March 20, 2018
Minutes #543

Minutes of the Board of Trustees' Meeting -1-

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

Present: Trustees: Richard Molan, Bill Sanders, Bob Lynch and Bob Gagne

MECRS Staff: Gerard Fleury, Sandi Aboshar and Suzanne Wilson

Excused: Dianne Mercier, Mike Woitkowski

Absent: Trustees: Mayor Craig

In Attendance: Attorney John Rich and Intern Kolbie McKay, from McLane Middleton, Professional Association, Ken Albers from Gabriel, Roeder, Smith & Co., Sebastian Grzejka from NEPC and Mark LaPrade from Berry Dunn

Approval of the Minutes of the Previous Board Meeting:

Trustee Sanders moved to approve the minutes for the board meeting held February 13, 2018, 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 Lynch and passed unanimously by all those trustees present.

Report of the Executive Director:

Meeting with Lexington: Mr. Fleury began by stating that he is called upon from time to time to meet with organizations, including past, present and potentially new money managers, who seek an audience with someone from the fund. He informed the board that he was recently contacted by Mark Andrew and Lee Tusconi of Lexington Partners, regarding an update of MECRS's participation in Fund VII and VIII, and to learn firsthand about Lexington's upcoming Fund IX. Since NEPC may be recommending a new commitment to private equity and since our investment results with Lexington have been favorable, Mr. Fleury stated that he has asked NEPC whether Fund IX might satisfy their upcoming recommendation. Mr. Fleury noted that the meeting, has been scheduled for Tuesday, March 27th at 3:00 p.m. and he invited any interested trustees with time available, to also attend and noted that the meeting is expected to run about an hour.

Rumors from the Membership: Mr. Fleury informed the trustees that MECRS has not been contacted by the City regarding possible policy changes that impact the MECRS, however rumors reaching the MECRS's office from the membership are speculating that sick time payout to non-affiliated employees may be capped in the future. While this is unsubstantiated, Mr. Fleury stated, the Retirement System continues to monitor the situation since a cap on sick time payout at retirement would result in lower lifetime benefit amounts and possibly a small actuarial gain for the Plan.

Presentation to Water Treatment Plant Members: Moving on, Mr. Fleury reported that on February 27th, he conducted a presentation on general benefits to approximately a dozen plan participants at the Manchester Water Works and the Water Treatment Plant on Lake Shore Drive. The presentation consisted of a brief overview of Plan benefits, followed by a question and answer period. Also, he noted that several calculation requests resulted from the session and it seemed to be relatively well received.

State Street to Provide Software Training: In closing his report, Mr. Fleury announced that MECRS's custodial bank, State Street Bank & Trusts, has scheduled training on their suite of investment reporting and tracking systems known as "My State Street" for March 28th. He indicated that the training is free and is delivered in a webinar format. At the April, Board meeting Mr. Fleury indicated that he will report on the usefulness of the cash flow management process and how expenditures are approved.

Trustee Gagne asked how the approval of expenditures would change once the My State Street software is implemented.

Mr. Fleury responded that a few steps would become obsolete and the process would be more efficient, however the audit trail would remain intact.

Report of the Monthly Cash Balance

Mr. Fleury reported a cash balance for the end of February of approximately $7 million. He stated that the Fund continues to receive cash on a regular basis from a number of the limited partnership investments and the Fund has been receiving capital calls on a regular basis as well. Mr. Fleury noted that the first capital call from HarbourVest Investment is due today.

Report of the Investment Committee:

Committee Chairman Lynch reported that the MECRS Investment Committee met on Wednesday, March 7, 2018 to interview real estate related managers. Prior to conducting manager interviews, Committee Chairman Lynch stated that the Committee voted to adopt a recommendation from NEPC to redeploy assets in the International Equity portion of the MECRS portfolio in order to have greater liquidity to satisfy anticipated capital calls. At the recommendation of NEPC, and as Chairman of the Investment Committee, Mr. Lynch made a motion, that MECRS's administrative staff be authorized to affect the orderly redeployment of international equity assets from Gryphon International,in the amount of $6,000,000 and from City of London, emerging Markets in the amount of $1,000.000, rebalancing over to Vanguard International Stock Index Fund ticker symbol VTSNX , in the amount of $7,000.000. Trustee Sanders seconded the motion to rebalance and the motion passed unanimously by all those trustees present.

