March 8, 2016
Minutes #520

Minutes of the Board of Trustees' Meeting -1-

Call to Order: Chairman Pinard called the meeting to order at 8:30 a.m.

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

Absent: Dianne Mercier and Mayor Gatsas

In Attendance: Attorney John Rich of the McLane Middleton Law Firm, Representatives, Sebastian Grzejka and Kevin Leonard of NEPC and Mark Laprade, Principal of Berry Dunn
Ken Alberts, GRS

Approval of the Minutes of the Previous Board Meeting:

Chairman Pinard entertained a motion to approve the previous board minutes of January 12, 2016.

Trustee Lynch moved to approve the board minutes of January 12, 2016, seconded by Trustee Woitkowski and passed unanimously by all those trustees present.

Approval of the Immediate Meeting Agenda:

Trustee Molan moved 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 2015 Preliminary Actuarial Valuation Results - Before beginning with his presentation, Mr. Alberts asked if the trustees had any questions or comments after their initial review of the preliminary valuation results that they had received in advance of the meeting.

There being no comments or questions, Mr. Alberts began by directing the trustees to turn to page A4, Development of Funding Value of Assets, of the presentation booklet. He explained that the funding value of assets recognizes assumed investment income fully, each year. Differences between actual and assumed investment income are phased-in over a 5-year period. During periods when investment performance exceeds the current assumed rate of 7.25%, the funding value of assets will tend to be less than the Market Value. During periods when investment performance is less than the assumed rate, 7.25%, the funding value of assets will tend to be greater than the market value.

Mr. Alberts reported that the recognized rate of return was 4.8%, despite the fact that the return on the market value basis was negative 2.5% (net of expenses). This he noted, is due to the fact that investment experience above or below the assumed rate is spread over 5 years. One fifth of this year's loss ($5,015,133) was added to the portion of gains and losses from the previous 4 years and scheduled to be recognized this year, resulting in an overall actuarial loss of $19.5 million. Mr. Alberts stated that next year, GRS is anticipating, recognizing a market loss in total, if the market rate of return is below 11% (after accounting for the gains and losses scheduled to be recognized next year), resulting in upward pressure on contributions, to the extent that it is not offset in the future, by future gains.

Mr. Alberts explained that funding the Retirement System comes from a few sources. Revenue coming in is made up of employee contributions, employer contributions and investment income. If the investment income is not sufficient, one of the other two pieces has to make up for it. Benefit promises fall under the category of expenses. He reported the preliminary 2015 funding value as $209,192,563, compared to a market value of $196,110,677 greater by 6%.

Next, Mr. Alberts reported that the Non-Investment Net Cash Flow was negative $939,910. which represents contributions, minus benefit payments. He noted that the pension funds ultimately reach this status, expecting that over time, the investment return income would pay for the benefit payments. Therefore, he stated, the Board should be aware of the current status which is to be expected. He also stated, there is no cause for immediate concern, but that it does introduce more volatility into the asset allocation modeling.

Turning the trustee's attention to page A-3 of the presentation, Summary of Current Asset Information, Mr. Alberts reported that the 2015 total revenues were $25,898,765, expenditures totaled $17,284,844, and the ending funding value of $209,192,563 results in a recognized rate of return of 4.8%.

Chairman Pinard asked for clarification on the 2015 employer contribution increase of $1 million from 2014, in which Mr. Alberts responded that Chairman Pinard's observation was correct and that the employer contribution is expected to increase another $1 million in 2016.

Working through the presentation, Mr. Alberts directed the trustees to turn to the chart on page A-15, detailing Active Members Added To and Removed from the Rolls. He reported the number of expected retirees/beneficiaries expected to come off the rolls, ending in 2015, was actually less than expected. He provided the trustees with the number of actual vs. expected plan participants who have terminated employment with the City, the number of members who have withdrawn or vested service, as well as the number of plan participants who have died in service, all of which did not have a big effect on the valuation modeling. He also noted that the number of retirements in 2015 was more than expected, with greater pension amounts as well. Mr. Alberts stated that the early retirement incentive, which expired on June 30, 2015, was apparently responsible for the increase in retirements in 2015.

