

TUCSON SUPPLEMENTAL RETIREMENT SYSTEM BOARD OF TRUSTEES

Meeting Minutes from Tuesday, February 27, 2007, 8:30 a.m., City Hall

Members Present: John Moore, City Manager's Appointee
Suzanne Machain, Designee for Cindy Bezaury, Human Resources Director
Jim Cameron, Finance Director
John O'Hare, Employee Representative
Gage Andrews, Employee Representative
Paul Miner, Retiree Representative

Absent, Excused: Brian Bjorndahl, Chairman

Staff Present: Frank Kern, Board Counsel
Joe Ladenburg, Deputy Finance Director
Robert Leko, Treasury Administrator
Allan Bentkowski, Investment Manager
Michael Hermanson, Retirement Manager
Doris Rentschler, Finance Analyst
Claire Beaubien, Administrative Assistant

Guests Present: Rob Van Den Brink, Hewitt Consulting
Mark Klimek, Hewitt Consulting
Judith Olson, former COT Librarian
Miliary Morgan, former COT Librarian
Marie Nemerguth, City Manager's Office
Rick Roeder, Gabriel, Roeder, Smith & Co. (San Diego office)
Leslie Thompson, Gabriel, Roeder, Smith & Co. (Denver office)
Jim Hutchinson, LaSalle Investment Management
Joel Damon, JPMorgan
Scott Stein – JPMorgan Hedge Funds Management
Jean Wilkins, CTRA Representative
Approximately 10 retirees in the audience

A. Call to order

Acting Chair John O'Hare called the meeting to order at 8:32 a.m.

B. Consent Agenda

1. Approval of January 25th, 2007 Board meeting minutes
2. Service & disability retirement facts and figures report – January 2007
3. TSRS Financials for quarter ended September 30, 2006

Suzanne Machain **moved to approve the consent agenda as presented, seconded** by John Moore. **Motion passed 6-0** (Brian Bjorndahl, absent, excused).

C. Applications for Medical Retirement*

1. Sue Reyes (reconsideration) - following a brief discussion, John Moore **moved for approval of the application, seconded** by Suzanne Machain. **Motion passed 6-0** (Brian Bjorndahl, absent, excused).
2. Sally Dalton - Suzanne Machain **moved to approve this application, seconded** by John Moore. **Motion passed 6-0** (Brian Bjorndahl, absent, excused).

3. Sung (Lisa) Rubi - Suzanne Machain **moved to approve this application, seconded by Jim Cameron. Motion passed 6-0** (Brian Bjorndahl, absent, excused).

D. Presentation from JP Morgan – Hedge Fund of Funds Management – Joel Damon, Scott Stein. Joel introduced Scott to the Board, stating that Scott has been working in the Hedge Fund of Funds since 1988. His primary responsibility is to clients in the United States and in Asia. Joel remarked that the term “hedge fund” is not defined or used in any of the current federal securities laws. This term refers to a variety of pooled investment vehicles, loosely regulated and not registered under federal securities law as public corporations, investment companies or broker-dealers. Hedge funds differ substantially in their investment objectives, using different financial instruments and exposures to various markets and risk and return objectives. Generally accepted attributes include ability to use leverage, ability to use short sales to mitigate or increase risk and performance based compensation schedules.

Investors have primarily used hedge funds to provide consistent, attractive risk-adjusted returns, differentiated sources of returns and low correlation with traditional asset classes. Some of the key risks of hedge fund investing include lack of information, liquidity risk, manager risk, leverage risk, event risk and headline risk. Of these, manager risk is the most important consideration.

Hedge funds employ many strategies: one strategy is the relative value / arbitrage approach that involves simultaneous purchase and sale of similar securities to exploit any pricing differentials available. This presents the potential to generate consistent returns while minimizing directional risk. Returns are typically generated through capital gains realized as relative spreads tighten or widen, or through the convergence/divergence of yields within capital structure and volatility mispricing. Arbitrage trades are generally driven by technical factors or fundamental factors, whereas a “relative value” trade may incorporate a macro view or some “directional” market exposure. Relative value/arbitrage contains many sub-strategies, some of which are cyclical in nature and can exhibit higher degrees of correlation. Examples of these sub-strategies include convertible bond and fixed income arbitrage or statistical arbitrage.

