: Committee Chairman Molan reported that at the March Board of Trustees meeting, the board authorized an Investment of up to \$8 million with Blackrock in their SIO Fund. The board further authorized staff to make an initial purchase in Blackrock at a lesser value, in order to accommodate cash flow constraints. He noted that \$8 million was redeemed from the S&P 500 Exchange Traded Fund and \$5 million was subsequently used to purchase Blackrock shares, \$1.1 million from the liquidation of Standish Mellon in December of 2015 remains in the S&P 500 ETF fund and there is at least another \$1 million in cash, which can be dedicated to Blackrock in the coming months to bring the MECRS Fund within \$900,000 of the board's target authorization without needing to sell other existing holdings.

Pending Report from NEPC: In closing his report, Committee Chairman Molan stated that NEPC investment representative, Sebastian Grzejka was present to deliver a revised cash flow and investment plan for the balance of 2016.

Previous Business:

MECRS 2015 Actuarial Valuation - It was moved by Trustee Molan to accept and place of file the final version of the MECRS 2015 Actuarial Valuation.

Executive Director Fleury noted that at the March meeting the board accepted and placed on file the preliminary valuation and that the final version is inclusive of schedules that were pending at that time. Motion carried.

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Consent Agenda:

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

Previous Business:

Continuation of Discussion on March 8, 2016 with NEPC Representatives on Asset Allocation and Investment Objectives for the Balance of 2016 – Mr. Sebastian Grzejka was present for a review of the MECRS asset allocation and to deliver a rebalancing recommendation.

Mr. Grzejka distributed the Assumption and Actions booklet and directed the trustees to turn to page one of the handouts. He listed the 2016 capital market observations which are centered around central bank policy, both in the US and abroad, therefore providing the board with background for NEPC's recommended portfolio actions.

Mr. Grzejka asked the trustees to turn to page 7 of the booklet, Federal Funds Expectations. He explained that the quarterly chart provides a detail of the Fed expectations on interest rates as well as the market expectations on interest rates. The chart indicated that the 2017, 2018 market expectation will be priced much lower than the Federal Funds Futures, however he noted that one year ago, the chart had indicated the opposite. Mr. Grzejka noted the importance of the market expectations, which calls for a steady increase but at a lower rate. He stated that if the market expectations play out, then the MECRS's fixed income investments will have a chance of shifting their underlying allocation without being impacted by a sharp increase in rates.

Moving on, Mr. Grzejka referred to the US and Global Economic Charts, noting that the US has de-levered, leaving the consumer in a better financial position of slow growth and the global economy also growing, by instituting quantitative easing plans. NEPC is therefore recommending balancing the exposure between US and non-US, by increasing the US commitment.

Mr. Grzejka then detailed the Oil and High Yield Energy Sector chart which indicated that the oil price collapse, presents opportunities for private strategies.

Mr. Grzejka went on to list the 2016 general actions for NEPC Clients. Overall, he stated NEPC would like to maintain exposure to US risk assets in a low return environment, reaffirm commitment to emerging market equities, seek tactical fixed income strategies but preserve duration exposure, and to explore positive yielding assets associated with energy market distress.

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Working through the presentation booklet, Mr. Grzejka referred to the 2016 Asset Allocation Review. He stated that relative to last year, most asset classes have seen an increase in expected return with the exception of cash and real assets. The Plan's expected return therefore slightly increased from 2015. The chart also provided a 5-7 year and 30 year outlook.

Trustee Sanders noted the importance of the upcoming Special Board of Trustees meeting, scheduled for Thursday, April 28, 2016 at 8:30, whereby the trustees will meet with the System's actuary to discuss factors within the board's control which can have a cost impact on the Plan.

Mr. Fleury stated that he has prepared a detailed list of factors that impact the employer contribution rate and funding level. He expected that some of these will be , discussed at the special meeting. The list has been reviewed by the Chairman Pinard, Attorney John Rich and Ken Alberts from GRS. Those topics are expected to be discussed in detail at the Special Board of Trustees meeting.

Mr. Grzejka resumed his presentation and directed the board to turn to page 18 of the booklet entitled, Asset Allocation Considerations. He stated that NEPC believes that the current target provides a solid investment foundation, however, enhancements can be made to better position the portfolio for today's opportunities. He went on to report that he had been tasked with showing different mixes, conservative, moderate and aggressive compared to the current target allocation. He explained the three allocation scenarios in detail and all three provide a sufficient level of liquidity for the portfolio but with differing risk/reward ratios.

After a lengthy discussion of the scenario analysis, probability of returns and liquidity comparisons, Mr. Grzejka stated that NEPC's recommendation for the System is to adopt the moderate mix. That option will not require a significant restructuring of the MECRS portfolio.

It was moved by Trustee Molan to accept NEPC's recommendation to adopt the moderate allocation mix, seconded by Trustee Lynch.

Mr. Fleury asked Mr. Grzejka when the moderate mix allocation would be phased in to which Mr. Grzejka responded that it would take three to six months for the complete restructuring of the portfolio from the current target to the moderate mix. Mr. Grzejka also added that as part of the moderate mix, NEPC is recommending the termination of Wellington Management from the MECRS portfolio and those funds would be re-allocated to core real estate.

Mr. Grzejka then went on to prioritize the steps for implementing the restructuring of the MECRS portfolio.

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Trustee Molan than revised his original motion to accept NEPC's recommendations to adopt the moderate allocation mix as the target allocation in order to add the termination of Wellington Asset Management, from the System's portfolio, seconded by trustee Lynch and passed unanimously by all those trustees present.

As part of the review, Mr. Grzejka stated that NEPC would also like the board to consider a review of international equity exposure and structure, to consider adding an absolute return fixed income manager, to reorganize hedge fund allocation to include liquid alternatives, and to continue a normal pace to the private equity commitment. He indicated that NEPC will draft a private equity pacing Plan for the boards consideration.

After brief discussion regarding NEPC's recommendation, Trustee Molan moved to execute the strategy on page 28 of the NEPC Outlook and to liquidate \$3 million from the Vanguard Fund to Blackrock and \$2.5 million from Mellon Capital into Cash, seconded by Trustee Lynch and passed unanimously by all those trustees present.

Mr. Fleury referred to page 18 of the booklet, regarding liquid alternatives, and he asked Mr. Grzejka to elaborate on the suite of managers that fit in the alternatives category.

Mr. Grzejka replied that the upcoming NEPC Client Conference is scheduled to provide an overview on liquid alternatives, which means hedge fund replication strategies without the liquidity constraints. He then listed some of the alternative managers that are expected to be recognized during the Client Conference.

In closing his presentation, Mr. Grzejka provided a brief summary of the MECRS February Flash Report.

Mr. Fleury reminded the trustees of the upcoming NEPC Client Conference, scheduled for May 10, 2016 and urged the trustees to attend.

Motion to Adjourn:

Having conducted all the business of the day, Trustee Sanders moved to adjourn the meeting at 9:43 a.m. seconded by Trustee Mercier and passed unanimously by all those trustees present.

Respectfully Submitted,

Gerard E. Fleury
Executive Director