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Mr. Alberts referred to the Pension Benefits as a Percent of Payroll and Active Members & Benefit Recipients charts. He reported on the large increase in annual benefit payments from 23.8% in 2014 to 29.3% for year ending 2015, therefore, putting a strain on the Plan.

Trustee Sanders stated that the early retirement payout incentive had been in effect for a three year period and it did not have an impact on the retirement plan until its final year. The incentive played a significant role in retirements, before its expiration of June 30, 2015. Moving forward, he stated, the System will probably see fewer retirements and some City positions will remain vacant. However, if the payroll is artificially low on the valuation date, then the benefits relative to the higher payroll will go down.

Working through the presentation booklet, Mr. Alberts stated that actual experience will never (except by coincidence) match exactly with assumed experience. Gains and losses often cancel each other over a period of years, but sizable year-to-year fluctuations are common. He provided details on the derivation of the experience gain (loss), along with a year-by-year comparative schedule.

Mr. Alberts noted that the contribution rates are sufficient to finance the employer normal cost and to amortize the unfunded pension actuarial accrued liability as a level percent of payroll over a period of 24 years for pension benefits, and 24 years for health subsidy benefits.

Trustee Sanders stated that the unfunded accrued liability is driving the employer contribution rate. He continued to provide examples of member activity that impact the Unfunded Actuarial Accrued Liability.

Mr. Alberts explained that the UAAL is the difference between the Systems accrued liability and the assets. He reported that the Retirement System is 63.3% funded for pension benefits and 47.4% funded for health subsidy benefits as of December 31, 2015. The pension UAAL of $115, 423,058 is amortized over a closed 24-year period and the health subsidy UAAL of $11,383.138 is amortized over a closed 24-year period.

Chairman Pinard referred to the change from chapter 159 service upgrades in the amount of $498,682 and he asked for clarification. Mr. Alberts explained that the amount referenced is the employer cost of the upgrade. However he continued to explain that the employer is paying off over the amortization period.

Mr. Fleury explained that the increase in Chapter 159 service upgrades is also attributable to the increase in early retirements before June 30, 2015.
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 an increase in the employer contribution rate from 21.71% to 23.74%.

Trustee Sanders discussed dealing with the narrowing amortization schedule and how it will affect the UAAL. He suggested that the Board should start to think about options it could considerfor future valuations. After discussion, the trustees were all in agreement to schedule a workshop with Mr. Alberts to discuss amortization periods, assumptions, review of the Funding Policy, and other factors that will ultimately affect the UAAL and future employer contribution rates.

After lengthy discussion on future amortization schedules, the trustees were in agreement to have the Executive Director coordinate a workshop with the System's actuary, Mr. Alberts, and the MECRS Board, to analyze future MECRS liabilities and Mr. Fleury responded that he will look at the availability of all the trustees and narrow down tentative dates to schedule a workshop, when the majority of the board is able to attend.

Attorney Rich asked Mr. Alberts to elaborate on the dual amortization schedule concept which he had mentioned in his presentation and how it impacts the contribution rate. Mr. Alberts explained the dual amortization concept, and provided an example of how the concept would be utilized in the public sector.

Next, Mr. Alberts referred to the increase in the Health rate and stated that again, due to the retirement incentive program which expired in 2015, the number of retirees increased, therefore having an upward impact on the health rate as well.

In closing his report Mr. Alberts stated that, in GRS's opinion, the methods and assumptions used in the valuation, satisfy the parameters of GASB Statement #43 and adequately measure the Plan's liability and required contributions. However, the calculations contained herein were not intended to satisfy the parameters of GASB Statement #45 and should not be used for that purpose.

Trustee Woitkowski moved to accept the preliminary valuation, with the employer contribution rate of 22.48% and the health contribution of 1.26% , totaling employer rate of 23.74%, subject to the City's Finance Departments, confirmation of the True-up computation, seconded by Trustee Sanders and passed by all those trustees present.

Consent Agenda:

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

Report of the Executive Director:

Compliance with New ACA Requirements: Mr. Fleury began by reporting that as a result of new ACA reporting requirements, MECRS has been obligated to file a compliance certification with the Centers for Medicare and Medicaid Services dealing with prescription drug eligibility and health plan disclosure. The first report for 2016 has been submitted and copies retained for the System files.