Moving on, Committee Chairman Lynch reported that the committee also conducted interviews of three managers recommended by NEPC of compelling but slightly dissimilar closed end real estate funds. The committee was very impressed by all three managers. Each possessed a unique focus, which resulted in the Committee's decision to increase the allocation target and split it between two of the three managers. At the recommendation of NEPC, and as Chairman of the Investment Committee, Trustee Lynch moved, that the MECRS Board vote to approve commitments of $4 million each, to Oaktree Real Estate Debt Fund II and Kayne Anderson Real Estate Partners Fund V, both subject to satisfactory completion of a review of the terms and condition by legal counsel. Funding for the commitment is to come without further approval from the board, from rebalancing to be determined by NEPC, seconded by Trustee Sanders.

Board Chairman Molan stated that all three manager presentations were well done and following the days' meeting, the board members will meet with legal counsel to discuss the manager subscription agreements.

Motion passed unanimously by all those trustees present.

Consent Agenda:

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

New Business:

Request From CarVal Investors to Amend Partnership Agreement - Mr. Fleury informed the trustees that CarVal Investors has contacted the MECRS requesting approval on an amendment of the partnership agreement to increase the overall total commitment from $3 billion to $3.15 billion. He noted that this amendment has been requested of all current investors, which has also been reviewed by the MECRS's investment advisor and by legal counsel, neither of whom expressed concerns.

Trustee Gagne moved to approve the amended partnership agreement with CarVal Investors, seconded by Trustee Lynch and passed by all those trustees present.

Mr. Fleury informed Board Chairman Molan that his signature is required, supporting the request by CarVal to increase of Fund's size.

Minutes of the Board of Trustees' Meeting -4-

Delivery of the Preliminary Results of the Actuarial Valuation for 2017 – Mr. Alberts began by explaining that the funding objective of the Retirement System is to establish and receive contributions which, when expressed as percents of active member payroll, will remain approximately level from year to year and will accumulate sufficient assets over each member's working lifetime to finance promised benefits throughout retirement.

Referring to the presentation booklet included in the board's agenda packets, Mr. Alberts directed the trustees to turn to page A-2, Summary Statement of System Resources and Obligations for 2017. He explained in detail the Present Resources and Expected Future Resources and how that information is calculated in reaching the Total cost for both the Pension and Health subsidy benefit. Mr. Alberts further explained the calculation cost for the actuarial present value of expected future benefit payments for retirees and beneficiaries, vested terminated members and active members in both pension and health.

Turning to Page A-5, Mr. Alberts then addressed the "Allocation of Funding Value of Assets" chart and the "Development of Unfunded Actuarial Accrued Liability (UAAL)" chart for the year ending 2017 which resulted in a funded ratio of 63.0 % funded for pension benefits and 47.0% funded for the health subsidy benefits. He stated that the pension UAAL of $127,334,354 is amortized over a closed 22-year period and the health subsidy UAAL of $13,995,069 is also amortized over a closed 22-year period.

Working through the presentation, Mr. Alberts reported that the experience during the year ended December 31, 2017 was less favorable then assumed for pension benefits and more favorable than assumed for the health subsidy, resulting in a small net experience loss for pensions and a small experience gain for the health subsidy. He noted that for pension benefits the losses in retiree and deferred member experience were partially offset by a 1.00% ad-hoc COLA being paid during 2017 (versus 1.25% assumed), pay increases less than assumed, and investment return on a funding value basis that was higher than expected return (7.25% assumed versus 7.4% recognized).

Next, Mr. Alberts noted that the recognized rate of return was 7.4%, despite the fact that the return on a market value basis was 15.9% (net of expenses). Due to the fact that investment experience above or below assumed is spread over 5 years, one fifth of this year's gain 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. It is important to note, Mr. Alberts stated, that next year GRS anticipates recognizing a market loss in total if the market rate of return is below 15% (after accounting for the gains and losses scheduled to be recognized next year), resulting in upward pressure on the employer contribution obligation. Mr. Alberts noted that for purposes of the valuation, actuarial practice assumes all assets are liquidated to determine the end of year closing value. He noted that this may not be the best way to value the portfolio in his opinion but it is the accepted practice.

Mr. Alberts provided the board with a breakdown of the development of the employer contribution rate of 26.87% as well as the contribution rate reconciliation.

Mr. Alberts noted 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 then detailed derivation of the experience gain (loss), along with a year-by-year comparative schedule.

Mr. Alberts reported that a number of assumptions were modified as a result of the Experience Study for the 5-year period ended December 31, 2016 which increased accrued liabilities by approximately $9.9 million.

Trustee Sanders asked Mr. Alberts how much of the $9.9 million is the reduction of the interest rate for which Mr. Alberts referred to the Economic Assumptions note on page A-11 where it is stated that the expected rate of investment return was lowered from 7.25% to 7.00% for the December 31, 2017 valuation. This change increased accrued liabilities by approximately $9 million and increased the computed contribution by $800,000 or 1.48% of active member payroll.

