B

City of Ann Arbor Employees' Retirement System
Minutes for the Regular Meeting
October 16, 2014

The meeting was called to order by Jeremy Flack, Chairperson, at 8:43 a.m.

ROLL CALL

Members Present:	Clark, Crawford, Flack, Hastie, Heusel, Monroe, Nerdrum
Members Absent:	Powers
Staff Present:	Kluczynski, Walker
Others:	Michael VanOverbeke, Legal Counsel Robyn Wilkerson, Human Resources Nancy Niemala, City Attorney's Office Eric Ronewicz, AAPD Edward Dreslinski, AAPD

AUDIENCE COMMENTS – ***None***

A. APPROVAL OF AGENDA

It was **moved** by Monroe and **seconded** by Clark to approve the agenda as submitted, and that item E-1 *(Pension Plan Considerations)* be placed before item D *(Action Items)* on the agenda.
Approved

B. APPROVAL OF MINUTES

B-1 Retirement Board Meeting – September 18, 2014

It was **moved** by Clark and **seconded** by Crawford to approve the September 18, 2014 Board Meeting minutes as submitted.
Approved

B-2 Special-Call Board Meeting – September 29, 2014

It was **moved** by Clark and **seconded** by Crawford to approve the September 29, 2014 Special-Call Board Meeting minutes as submitted.
Approved

C. CONSENT AGENDA

C-1 Reciprocal Retirement Act – Service Credit

WHEREAS, the Board of Trustees is vested with the authority and fiduciary responsibility for the administration, management and operation of the Retirement System, and

WHEREAS, the Board of Trustees acknowledges that, effective July 14, 1969, the City of Ann Arbor adopted the Reciprocal Retirement Act, Public Act 88 of 1961, as amended, to provide for the preservation and continuity of retirement system service credit for public employees who transfer their employment between units of government, and

WHEREAS, the Board acknowledges that a member may use service credit with another governmental unit to meet the eligibility service requirements of the Retirement System, upon satisfaction of the conditions set forth in the Reciprocal Retirement Act, and

WHEREAS, the Board is in receipt of requests to have service credit acquired in other governmental unit retirement systems recognized for purposes of receiving benefits from the Retirement System, therefore be it

RESOLVED, that the Board of Trustees hereby certifies that the following member(s) of the Retirement System have submitted the requisite documentation for the recognition of reciprocal retirement credit:

Name	Classification	Reciprocal Service Credit	Prior Reciprocal Retirement Unit
Brandon Knobelsdorf	**Police**	**3 years, 6 months**	**City of Detroit**

RESOLVED, that the Board of Trustees notes that pursuant to the Reciprocal Retirement Act, said reciprocal retirement credit may only be used for purposes of meeting the retirement eligibility requirements of the Retirement System and that retirement benefits will be based upon actual service rendered to the City and shall be made payable consistent with the City Charter, applicable collective bargaining agreements, Retirement System policies/procedures, and applicable laws (specifically, MCL Public Act 88 of 1961, as amended), and further

RESOLVED, that a copy of this resolution shall be provided to the appropriate City and Union representatives and interested parties.

It was **moved** by Crawford and **seconded** by Hastie to approve the consent agenda as presented.

Approved

E. **DISCUSSION ITEMS** *(moved forward on agenda)*

E-1 **HR Request for Board Feedback: Pension Plan Considerations**

Ms. Walker informed the Board that Ms. Wilkerson and Ms. Niemala were present to discuss pension plan considerations regarding City Council's recent requests for the City to consider changes to the defined benefit program. Ms. Wilkerson stated that City Council has requested that Mr. Crawford, herself, and Ms. Walker explore various options through the Labor Committee, and are looking at different recommendations and have not presented anything to City Council yet, but most likely will be in the next few weeks. The purpose of today's discussion is not to propose one thing or another, but to get feedback on what the Board feels regarding potential changes. Mr. Monroe stated that his initial concern is when moving from a defined benefit plan you get the best returns when you have outside boards managing defined benefit plans, so to move away from that, he is concerned that we are not going to get as much return for the investment dollar for retirees, so why do that, and added that he would need to understand the concerns that the City has if they want us to move away from that direction. If there are alternatives that can address the City's concerns that is not going to result in less return for the dollar invested, a defined contribution plan wouldn't accomplish anything.