NEPC 2016 Client Conference & MECRS May Board Meeting Dates Conflict: Mr. Fleury informed the board that NEPC has set the date for its 2016 Client Conference in Boston, which conflicts with the regularly scheduled MECRS Board meeting for May. He asked if the Board was disposed to change the date of its May meeting to accommodate himself and those trustees who wish to attend the NEPC Client Conference After a quick review of their personal calendars, the Board agreed to re-schedule the MECRS May Board of Trustees meeting to the third Tuesday, May 17, 2016.

Request to Attend the 2016 Public Retirement Fund Summit in Newport, RI in July: Mr. Fleury requested permission to attend the three day, July, 2016 Public Funds Summit in Newport RI. He explained that the event provides a low cost opportunity to keep pace with trends and issues in the public fund sector. He also urged the trustees to attend if they are so disposed.

It was moved by Trustee Lynch to grant Mr. Fleury permission to attend the 2016 Public Funds Summit in July, seconded by Trustee Woitkowski and passed unanimously by all those trustees present.

Expanded Cash Flow Controls: Moving on, Mr. Fleury reported that in order to create a clear audit trail of investment redemptions as authorized by the Board at their January 2016 meeting, the Monthly Cash Management Report included in the board packet has been modified to report each redemption and the cumulative results of the Board's authorization. In addition to an email notification to board members, required as part of the authorization, Mr. Fleury stated that each redemption shall also be reported on a monthly basis as part of the Executive Director's Report and that the same information will be itemized in cash flow information provided to NEPC.

Website Development Underway: Next, Mr. Fleury was pleased to report that the firm, Wedu, has been selected for a replacement website. Wedu was selected based upon the content management platform and proposal price. He noted that rollout of the new site is planned for late spring. He also informed the trustees that MECRS has been successful in keeping the old site operational, despite complex challenges associated with its obsolescence.

MECRS IT Security Audit Underway**:** Mr. Fleury stated that an Information Technology Security Audit began on February 25th. The firm, RSM International, conducted the audit and will report any vulnerabilities and recommended remedies. The report will be presented to the Board at a future meeting.

US Labor Dept CPI Published**:** Mr. Fleury announced that the annual numbers for the Consumer Price Index, for calendar year 2015, are now available from the U.S. Labor Department. He reported that using the guidelines in the MECRS Administrative Rules, a cost of living increase of less than three quarters of one percent, (.72952 to be precise) would be used when the Board reviews the affordability of a retiree COLA increase this year. He then noted that the remaining COLA factors, will not be available until the valuation has been completed.

MECRS Current Cash Flow Negative**:** In closing his report, Mr. Fleury informed the board of his findings after researching the current negative cash flow status of the Plan. He stated that while active contributing populations have varied over the ten year period reviewed, the trend has been definitely downward, so there are fewer members contributing. Retiree populations during the same period have grown by 73 percent. Over the charted period, the ratio of active to retired members has gone from 2.8 to1, down to 1.4 to 1, or been reduced by approximately half. Also, he stated, his findings do not take into account the exacerbating cash flow effects of COLA awards or the impact of the early retirement incentive, which increased benefit payouts for a two year period.

New Business:

Recommendations from the MECRS Investment Committee: Committee Chairman Molan reported on the Investment Committee meeting held March 3, 2016.

Committee Chairman Molan noted that in addition to himself, present were, Committee Members William Sanders and Mike Woitkowski, NEPC Consultant Sebastian Grzejka, Attorney John Rich, Jr., and Executive Director Fleury.

Committee Chairman Molan stated that the objective of the meeting was to interview potential absolute return managers to complement the existing suite of portfolio managers hired by MECRS.

Committee Chairman Molan reported that the Committee interviewed three absolute return managers with varying investment styles. The managers included: Blackrock, which presented their Strategic Income Opportunity Fund; GAM, which presented their Unconstrained Bond Strategy; and Schroder, which presented their Global Strategic Bond Fund. Manager interviews averaged 45 minutes and each manager provided details about their product offering, including risk and return histories.

Committee Chairman Molan informed the trustees that NEPC's recommendation was for MECRS to commit approximately 5% of the total portfolio to an absolute return investment, which equates to $8 million. He went on to report that after hearing the presentations and deliberating on the matter, the Committee concluded that Blackrock has a superior track record over the other managers, for returns in this space.

