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, Dick Molan, Mike Woitkowski, Dianne Mercier, Bob Lynch and Bill Sanders
MECRS Staff: Gerard Fleury, Sandi Aboshar and Suzanne Wilson

Absent: Mayor Gatsas

In Attendance: Attorney John Rich, from McLane Middleton, Professional Association
Kevin Leonard, Sebastian Grzejka, both from NEPC and Mark LaPrade, Tyler Butler, both of Berry Dunn

Approval of the Minutes of the Previous Board Meeting:

Trustee Molan moved to approve the minutes for the board meeting held June 13, 2017. Trustee Mercier seconded the motion and it was 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:

Mr. Fleury stated that while there are a number of projects underway, there is nothing of material importance to report at this time.

Report of the Administrative & Accounting Committee:

Committee Chairman Woitkowski, stated that the A&A Committee met on July 10, 2017, to consider three issues within the committee's jurisdiction. He listed the committee's recommendations, starting with the approval of the board commissioned, Compensation Study, conducted by Condrey Associates, followed by a recommendation to adopt and place on file the current draft of the MECRS Funding Policy, and finally, the requested authorization by MECRS Staff to proceed with amendments to the MECRS By-Laws and Administrative Rules, which were also reviewed by the Committee.

Beginning with the A&A Committees first recommendation, Chairman Woitkowski offered a motion that the board approve the April 2017, Compensation Study performed by Condrey Associates for implementation, effective August 1, 2017, which would increase the staff payroll in the amount of $224.68 for the remainder of 2017, seconded by Trustee Molan.

Mr. Fleury explained that in preparing the Compensation Study regarding MECRS' administrative staff, Condrey Associates polled 16 public retirement funds of compatible size, performed an audit of existing job duties at MECRS and updated the salary scales, which were last approved by the board in 2005. Mr. Fleury noted that representatives from Condrey Associates summarized the study results via conference call during the A&A meeting, answered questions and addressed concerns from the committee.

After brief discussion by the board, Trustee Mercier stated that the study represents a confirmation that personnel classifications and wages paid to MECRS staff, are in line with those in public plans of similar size and mission.

Mr. Fleury detailed the objective of the study which included, reviewing and revising the current classification system and pay plan for all MECRS's staff, collecting salary data and producing a recommended pay plan based on job analysis, job evaluation and wage survey data.

After further discussion by the trustees regarding the dynamics of the study, Chairman Pinard, referred to the motion on the floor, to implement the Condrey Study results, effective August 1, 2017, which the trustees voted unanimously to approve, so the motion carried.

Committee Chairman Woitkowski referred to the A&A Committee's second recommendation, to adopt and place on file the current draft of the MECRS Funding Policy.

Mr. Fleury summarized the development of the Funding Policy as well as input received from the A&A Committee, Gabriel, Roeder, Smith & Co. the System's actuary, MECRS's Investment Advisor, NEPC and MECRS's legal counsel. He explained that MECRS recognizes that the main financial objective of a public employee defined benefit plan is to fund the long term costs of promised benefits to members.

Chairman Pinard asked the NEPC representatives for their interpretation on the recommended Funding Policy. Representative Sebastian Grzejka from NEPC stated that they are in agreement with the Draft Policy.

Chairman Pinard then asked Attorney Rich for his opinion regarding the policy, to which Attorney Rich responded that the Funding Policy provides the board with a risk management framework, identifies the actuarial cost method, and also addresses the issues of funding objectives and funding targets.

After brief discussion regarding the policy, Chairman Pinard requested more time to review the Draft Funding Policy, before voting to approve it, to which Trustee Mercier concurred with Chairman Pinard.

Trustee Molan then moved to table the approval of the Funding Policy until the August board meeting, seconded by Trustee Lynch and passed by all those trustees present.

Trustee Mercier noted several vague areas within the draft policy, requesting clarification regarding expectations, assumptions and actual rate of returns.