Ms. Wilkerson stated that at least one of the concerns that she has heard from several Councilmembers is the unfunded liability, and the idea of "kicking the can" of unfunded liability down the road. Mr. Crawford stated that the investment risk is an issue for communities, and is an issue here. Mr. Monroe stated that if it isn't being funded adequately, he understands the concern, and they'd have to show him that it's a concern - and a legitimate concern, and if it is, there has got to be changes if it's legitimate. Mr. Monroe stated that we could stay with a defined benefit plan and increase contributions, reduce benefits, have employees work longer, etc., so there are ways of addressing a funding issue that would still keep a defined benefit plan in place. Mr. Monroe stated that his concern with defined contribution plans is the individual trying to recover from poor investment decisions or what happens to the individual over their lifetime as opposed to Cities or Companies that can sustain losses over a longer period of time.

Mr. VanOverbeke described a pure defined benefit plan and various tiered systems. In a pure defined benefit plan, employee contributions are fixed and employer contributions are actuarially determined, so you can have a tiered system where you have actual employees receiving a lesser benefit accrual and have a higher contribution rate for those employees if that's how you designed the Plan. The concerns from the Board is that they are so involved and informed on these plans all the time, and that very often the decision makers aren't involved with plans enough that they don't understand all of the options and variables and how things work, and in many people's minds, the complexity of a pure defined benefit plan vs. a pure defined contribution plan, is that a defined contribution plan is a little easier to understand so it must be the better solution. Mr. VanOverbeke stated that the key is to figure out what the goals and concerns are and then address them. When you go from a defined benefit plan to a defined contribution plan, it doesn't do away with the unfunded actuarial accrued liability, you would change perhaps your normal cost going forward, but your unfunded accrued liability is a result of past service credit, so those communities that go to a defined contribution plan are very often surprised in the subsequent next several years that the contribution rate actually goes up because when you close a plan your funding requirements and actuarial principles change and you actually have accelerated funding to your defined benefit plan that result in greater contributions to the defined benefit plan especially if you have a lot of new hires going into the plan. The ability to see the benefits of that change are way down the road and you haven't taken care of the unfunded accrued liability.

Mr. VanOverbeke stated that it's important that everyone understands what new designs look like. Many communities are moving towards a hybrid plan, and the System currently does have a form of a hybrid plan due to the annuity withdrawal option, because you are getting a cash option. When you do that, risk is shifted to the employees in retirement. If one of the key issues is the amount of risk or pressure on the employer for the unfunded accrued liability, that's a completely different set of solutions and ways of addressing it is "what's the best benefit structure going forward?" One of the bigger concerns with the defined contribution plan is the tremendous amount of cost associated; very often the administrative and investment costs of a defined contribution plan are 3-4 times higher than a traditional defined benefit plan; one of the other bigger concerns with pure defined contribution plans besides the cost element is the investment return component, where a board of trustees investing the assets of a plan will outperform a typical average employee investing their own account by anywhere from 300-400 basis points or more annualized over time. When you look at the benefits that are payable from a retirement system, the greatest source of those funds is from investment returns, so even if you put the same amount of dollars into a defined contribution plan vs. the same amount of dollars into a defined benefit plan you look at the compounding effect and the differences in those costs which take money out of the plans and then investment returns, which really impacts the plan. The amount of benefits a defined benefit plan can offer, dollar for dollar, is more than double what a defined contribution plan can over the life of an average employee and retiree.

