

NHRS Regular Board of Trustee Meeting
December 14, 2010

Note: These minutes from the December 14, 2010, regular meeting were approved and executed at the January 11, 2011, regular meeting of the Board of Trustees.

**Regular Meeting
Board of Trustees
December 14, 2010**

**New Hampshire Retirement System
54 Regional Drive
Concord, New Hampshire**

Trustees: Lisa Shapiro, *Chair, presiding*, Danny O'Brien, *Vice Chair*, Dean Crombie, Sam Giarrusso, Rep. Ken Hawkins, Keith Hickey, Germano Martins, Brian Morrissey, Cathy Provencher, Jill Rockey.
Absent: Justin Cutting, Charles Koontz.

Staff: Richard Ingram, *Executive Director*; Larry Johansen, *Director of Investments*; John Browne, *Internal Auditor*; Jack Dianis, *Director of Finance (as of 12-20-10)*; Tim Crutchfield, *Chief Legal Counsel*; Nancy Miller, *Director of Member Services*; Carolyn Johnson, Esq., *Hearings Examiner*; Bill Spead, *Regulatory Compliance Officer*; Kristie Kathan, *Human Resources Coordinator*; Marty Karlon, *Public Information Officer*; and Shannan Hudgins, *Administrative Coordinator*.

Dr. Shapiro called the meeting to order at 10:25 a.m. She introduced Mr. Jack Dianis, new Director of Finance for the System, and asked that he provide the Board a brief statement about his work and anticipated arrival at the System. Mr. Dianis informed the Board that he was coming from the Legislative Budget Assistant (LBA) Office, a non-partisan group that works with both the House and the Senate. After sixteen years with the LBA, he stated that he looked forward to joining the NHRS on December 20th, and that the next six to eight months would be very busy.

The Chair next introduced Rep. Ken Hawkins as the new member of the Board appointed by the Speaker of the House. She emphasized his familiarity and experience with the System as a member of the House Executive Departments and Administration (ED&A) Committee and welcomed him to the Board. Dr. Shapiro asked the Board and Staff to introduce themselves and their role at the meeting to Rep. Hawkins.

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On a motion by Mr. Morrissey, seconded by Ms. Provencher, the public minutes of the October 12, 2010, Board meeting were approved. Rep. Hawkins abstained. On a motion by Mr. Morrissey, seconded by Ms. Provencher, the public minutes of the November 9, 2010, Board meeting were approved. Rep. Hawkins abstained.

Vice Chair O'Brien respectfully requested that Trustees be recognized before speaking and that all remarks by Board members reflected in the minutes be identified by the speaker. Dr. Shapiro confirmed that the shift in practice would appear in the December minutes.

On a motion by Ms. Rockey, seconded by Mr. Hickey, the Consent Agenda, with the removal of S.B. and the Administrative Recommendation, was approved.

Dr. Shapiro stated she would entertain a motion to enter into non-public session under RSA 91-A:3, II(c) to discuss a disability application. Trustee Hickey moved, Trustee Giarrusso provided the second, and a roll call vote was taken, as follows:

Ayes: Dr. Shapiro, Mr. O'Brien, Mr. Crombie, Mr. Giarrusso, Rep. Hawkins, Mr. Hickey, Mr. Martins, Mr. Morrissey, Ms. Provencher, Ms. Rockey.

Nays: none.

On a motion by Ms. Provencher, seconded by Mr. Giarrusso, the Board of Trustees concluded the non-public session.

On a motion by Mr. Hickey, seconded by Rep. Hawkins, the Board tabled the Hearings Examiner's recommendation in the matter of S.B. until the January Board meeting so that Staff can gather more information regarding the request for the Board's review and consideration.

In consideration of the Administrative Recommendation from the Consent Agenda, the Chair requested a motion to allow the member to purchase prior service outside the administrative rules. Mr. Ingram provided an explanation of the disparity between the statutory language and the NHRS rules. Although the statute for most service-purchase allowances was open-ended, the NHRS rules were specific about a time limit for such requests. He explained that Staff were bound by the rules and could not unilaterally overturn them for a member's request. Rep. Hawkins requested an explanation of the calculations used in the prior service request before the Board for approval. Mr. Ingram explained that the calculation described in current statute for most service credit purchases was an algebraic one, not a full actuarial calculation. Driven

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by statute, the calculation was “salary x employee plus employer rates x number of years requested.” Dr. Shapiro surmised that in order to obtain an actuarial calculation, the Board would need to seek a legislative change in the statute. Mr. Ingram confirmed her statement, noting that such a change had been proposed, but failed to pass, in the last legislature. Rep. Hawkins stated that he expected the Legislature to eliminate service purchases altogether.

Upon the Chair’s request, Rep. Hawkins moved, and Mr. O’Brien seconded, the Hearing Examiner’s recommendation that the Board not uphold the staff’s determination denying Petitioner P.T.’s prior service request. The motion carried unanimously.

Mr. Ingram began his report to the Board with reference to the Organizational Development memorandum that had been sent to all Board members under separate cover the previous week. He reminded the Board there was a meeting of the PPCC, scheduled to follow the regular Board meeting. Hearing no questions or commentary, he offered the Financial Summary. Mr. O’Brien expressed his concern with the percentage increases in salaries (21%) and expenses (21%) from actual year-over-year, as well as his frustration with the continued comparison of the Financial Report to the Budget. He named the following items as troublesome: budget process; absence of comparison of budget with actual; absence of budget reconciliation; and lack of discussion and scrutiny of double-digit increases of specific items in the report. Additionally, he requested more focus be made on year-over-year actual results.