Mr. Fleury stated that he understood Trustee Mercier's concerns and that he will amend the draft policy as requested by Trustee Mercier. He then stated that any other requests regarding amendments to the draft, be sent to him via email. All amendments, Mr. Fleury stated, will be reflected in the revised draft Funding Policy, and will be scheduled for consideration and approval at the August, Board of Trustees meeting.

In closing his report, Committee Chairman Woitkowski made a motion to authorize MECRS staff to proceed with minor clerical amendments to the MECRS By-Laws and Administrative Rules, which were reviewed by counsel.

Mr. Fleury explained that the review and recommendation by the A&A Committee is the first step in the procedure for adopting the Administrative Rules, which will be followed by requirements in the System's By-Laws, that proposed amendments to be posted for a thirty (30) day period, before their adoption to afford interested persons an opportunity to submit data and comment. Subsequent to the 30- day posting, there will be a public hearing, whereby any individual can provide testimony for consideration.

After brief discussion, regarding the proposed changes within the Administrative Rules and By-Laws, the trustees were in agreement that more time was needed to review the changes. Committee Chairman Woitkowski therefore withdrew his motion.

Report of the Investment Committee:

Committee Chairman Molan reported that the Investment Committee met on May 18, 2017 to review the latest draft of the Liquidity and Cash Management Policy. The committee heard reports and recommendations from the investment advisors from NEPC. He noted that the committee voted to recommend its adoption to the full Board.

Committee Chairman Molan stated that while events at the meeting were reported verbally at the June 13, 2017 meeting of the MECRS Board, there was one item which should have been discussed, which was unintentionally missed.

Therefore, on behalf of the MECRS Investment Committee, Committee Chairman Molan offered a motion to accept the recommendation of the Investment Committee, from its' May meeting, that the Board adopt the draft Liquidity and Cash Management Policy, which was included as an informational item in the trustee's agenda packets. Trustee Mercier seconded the motion and the motion passed unanimously by all those trustees present.

Moving on, Committee Chairman Molan reported on the Investment Committee meeting held June 22, 2017. He stated that the committee reviewed a revision to the Asset Allocation Model, initially reviewed on May 18th, and voted to recommend adoption of the "Blended Mix" option to the full Board. Adoption of the Blended Mix, he stated, will reduce the present allocation to Core Bonds from 9% to 6%, create an allocation to TIPS of 4%, which will be filled through the use of an ETF to be recommended by NEPC, increase the allocation to Private Markets from 6% to 10%, and reduce the allocation for Hedge Funds from 5% to zero.

Committee Chairman Molan reported that the committee also conducted interviews of three private market managers, for Multi-Strategy Credit Opportunities, North American Direct Lending, and Diversified Global Private investments. He informed the board that at the conclusion of the interviews, the Committee did not settle on a recommendation and elected to adjourn for the day and reconvene on July 11th to finalize a manager recommendation.

Committee Chairman Molan offered a motion to accept the recommendation of the Investment Committee to adopt the amended Asset Allocation, dubbed "Blended Mix" as shown in NEPC's report of June 22, 2017, and included as an informational item in the trustees board packet. As a result of this action, termination of Hedge Fund Manager, Permal, will be initiated and $8.5 million in funds will be redeemed from core bond managers with $6 million coming from Income Research and $2.5 million from Loomis Sayles. The proceeds will purchase $8.5 million in shares of ETF ticker symbol VIPIX. Trustee Sanders seconded the motion and the motion passed unanimously by all those trustees present.

Finally Committee Chairman Molan reported on the Investment Committee meeting held earlier that morning, where the committee continued deliberations on manager interviews held on June 22, 2017. He listed the managers interviewed as ComVest Capital IV – Direct Lending Fund, CarVal Investors – Credit Value Fund IV, and Harbourvest – International Private Equity Fund VIII.

The Committee Chairman, on behalf of the Investment Committee, offered a motion to invest $5 million in CarVal Credit Value Fund IV, and $5 million in Harbourvest International Private Equity Fund VIII. He also stated that the recommendation to hire these managers is subject to a favorable review of subscription agreements by the Retirement System's legal counsel.