Mr. Alberts continued listing items that affected the 2017 valuation results. He noted that liabilities increased by $406,264 as a result of members electing to upgrade their service rendered prior to 1999 but an additional $203,132 in member contributions was contributed as a result of these elections that offset the increase. COLA during 2017 were assumed to be at 1.25% of current pensions whereas the actual COLA was 1.00% of current pensions. Retiree Health Benefits which are funded in part by retired members, but mostly by employer contributions to the Retirement System that are permitted by 401(h) of the U.S. Internal Revenue Code.

Next, Mr. Alberts reviewed the Comment Section of his presentation. Referring to Comment A, Trustee Sanders asked, in terms of the remaining 22 year amortization period, how does MECRS compare relative to other pension plans across the U.S., for which Mr. Alberts replied that it is a standard period of time that but that it may vary from region to region.

Moving on, Mr. Alberts stated that for each 1% ad-hoc COLA increase above the assumed COLA, the UAAL will increase by approximately $1,841,000 and the employer contribution rate will increase by approximately 0.24% (based on current payroll and a 22-year amortization period).

Discussion followed regarding the impact of the amortization period shortening and the reduction of plan participants and the how it would affect UAAL going forward.

Referring to the note on page A-7, which states that the computed rate is in compliance with the Board's Funding Policy, Attorney Rich, noted that last year when the board adopted the Funding

Policy it included a provision which states that the intention of the board is to reach 75% funding on or before 2025. Attorney Rich noted that the Amortization Schedule and Projected Funded Status in the preliminary valuation reflect a slightly lower projection for 2025.

Attorney Rich asked if GRS is compelled to change the contribution rate, or if the Funding Policy is more of a statement of intention or aspiration, to which Mr. Alberts agreed.

Trustee Sanders referred to page A-6, "True-up Contribution Payable during the City's Fiscal Year 2019." He explained that the True-up is to account for the difference in actual and assumed payroll that would have affected the contribution had the City been making contributions on a payroll period basis.

Mr. Fleury referred to the Revised True-Up page distributed to the trustees. He explained that when the valuation was done it used the 7. 25% interest rate which was changed to 7% by the Trustees at their January meeting. The revised cost to the City of $154,007 reflects 7% from Jan. 1, 208 to June 30, 2018, whereas the original page used the 7.5% rate.

Referring to Comment C in the presentation, Mr. Alberts asked the trustees to confirm that it is reflective of the general sentiment of the board action taken in January. The Board had adopted assumptions of Alternate 2 from the Experience Study also noting that the Board elected not to change the load for end of career payments as much as recommend in the study, due to expectations that future experience will differ from past experience because of the expiration of certain temporary incentives. The Board also elected to accelerate the next experience study from 2022 to 2020.

The board confirmed that Comment C is reflective of board action taken in January.

In closing his presentation, Mr. Alberts referred to Comment H, stating that the load for end of year career payments affecting final average compensation was increased from 9% to 10% and he called attention to a historical schedule of the increases over a ten year period.

Trustee Gagne moved to accept the preliminary valuation as presented, inclusive of Alternate page A9, seconded by Trustee Sanders and passed unanimously by all those trustees present.

Before Mr. Albert's departure, he stated that at the inception of the Additional Contribution Program, the board adopted an Administrative Rule citing a 5% interest rate on the Additional Contributions and he suggested that the board review an amendment to the Rule that sets the interest rate applied to all member contributions and place them in sync with the actuarial assumptions.

Trustee Gagne suggested that instead of adopting the fixed interest rate, that the board review other options such as setting the interest rate at 2.5% below the assumed rate.

Following discussion regarding the various interest rate options, Chairman Molan assigned the review of Administrative Rule, Part 6, Section 6.5, Interest on Additional Contributions, to the Administrative & Accounting Committee and to also take into consideration, Trustee Gagne's suggestion.

Chairman Molan asked Mr. Laprade from Berry Dunn Audit Firm if he had any comments regarding the valuation, for which Mr. Laprade expressed his opinion that the 2017 Valuation presentation was well done.

Chairman Molan declared a recess to consult with counsel at 9:58 a.m.

Chairman Molan reconvened the meeting at 10:49 a.m.

Motion to Adjourn:

Having conducted all the business of the day, Trustee Lynch moved to adjourn the meeting at 10:50 a.m., seconded by Trustee Gagne and passed unanimously by all those trustees present.

Respectfully Submitted,

Gerard E. Fleury
Executive Director