One option in a defined contribution plan could be to have the same investment structure, but credit a market rate of return; meaning the City could come up with a hybrid plan with a defined contribution plan component that the assets were still invested by the Board of Trustees rather than participant-directed. The big advantage of that is that it really takes out a lot of the longevity and market risk for an employee because you can average in the risk across all employees. When an individual invests their own money, not only are they generally not as sophisticated and they chase the market, they manage their money differently at the end of their lifetime, so there are many ways to go about designing a plan when it comes to shifting various risks. Mr. Flack asked Mr. VanOverbeke to review Washtenaw County's situation when they switched back and forth between a defined benefit and defined contribution plan. Mr. VanOverbeke gave a brief overview, stating that the City of Troy did something similar, which resulted in unhappy employees who did not invest very well and decided to go back into the defined benefit plan. Mr. VanOverbeke stated that another item to look at would be the City's 457 plan (ICMA) and how well the employees are investing, although they are more likely to be more aggressive with this type of fund than they would a defined contribution plan, since they can rely on a DB. Mr. Flack mentioned another concern with the City's police and fire members is that they do not receive Social Security, and Mr. VanOverbeke stated that when designing a new plan, the City would have to make sure that it meets the Social Security requirements because there are minimum level of benefits and clearly for someone who does not participate in Social Security, a pure defined contribution plan is potentially very disastrous to have long term service because most of the public safety members are not a mobile work force and have worked their career for one community, and to have one of your long term public safety officers out and retired without no more money left in a defined contribution plan you end up with retirees below the poverty level. A discussion ensued regarding the funding of the VEBA, which has saved the City a lot of money. It has been doing very well, and now there is not a lot of risk there that would have existed if the VEBA had not been put in place.

Ms. Nerdrum stated that in her experience, we have never seen a generation retire on just a defined contribution plan, so most defined contribution plans have not been put in place for that long. There are very few organizations where a DC has been their sole benefit, so one of the things that we see is that people don't save money, they don't save *enough* money, they don't invest the right way, and not only are they not as sophisticated, but individual investors don't have access to the same type of alternative investments or asset classes as institutional investors have in pension funds. As consumers and investors, we spend our money based on our individual life circumstances, i.e. paying 5% towards a retirement plan vs. a college loan or kids' braces, we make the decision that is most important to us today. Ms. Nerdrum stated that one of the things her firm looks at is "retirement readiness" and people's ability to ever stop working. Few are able to retire well on just a DC, as according to research, the average 401k plan is approximately $29,000 which does not include healthcare. When this happens, many companies find that employees aren't leaving; another cost to an organization which has not been considered because now there are what are sometimes called "hidden pensioners" who can't afford to leave employment. Ms. Nerdrum believes the City should think holistically about this before it suddenly makes changes because going from defined benefit to defined contribution. Yes, it can stop growth of an unfunded liability, but she also believes that a defined benefit plan and its investment structure have the ability to correct itself and we've seen that over time when we've had good markets for years. Ms. Nerdrum noted that the other thing they look at is that people say that defined benefit plans can be expensive, but they are actually efficient, not only in the way that they accrue benefits, but pay for themselves and there are studies that show that.

Ms. Walker agreed, stating that in her experience in the private sector, employees were not able to save up enough money, and in many situations, those who need funds for a life emergency will turn to their retirement savings. Also, if you are forced to retire in a down market and you have to start withdrawing from your 401k to fall back on, that will impact your lifestyle for the rest of your life. You may or may not ever be able to get back to what someone else who was able to hang on and retire in a good market could achieve in terms of retirement savings. Some of the defined contribution vendors now are trying to address some peoples' payout streams and make it easier for them to assess the value of their defined contribution balances and try to at least get some kind of guaranteed income, but it is very expensive. Ms. Nerdrum agreed, stating that some defined contribution providers are trying to offer annuities and things like that, but the problem is that they're offered on an individual basis, so they are expensive because annuity

isn't priced in a way that's like a group product where you have better pricing.
Mr. Monroe asked if you take new hires out of this plan, does it impact the current plan for those that remain. Mr. VanOverbeke stated that it doesn't impact the benefit ultimately that is payable, but it does impact the plan because now you have some liquidity concerns because long term you no longer have contributions coming in, so money is going to be flowing in only one direction so now you have to be very concerned as to what your liquidity needs of the System are. You need to realize that you may at some point in time need to change your investment return assumption because in a closed plan, it affects the current plan because if we lower the investment return in this plan from 7%-6.5%, the accrued liability goes up tremendously as well as the normal service cost. Ms. Nerdrum gave examples of how various private companies have made changes to their defined benefit plans without moving to a defined contribution plan, stating that there is a ton of things you can do to help with costs and still give people a defined benefit when they retire.