Committee Member Woitkowski had offered a motion to recommend an investment of $8 million to the full MECRS Board at its upcoming meeting. The motion received a second from Committee Member Sanders, the vote was taken and passed unanimously.

Committee Chairman Molan then moved to act in accordance with the recommendation of its Investment Committee and advisors at NEPC, and vote to allocate $8 million to Blackrock's Strategic Income Opportunity Fund.

New Business:

After brief discussion, Trustee Sanders seconded the motion offered by Committee Chairman Molan and the motion passed unanimously by all those trustees present.

Request For Motion – Change in Appropriation For 2015 - Referring to the itemized back-up included in the trustee's agenda packets, Mr. Fleury stated that he is requesting the transfer of previously approved and budgeted funds for 2015, in the amount of $950.14 from the identified areas with a surplus appropriation, to identified areas, which ran a deficit. He noted that each year, transfers of this type are a customary end of year exercise to wrap up the budget, without any lines overdrawn and without the need to increase the original appropriation request.

It was moved by Trustee Lynch to approve the 2015 budget transfer, in the amount of $950.14, seconded by Trustee Molan and passed unanimously by all those trustees present.

Mr. Fleury asked the board for a re-affirmation with respect of the MECRS cash flow needs. Mr. Fleury recapped the board's recent approval to commit $8 million to the Blackrock SIO Fund, recommended by NEPC, in addition to previous commitments for a $6 million split between investments in Blue Vista, Brookfield and DSF Group. He then referred to the board's directive at the end of 2015 to terminate Standish Mellon from the System's portfolio, with resulting proceeds of $9.1 million. Mr. Fleury stated that the full liquidation of Standish would be used to fund value-added real estate commitment and would also meet MECRS payroll obligation for April 1, 2016.

Trustee Molan asked the NEPC consultants if it was necessary that the $8 million investment to Blackrock be paid all at once or if it the board would be able to fund half the allocation of $4 million and the balance at a later date.

Mr. Grzejka replied that due to the cash flow needs of the System, the board is able to split the cost of the funding to Blackrock and that NEPC will also be suggesting some cost changes and re-balancing of the MECRS portfolio in the coming months.

Referring to the handout, Assumptions and Assets booklet, Mr. Grzejka reviewed the MECRS asset allocation. He stated that NEPC believes the current target provides a solid foundation;

however, enhancements can be made to better position the portfolio for today's opportunities. In particular, he stated, NEPC believes non-US equities provide an attractive opportunity.

Mr. Grzejka referenced discussion from the Board's January meeting in keeping the portfolio in target with the asset allocation model. Mr. Grzejka turned the trustees' attention to page 18 of the hand-out and provided an in-depth analysis of the MECRS current target, as well as re-jiggering the make-up of the allocations to conservative, moderate or aggressive mix.

Mr. Leonard then provided the board with the scenario analysis of each mix and the probability of returns over the next 5 to 7 years.

Mr. Sanders stated that he was focused on the moderate mix.

Addressing the moderate mix, Mr. Grzejka stated that NEPC believes that the conservative mix is not meeting NEPC's goals and objectives and the aggressive mix is earning a minimally high return, with a lot more risk.

The board continued to discuss the implementation of the re-balancing within equities, fixed income, alternatives, and Global Asset Allocation.

Chairman Pinard suggested that the trustees should schedule a special meeting for continued discussion of the Asset Allocation considerations.

Due to a schedule conflict, Chairman Pinard excused himself and turned the meeting over to Acting Chairman, Sanders.

After brief discussion of the structure of the MECRS portfolio as well as the schedules of liquid investments and final distributions, the trustees agreed to coordinate a special meeting in April with NEPC Consultants present, for a continued review.

Trustee Molan referred to his previous request of NEPC , for a list of the current MECRS Money Managers and their objectives.

Mr. Grzejka responded that the list is complete and will be included in NEPC's quarterly report to be distributed at the April Board of Trustees meeting.

Before departing, Mr. Grzejka briefed the board on the January, 2016 Flash Report and stated that the market in January proved to be volatile with underperformance, followed by a slight rebound in February.

Motion to Adjourn:

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

Respectfully Submitted,

Gerard E. Fleury
Executive Director