Committee Chairman Molan added, that the Investment Committee had spent a considerable amount of time interviewing the managers and found all the interviews very educational and informative.

Trustee Sanders seconded Committee Chairman Molan's motion to hire CarVal and Harbourvest, both in the amount of $5 million. Motion passed unanimously by all those trustees present.

Moving on, Investment Consultant Sebastian Grzejka from NEPC distributed the Investment Summary booklet and provided the board with a review of total Plan Performance. He reported very strong performance through the end of May 2017, with a total composite value of $216,706,910 for the Plan, and returns, year-to-date of 7.2%. He cited strong performance across the portfolio and credited good active management for much of the favorable return.

Mr. Grzejka reviewed each of the asset classes, focusing on the domestic equity composite. He highlighted Sands Capital, up nearly 22% for 2017 after a lack luster 2016.

Referring to the International Equity Composite funded earlier in 2017, Mr. Grzejka reported that Kabouter International is doing very well, and is up 13%.

Representative Kevin Leonard concurred with Mr. Grzejka's earlier comment regarding active management, and provided examples of active management vs. passive management, both on the U.S side and International side of investments.

Mr. Grzejka reported very strong performance from all three fixed income managers, Income Research & Management, Loomis Sayles and Blackrock Strategic Income Opportunities.

Continuing with the performance review of the alternative composite, Mr. Grzejka addressed the performance of the hedge fund composite, liquid alternatives and private markets composite. He referred to the unanimous vote taken earlier in the meeting and noted that both Harbourvest and CarVal Investments will be additions to the Private Markets Composite.

Mr. Fleury referred to the 2017 asset allocation review booklet and asked the NEPC representatives and board members to turn to page 5. Mr. Fleury questioned whether the board needed to act on the redistribution between equity managers, to achieve a balance between active and passive managers. He noted that while the redistribution was in the report, it had not been acted upon by the trustees and their NEPC Advisors.

Mr. Leonard replied that it had been discussed at the Investment Committee level but that NEPC was not prepared to recommend the redistribution from active to passive at this time and informed the board that NEPC would revisit the matter in the coming months.

Mr. Fleury thanked the NEPC representatives for the clarification, and their report having concluded, the NEPC representatives departed.

Consent Agenda:

Trustee Sanders moved to accept the Consent Agenda, seconded by Trustee Woitkowski and passed by all those trustees present.

New Business:

Presentation of Audit Results for 2016 - Representatives, Mark LaPrade and Tyler Butler of the firm Berry Dunn, were in attendance to deliver the DRAFT, MECRS's Audit results for 2016. Mr. LaPrade began by distributing the Executive Summary and outlining his presentation.

Mr. LaPrade directed the trustees to turn to slide three of the Executive Summary Booklet and noted 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.

Mr. LaPrade also noted that the audit does not relieve management of its responsibility and he commended MECRS staff in working through the audit process on a job well done.

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 statements. Mr. LaPrade stated that Berry Dunn's audit opinion on the basic financial statements is unmodified and their opinion does not cover other information included in the draft MECRS's 2016 Comprehensive Annual Financial Report.

Representative Tyler Butler then announced the recent accounting pronouncements that were adopted by the System. Referring to GASB Statement No. 72, Fair Value Measurement and Application, Mr. Butler explained that in accordance with GASB 72, except for investments using Net Asset Value (NAV) as a practical expedient to estimate fair value, the Retirement System categorizes the fair value measurement of its investments within the fair value hierarchy defined in U.S. GAAP. The fair value hierarchy conforms to one of three valuation techniques as follows. Level 1 correlates to quoted prices in active markets for identical assets and contains most of the assets held by the Retirement System. Level 2 and 3 correlate to significant other observable inputs and significant unobservable inputs, respectively, and none of the assets held by the Retirement System fall within those levels. In addition to the 3 levels identified, Mr. Butler stated, assets are also held which are reported in accordance with their NAV. Unfunded commitments shown in the table on page 35 of the MECRS CAFR, represent the difference between contractual commitments to any investment and the life to date accumulations of capital calls, less any investment distributions, which are subject to recall.