Mr. VanOverbeke stated that a defined contribution plan would have to have mandatory contributions, and if it does not have at least 12-15% of employees' pay going into it, it's not substantive enough. Mr. VanOverbeke stated that studies support that dollar for dollar a defined benefit plan buys you a better benefit than a defined contribution plan, and you can modify a defined benefit plan to address the issues of contribution volatility, risk, etc., but there should be a real recognition that dollar for dollar a defined benefit plan will buy you 1.5 to 2 times the benefit in retirement dollars. There are hybrid plans that will share contribution volatility with employees and investment risk, although they are a little more complicated to design.

Ms. Wilkerson stated that City Council is a public body, and the best debate any individual or groups may have regarding this issue is publicly, and the Labor Committee can pass the information along to Council, but it will not have the same effect as if you speak about it publicly. By the time they get to the bargaining table, in her opinion, it is too late; so if someone has strong opinions, the time to express it publicly is coming very soon. Mr. VanOverbeke agreed, and stated that it may help the Board to know what the real concerns of City Council are, i.e., unfunded accrued liability, employer costs, which all have different routes to solutions and what they may perceive as a quick easy fix may not even be the fix that they're looking for, and the Board encourages that Council include them in the dialogue.

D. ACTION ITEMS

D-1 Resolution to Hire Tse Capital and Standard Pacific as Part of Hedge Fund Program Revision

WHEREAS, the Board of Trustees is vested with the general administration, management and operation of the Retirement System, and

WHEREAS, the Board of Trustees is required to act with the same care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a similar capacity and familiar with those matters would use in the conduct of a similar enterprise with similar aims; and

WHEREAS, Meketa as the Retirement System's investment consultant, the Investment Policy Committee, and the Board of Trustees have discussed reviewing and restructuring the Retirement System hedge fund program to a direct program for efficiency and cost savings, and

WHEREAS, the Investment Policy Committee has reviewed Meketa's proposed hedge fund portfolio program design, potential new funds, and the timelines for changes to current funds, and

WHEREAS, two potential managers, Tse Capital and Standard Pacific, presented their investment strategies to the IPC on October 7, 2014, and

WHEREAS, Meketa and the Investment Policy Committee have recommended an investment with Tse Capital (global macro) and with Standard Pacific (global long/short equity), so be it

RESOLVED, that the Board of Trustees approves the hiring of Tse Capital and Standard Pacific with investments in the amounts of approximately $6 million and $1.2 million respectively, pending review of investment management documents by the Board's legal counsel and any recommended additional due diligence, if applicable, and further

RESOLVED, that the Board of Trustees allow Meketa to work with staff and legal counsel to draw down the Optima and Orion mandates and eventually terminate them for timely funding of the newly approved mandates.

It was **moved** by Hastie and **seconded** by Flack to approve the Resolution to Hire Tse Capital and Standard Pacific as Part of Hedge Fund Program Revision in the amounts indicated above, and to pull those funds from out other fund-of-fund managers.

Approved

E. DISCUSSION ITEMS – ***Moved above, before Item D on agenda.***

~~**E-1 HR Request for Board Feedback: Pension Plan Considerations**~~

F. REPORTS

F-1 Executive Report – ***October 16, 2014***

ACTUARIAL VALUATION

The pension actuarial valuation draft is now anticipated in late October. The VEBA valuation is in process.