John O’Hare asked about fees charged by hedge fund managers. Scott replied that a typical fee arrangement would be a 1% management fee plus a 20% performance fee. Two years ago, JP Morgan’s fee arrangement included a 1.6% management fee and a 5% performance fee. Currently, JPMorgan charges a 1% management fee and a 10% performance fee.

The acting chair indicated that the time allowed for their presentation had quickly passed, and he asked if this presentation could be continued at a future date – either in person or via teleconference. Both Scott and Joel responded they would welcome the Board’s invitation to finish up this discussion at their convenience.

E. Investment Activity / Status Report - Portfolio composition, transactions and individual investments

1. Portfolio composition, transactions and individual investments - Allan Bentkowski reported on the portfolio balances and composition. He reported that as of 1/31/07 the fund value was \$662.4m. \$2.5 million was transferred out of Julius Baer on 2/8/07 to provide cash flow for fund 72. On 2/20/07, the fund’s value hit an all time high of \$672,548,000, including he \$2.5 million of cash.

2. PRIME report for 12/31/06 – Hewitt Consulting – Rob Van Den Brink, Mark Klimek - Acting Chair O’Hare turned the meeting over to Rob Van Den Brink and Mark Klimek from Hewitt Investment Group to give the quarterly Performance Review and Investment Manager Evaluation for the last quarter of 2006. Rob began the presentation by reporting that the fourth quarter ended very

strong, mainly due to lower oil prices. The Federal Reserve Bank has not lowered their lending rate but some managers, like PIMCO believe they will soon be lowered. Rob reported that markets are up 3-5%. Small to mid-cap stocks are doing better than large-cap stocks. Growth did better than value in the fourth quarter of 2006. Rob reported that for the calendar year-to-date, the overall performance was very strong, performing well even with benchmark results that were quite competitive.

3. TCW report – Hewitt - Mark reported that on a calendar year-to-date basis, there was nothing substantive. Barclay's Alpha Tilts trailed the benchmark for the first year since 1999. Fidelity small-cap was at +3.6%. TCW Concentrated Core's underperformance was due to poor stock selection. Hewitt recommends TCW Concentrated Core be given three more quarters to see if they can turn their underperformance around. If in the near future turnaround isn't seen, then Hewitt will recommend replacement managers to the Board for consideration. Also, TCW Value Opportunity should be looked at closely through the first quarter of 2008. If they have not improved their performance, a replacement manager search will be completed for the Board's consideration.

4. LaSalle Fund V – Hewitt - Rob and Mark turned the meeting over to Jim Hutchinson of LaSalle Investment Management. Jim spoke to the Board regarding LaSalle's next investment fund – Income and Growth Fund V. This product is similar to Fund IV, which buys real estate that needs improvements, completes them and increases the occupancy rate and then seeks to sell the property at a price that will provide a nice return for investors. Jim emphasized that LaSalle Fund V invests only in income producing property that appears to offer consistent and predictable returns in the mid-teens.

F. Gabriel, Roeder, Smith and Company – organizational changes - actuarial services: Mike Hermanson reported that the firm had recently announced they would be restructuring and closing their San Diego office. The Denver GRS office will complete future actuarial services and their senior actuary Leslie Thompson will oversee the work. Both Leslie and Rick Roeder are here today as part of a transition team available to answer any questions that our board members may have. The discussion wrapped up with Mike confirming that our board could consider the following options for future actuarial work:

- The board could specifically request Rick Roeder as our actuary for continued service to our account, and indicate in the contract a specific number of annual appearances per year (recommend a minimum of two)
- Accept Ms. Leslie Thompson as our actuary without any further stipulations
- Contemplate an RFP to invite any number of actuary firms to propose contractual work, including GRS (approx. 6 to 8 months to complete). No action taken.