Mr. Butler reported 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. Butler then listed the most sensitive disclosures, Those included, the GASB 72, schedule of fair value hierarchy of investments, just mentioned, the disclosures on page 37 and 38 regarding interest rate risk, custodial risk and credit quality risk. Also, the net pension liability (NPL) and Plan Net Position as a percentage of total pension liability, as well as the disclosure of the actuarial valuation method and assumptions, found in note 7 of the draft CAFR.

Mr. Butler referred to pages 40-46, which is a disclosure of all the assumptions that are used in determining the actuarial liabilities, which were relatively unchanged from last year, with a discount rate of 7.25% and with updated mortality tables. Mr. LaPrade elaborated on the updated mortality tables indicating that the actuary had noted that RP 2000 mortality assumptions would likely be updated as a result of a five-year experience study which is being conducted this year.

Mr. Butler turned the trustee's attention to page 42 of the draft CAFR, Sensitivity of the Net Pension Liability, reflecting changes to the single discount rate assumption, if the NPL was calculated using a single discount rate that is one percent higher and one percent lower.

Mr. Butler highlighted the more significant accounting estimates that affected the financial statements as follows: 1.) Calculation of actuarially determined contributions, 2.) actuarial accrued liability and actuarial value of plan assets of the Health Trust and the total pension liability and net pension liability of the pension trust, 3.) the estimated fair value of investments valued using Net Asset Value, allocation of financial statement amounts between the pension and health subsidy trusts. Mr. Butler stated that management judgments used in developing the accounting estimates are appropriate.

Moving on, Mr. Butler reported that there were no adjustments to the financial statements as a result of the audit process. He identified three unrecorded audit adjustments for 2016 as follows, which are very consistent with past years. He then listed the unrecorded audit adjustments as follows: 1.) Reversal of prior year unrecorded adjustments that impacted the fiduciary net position as of December 31, 2015, 2.) To determine the impact of the actuarially calculated underpayment of employer contributions for the applicable City departments for period of July, 2016 through December 31, 2016, 3.) To adjust the fair value of investments to balance reported by investment managers on audit confirmations. Mr. Butler reported that cumulatively, the unrecorded audit adjustments would result in a decrease in the net increase in fiduciary net position of approximately $122,000 (approximately 2% of the net reported net increase.)

Mr. LaPrade, continued the audit presentation by listing other information that the CAFR includes, that is not a required part of the basic financial statements, and noted that this is consistent with past audits.

Mr. Butler reported that in performing the audit, there were no difficulties or disagreements with management and there were no consultations with other accountants about auditing or accounting matters. He noted that the auditors will request certain representations from management in connection with the procedures to issue the final reports.

Next Mr. LaPrade asked the trustees present, if any of them are aware of any instances or allegation of fraud, to which there were none.

Mr. Butler summarized the first part of the Yellow Book Report, Internal Control over Financial Reporting. He stated that Berry Dunn did not perform an audit of the internal controls, therefore, they do not express an opinion on the internal controls and they did not identify any control matters that they would consider to be a material weakness. However, due to the fact that the audit was not designed to identify all deficiencies in internal control, material weaknesses may exist that have not been identified.

The second part of the Yellow Book Report, Mr. Butler stated, relates to Compliance & Other Matters. He informed the trustees that the audit team did not note any instance of noncompliance or other matters that would be required to be reported.

Mr. LaPrade referred to slide 13 in the presentation booklet and he reported the Fiduciary Net Position ending 2016 as $202,387, with the 2016 net investment income resulting in a complete turnaround from 2015, compared to the previous year. Total contributions, Mr. LaPrade noted, decreased in 2016, due to the timing of the employer contributions received from the City. Benefit payments have increased about nine percent due to the increase in the retiree base. Other deductions went down, due to lesser refunds of employee contributions. A decrease of about $220,000 was partially offset by about $100,000 in increases in other expenses including administrative expenses of the Retirement System.