FINANCIAL AUDIT

The auditors from Rehmann Robson are waiting for the pension valuation figures in order to complete the financial statements audit. Executive Director has supplied the time weighted return calculations, benefit plan provision discussion, and investment policy summary to the auditor to fulfill new GASB 67 requirements. After reading another Michigan retirement system's minutes, ED learned that Northern Trust will create a time weighted return calculation for that system, but the charge for the initial year will be $2500 plus $150 for each year provided. After this initial year, the cost will be $500 per year plus $150 per return. The auditor indicates that he believes ED's approach to this calculation conforms to the new requirements.

HEDGE FUND AND OTHER MANAGER CHANGES

Thornburg has been notified of the termination of their services and redemption of all funds has been requested. As soon as the funds are received - anticipated early November 2014 - they will be invested in the Northern EAFE index fund.

BlackRock has been notified of their termination and redemption requested. Blackrock's liquidity is quarterly with a 90 days' notice period and some delay as they liquidate requested funds. 90% of the funds are expected to be received in late January to early February, with a 10% holdback on the balance of funds. Further draw downs of the other current hedge fund managers' allocations will be initiated as additional hedge fund managers are hired and as funding requirements dictate.

PENSION TRAINING

ESS pension training took place October 1st with a lighter turnout than enrolled. An additional session will be held October 29 at City Hall.

TRUSTEE SEAT UP FOR RE-ELECTION

The Board term of Jeremy Flack, elected Fire Trustee, will expire 12/31/2014. The Declaration of Candidacy form that each candidate must complete has been sent to the Clerk's Office. The deadline for filing this form will be Friday, October 31, 2014. The election is scheduled for Wednesday, December 17th and Thursday, December 18th. The new 3-year term will begin January 1, 2015 through December 31, 2017.

F-2 City of Ann Arbor Employees' Retirement System Preliminary Report for the Month Ended September 30, 2014

N. Gail Jarskey, Accountant, submitted the Financial Report for the month ended September 30, 2014 to the Board of Trustees:

9/30/2014 Asset Value (Preliminary)	$470,689,584
8/31/2014 Asset Value (Audited by Northern)	$475,694,461
Calendar YTD Increase/Decrease in Assets *(excludes non-investment receipts and disbursements)*	$22,176,868
Percent Gain <Loss>	4.8%
October 15, 2014 Asset Value	**$459,088,101**

F-3 Investment Policy Committee Minutes – *October 7, 2014*

Following are the Investment Policy Committee minutes from the meeting convened at 3:11 p.m. on October 7, 2014:

Member(s) Present:	*Clark, Flack, Hastie, Monroe*
Member(s) Absent:	*None*
Other Trustees Present:	*None*
Staff Present:	*Jarskey, Kluczynski, Walker*
Others Present:	*Edward Urban, Meketa Investment Group*
	Brian Dana, Meketa Investment Group

MEKETA - HEDGE FUND OVERVIEW

Mr. Dana updated the Committee on the transition process for the hedge fund program, stating that everything is on schedule, and the program should most likely be in place before the third quarter of 2015. Mr. Dana gave a brief introduction of the two managers making presentations today.

HEDGE FUND MANAGER PRESENTATIONS

Tse Capital
Amy Nadeau, Head of Investor Relations
Marcel Kasumovich, Chief Strategist

Tse Capital is a global macro investment manager that uses a top-down macroeconomic research process to identify potential changes in economic and financial trends over a multi-year period. The firm seeks to profit from anticipating changes in central bank policy across *fixed income, currencies, commodities and equity. The firm's portfolio manager, Irene Tse, previously served as North American Chief Investment Officer at JP Morgan, Managing Director and Portfolio Manager at Duquesne Capital Management, and Partner and Co-Head of U.S. Rates trading at Goldman Sachs.*

Standard Pacific
Raj Venkatesan, Portfolio Manager and Managing Partner

Standard Pacific launched in 1995 as a long-short equity fund. Standard Pacific seek investments around the globe both long and short and typically invests in 65 to 100 securities, with the top 10 securities comprising near 30% of the portfolio.