G. CTRA request for Code Amendments - Jean Wilkins, on behalf of the City of Tucson Retirees Association (CTRA) to request an amendment to Article III, Section 22 of the Tucson City Code: to prohibit the use of TSRS assets for any purpose other than for the exclusive benefit of the members. She added that the assets be used only to pay benefits to members or their beneficiaries or to pay expenses of operation and administration of the System and fund. Retirees are concerned that TSRS's assets are being used to fund the City's "End of Service Incentive Program" which will cost the system approximately \$1.7 million. CTRA believes that the program should have been

funded through salary savings in the same way previous incentive programs have been funded. Frank Kern responded that the City already pays for the incentive program by providing the employer contributions recommended by the valuations done annually. His opinion is that the Board is acting responsibly and that it is not unusual for any employer to offer incentive programs in order to avoid layoffs. The Trustees' responsibility is to make sure their decisions are actuarially sound.

Gage Andrews asked if the Board had considered the actuarial consequences for past approvals. Frank Kern assured him that the Board routinely considers the actuarial effect of any change in the program, and the End of Service Program was no exception. Mike Hermanson asked whether CTRA could specify what they were trying to accomplish with this code amendment. Jean Wilkins answered the retirees are concerned by the precedent set from this program, and that pension monies are being used to pay for employer incentives. John Moore asked to hear from the actuary and the retirement system manager. Rick Roeder commented that it the End of Service Program probably costs the system a small amount in the short term, but this would be paid back through future contributions made by the employer. Rick also stated that the notion of excess earnings is not clear. Mike stated that accepting this request for a change in the code is tantamount to relinquishing control over benefit programs the board might consider for recommendation in the future, and in that sense would handcuff the ability of this Board to make future recommendations to Mayor & Council.

Jim Cameron commented that CTRA's language is very restrictive, which will tie the hands of the Board and Mayor & Council. Paul Miner remarked that the City could use the perceived savings to fund new incentives. John Moore asked if the Board could recommend that incentives not be funded from pension monies. Paul Miner **moved, seconded** by John O'Hare, to recommend to Mayor & Council that future incentives not be funded by pension funds. **Motion failed 2-4** (Brian Bjorndahl, absent, excused). Gage Andrews **moved, seconded** by Paul Miner, to table further consideration of this topic to a future meeting. **Motion passed 6-0** (Brian Bjorndahl, absent, excused).

H. City of Tucson Part-time Librarian Request

Mike Hermanson gave a synopsis of a letter from two former City of Tucson employees who were part-time status librarians moved to Pima County at the end of last June. In the letter, Milary Morgan and Judith Olson requested that the Board consider making a special adjustment to the way TSRS reports their service credit to the Arizona State Retirement System. Part-time employees' service time is calculated on the basis of the number of hours worked, which is different than how this is done for employees participating in the Arizona State Retirement System. For ASRS, after a member reaches qualification, ASRS counts an entire month of service credit for part-timers that work a minimum of 20 hours per week. TSRS annualizes salary, so that the average final salary is equivalent to that of a full time employee, so that their formula is not affected by the amount of pay received. ASRS uses the actual pay received for par-timers. John O'Hare asked how many people were affected, Mike responded there are less than 10. Milary Morgan addressed the board at length. She believes there should be an "across the board" amendment to change the way TSRS reports their service time to ASRS. Jim Cameron **moved, seconded** by Paul Miner, to table this topic until the next meeting so that the Board has time to explore solutions to this issue. **Motion passed 6-0** (Brian Bjorndahl absent, excused).

- I. Study group report - Post Retirement Benefits - Jean Wilkins reported that the committee was making headway. They were waiting for some actuarial analysis to be completed and the committee should have a recommendation for the Board in about 6 weeks.
- J. Board member listing - Mike mentioned that with the few new members on the Board, a new Board Member listing had been included in the packets.

K. Future Agenda Items

The following agenda items were listed for future meetings:

- Discuss part-time library situation
- CTRA request follow-up
- RFP for actuary
- Fidelity annual report in March
- TCW Concentrated Core and TCW Value annual reports in May

L. Call to Audience

None heard.

M. Adjournment

Suzanne **moved, seconded** by Gage Andrews, to adjourn. **Motion passed 6-0** (Brian Bjorndahl absent, excused). Meeting adjourned 11:46 a.m.

Approved:

Brian Bjorndahl
Chairman of the Board

Date

Mike Hermanson
Retirement Manager

Date