Moving on to slide 14, Mr. LaPrade reported on the Plan Net Position as a percentage of Total Pension Liability, which was held fairly stable at 59.63% and the funded status of the Health Trust, which was also stable at 48.4%.

Trustee Mercier requested that the board members and the Berry Dunn representatives turn to page 27, funded Ratio To Plan Asset Comparison, of the draft CAFR. She identified an inconsistency in the funded ratio composite, between the draft audit and the draft CAFR.

Mr. Butler explained that the difference involves the actuarial smoothing of assets, which is higher due to losses that are being amortized.

Trustee Mercier expressed her concern in the perceived discrepancy between the audit and the CAFR and requested further clarification explaining the difference to the membership of the System.

After lengthy discussion regarding Trustee Mercier's concerns, Mr. Fleury stated that he will work to reconcile the charts.

Next, Trustee Mercier noted that within the audit, there are pages reserved for the Independent Auditor's Report. However, the audit opinion is expressed on pages 29 forward, therefore, she asked if the Auditors Report's placement is the most efficient.

Mr. Butler replied that the placement of the Auditors Report on the earlier pages is a very common position. In the subsequent pages where the opinion is expressed, there is a reference to the pages where the reader will find the Auditor's Report.

Trustee Mercier commended Mr. Fleury for his work in relaying information in the CAFR, pertaining to the Reporting on the Retirement System's Finances as a Whole.

Trustee Mercier then referred to page 24 of the CAFR and asked for clarification on the range of the Policy Mix.

Mr. Fleury stated that the table in question cites the target defined by NEPC rather than the range. In order to present the range rather than the target, narratives would need to be revised and he promised to take Trustee Mercier's observation into consideration and will work to incorporate range data in future CAFR's

The trustees continued to discuss the different reporting of financial highlights, within the CAFR.

Trustee Mercier moved to accept the 2016 Auditors Report as presented by Berry Dunn, seconded by Trustee Woitkowski and passed unanimously by all those trustees present.

<u>Fee Policy Amendment for Additional Contribution Program</u> - First, Mr. Fleury referred to previous discussions by the board, regarding the existence of the Additional Contribution Program enacted in 2003, when the board subsequently allowed the purchase of a software program from Gabriel, Roeder, Smith & Co., in the amount of $10,000 capable of performing actuarial calculations needed for the operation of the Additional Contribution Program. He noted that the cost of the license was paid by the pension trust and carried as a receivable. The promulgated Rule, called for a $50 fee for the basic calculation, with an additional $100 payment when a member elected to pursue participation in the program.

Mr. Fleury informed the board that the $10,000 has been recovered and the future practice regarding fees for the Additional Contribution Program needs to be formally addressed by the Board.

Mr. Fleury explained that pension trust funds were used to finance the license from GRS and it seems logical that earnings which would have accumulated on the $10,000 over the 13 years, in which the receivable was collected, should still be due the Pension Trust. Mr. Fleury calculated that had the trust fund invested the $10,000 it paid for the license, approximately $4,200 in net investment earnings would have been earned and so that amount is still due the Pension Trust in order to break even.

Mr. Fleury stated his recommendation that future amounts collected from prospective participants in the Additional Contribution Program remain at the traditional rates and be recorded as a payable, so that they will carry forward at the end of each year, and allowed to accumulate. Those proceeds could be used at some future date to finance changes to the calculation program if changing regulation necessitated such a change.

Trustee Mercier moved to continue to charge the same Additional Contribution rates as past practice, seconded by Trustee Woitkowski and passed unanimously by all those trustees present.

Motion to Adjourn:

Having conducted all the business of the day, Trustee Lynch moved to adjourn the meeting at 9:55 a.m., seconded by Trustee Mercier and passed unanimously by all those trustees present.

Respectfully Submitted,

Gerard E. Fleury
Executive Director