*It was **moved** by Flack and **seconded** by Monroe to recommend that the Board of Trustees hire both Tse Capital (with $6 million) and Standard Pacific (with $1.2 million), as part of the Committee's plan to transition to a direct program for efficiency and cost savings in the dollar amounts recommended by Meketa Investment Group, subject to review of fund documents by legal counsel.*

Approved

*It was **moved** by Flack and **seconded** by Clark to recommend that the Board of Trustees allow Meketa to work with staff and legal counsel to draw down the Optima and Orion mandates and eventually terminate them for timely funding of the newly approved mandates.*

CORRESPONDENCE FROM NORTHERN TRUST:
"UPDATE TO ASSET MANAGEMENT SERVICING TEAM STRUCTURE"

Ms. Walker reviewed a memorandum from The Northern Trust Company regarding an update to their asset management servicing team structure.

ADJOURNMENT

*It was **moved** by Flack and **seconded** by Clark to adjourn the meeting at 6:20 p.m.*

Meeting adjourned at 6:20 p.m.

F-4 **Administrative Policy Committee Minutes** – ***None***

F-5 **Audit Committee Minutes** – ***None***

F-6 **Legal Report** – ***None***

G. INFORMATION *(Received & Filed)*

G-1 Communications Memorandum

G-2 November Planning Calendar

G-3 Record of Paid Invoices

The following invoices have been paid since the last Board meeting:

	PAYEE	AMOUNT	*DESCRIPTION*
1	**DLA Piper**	**503.10**	Securities Litigation defense svcs/Lyondell – Inv. #3045730
2	**Coverall North America, Inc.**	**35.00**	Office cleaning services for September 2014 *(1 week)*

3	**DTE Energy**	**48.43**	Monthly Gas Fee dated September 11, 2014
4	**DTE Energy**	**319.70**	Monthly Electric Fee dated September 11, 2014
5	**Comcast**	**82.81**	Monthly Cable Fee
6	**Buck Consultants**	**1,583.33**	Monthly hosting fees for July 2014
7	**Meketa Investment Group**	**8,750.00**	Investment Consultant Retainer - August 2014
8	**Med Source Services/Consulting Phys.**	**875.00**	Disability exam & report – D. Churches
9	**Med Source Services/Consulting Phys.**	**1,100.00**	Disability re-exam & report – R. Robinson
10	**Lora Kluczynski**	**275.57**	Petty cash reimbursement
11	**NCPERS**	**250.00**	Membership renewal 1/1/2015 – 12/31/2015
12	**AT&T**	**260.67**	Monthly telephone service
13	**Jeremy Flack**	**1,056.30**	Fall MAPERS reimbursement
14	**GFOA**	**270.00**	Reg.fee/online training–GAAP Update 11/6/14
15	**B Green and Clean**	**96.92**	Office cleaning services for September 2014
16	**Hasselbring-Clark Co.**	**66.38**	Monthly copier cost per copy
17	**Buck Consultants**	**1,583.33**	Monthly hosting fees for August 2014
18	**Staples Advantage**	**78.77**	Miscellaneous Office supplies
19	**Robertson Morrison, Inc.**	**195.00**	Routine maintenance agmt – 4/22/2014 - 4/22/2016
20	**Meketa Investment Group**	**9,999.98**	Inv. Cons. Retainer–Sept. 2014 (+ Jul & Aug fee incr.)
21	**IFEBP**	**1,055.00**	Annual membership dues – 1/1/2015 – 12/31/2015
22	**N. Gail Jarskey**	**1,459.48**	MGFOA travel reimbursement – September 2014
23	**David Monroe**	**665.12**	2014 Fall MAPERS Conference – September 2014
24	**Rehmann Robson**	**2,340.43**	Audit progress billing – Payment #1
	TOTAL	**32,950.32**	

G-4 Retirement Report - ***None***

H. TRUSTEE COMMENTS - ***None***

I. ADJOURNMENT

It was **moved** by Nerdrum and **seconded** by Crawford to adjourn the meeting at 10:34 a.m.

Meeting adjourned at 10:34 a.m.

Nancy R. Walker

Nancy R. Walker, Executive Director
City of Ann Arbor Employees' Retirement System

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