In response to Mr. O’Brien’s comments, Mr. Ingram stated that staffing levels and increased communications with constituents during the last six months reflected appropriate business operations. He emphasized that a comparison with the artificially low activity in the organization in previous years did not appropriately reflect the shift in operations NHRS had experienced.

Ms. Provencher questioned the State’s share of employer contributions (found on Schedule A) as nearly 31% over budget. Mr. Ingram stated that he believed that it was a timing difference of pay periods versus reporting timetables. Ms. Provencher also asked how and who caught the \$12,068,333 accounting error in Non-Investment Income made by Northern Trust. Mr. Johansen confirmed that it was detected by the reconciliation performed by the NHRS Investment Team. Mr. Ingram noted that the error was identified in the month it occurred and the correction was made the following month.

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Dr. Shapiro inquired whether the IT report was in line with the audit review. Mr. Ingram explained that the large number of helpdesk tickets reflected open technology issues that Staff was completing. Mr. O'Brien asked for a report of IT priorities with an emphasis on return on investment. In reviewing Schedule J - Legal Fees, Dr. Shapiro requested an in-depth explanation of expenditures and a projection of expected fees for the remaining months of FY 11.

Mr. Ingram addressed fiduciary insurance renewal, which expires January 15, 2011, and asked Attorney Crutchfield to review the process he had followed in obtaining coverage quotes. Dr. Shapiro expressed concern that \$13 million was too low an amount of coverage, particularly because the coverage includes Independent Investment Committee (IIC) members, and requested additional quotes and options for Board review. Mr. O'Brien asked whether break points had been explored, and whether negotiation on the 15% broker fee had occurred. Attorney Crutchfield affirmed both actions in his process, referring the Board to the details of his memorandum. Rep. Hawkins questioned the arithmetic of the \$15M quote, resulting in a correction of the RLI \$5M excess coverage quote to \$34,100. The total quote of \$149,000 did not change.

Mr. O'Brien suggested that additional quotes be obtained, as well as more research performed for break points and increased coverage. Following a discussion of the number of Trustees and IIC members covered under the fiduciary insurance policy, the Chair asked for an expanded report for presentation and decision at the January Board meeting. Mr. Ingram stated that the requested materials would be forwarded to all Board members in advance of the monthly mailing.

In reference to the four one-page reports he included in his monthly report to the Board, Mr. Ingram briefly noted the progress of member/non-member data gathering, the administrative budget process with the Governor's staff, legal fee analysis, and an IT consultant update. Mr. O'Brien cautioned against paying a consultant for tasks to be performed by a full-time IT manager. He also inquired about the hiring status of an IT manager, to which Mr. Ingram briefly described the current relationship with the IT consultant and the mapping of an NHRS technology plan, as directed by the Board at its October meeting. Dr. Shapiro confirmed that the Board was awaiting a report from Staff outlining an appropriate plan for the IT department. Mr. O'Brien asked if the Board could expect said report in January, and Mr. Ingram offered a qualified yes, determined by staff health and workload.

Dr. Shapiro requested a report that would better aid Board members in their monitoring of action items and progress on those items from month to month. Mr. Ingram stated that the Audit Tracker was the most

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comprehensive document to fulfill that request. The Management Letter from KPMG for the audit was expected at week's end. Each point made in the Management Letter would then migrate to the Audit Tracker, as maintained by John Browne. Mr. Ingram confirmed that the January Audit Tracker would include IT issues, noting that the Management Letter only addressed IT matters.

Trustee Rockey requested a discussion of member/non-member data gathering, asking whether RSA 91:A could be the appropriate mechanism for NHRS to request participation data from employers. Mr. Ingram replied that Staff was interested in the capability to capture data from payroll submissions, but the technology system implications had yet to be fully reviewed. He noted that employer audits captured the information, but Staff was looking to a more comprehensive data-capturing mechanism.

Dr. Shapiro stated she would entertain a motion to enter into non-public session under RSA 91-A:3, II(c) for a discussion that adversely affects the reputation of someone not a member of this body. Trustee O'Brien moved, Trustee Giarrusso provided the second, and a roll call vote was taken, as follows:

Ayes: Dr. Shapiro, Mr. O'Brien, Mr. Crombie, Mr. Giarrusso, Rep. Hawkins, Mr. Hickey, Mr. Martins, Mr. Morrissey, Ms. Provencher, Ms. Rockey.

Nays: none.

On a motion by Mr. Morrissey, seconded by Mr. Crombie, the Board of Trustees concluded the non-public session.

Ms. Provencher, as Chair of the Audit Committee, presented the Committee's unanimous recommendation that the Board accept the Comprehensive Annual Financial Report (CAFR), with a replacement of the Chair's letter, as amended by recommendation of counsel. On a motion by Mr. Hickey, seconded by Mr. Hawkins, the Board of Trustees accepted the CAFR. In accordance with statutory guidelines, Mr. Ingram stated that the CAFR would be delivered to the appropriate State officials, twenty-five copies would be sent to the State Library, and the report would be posted to the NHRS website. Mr. Johansen added that the Comprehensive Annual Investment Report, approved by the Board at its November meeting, would be included with the CAFR distribution.

Ms. Provencher continued her report of the Audit Committee with a discussion of the 401(h) plans. She presented the NHRS Staff memo delineating the funding status of each of the four plans that included

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analysis of projected cash flows for the sub-trusts and related fiduciary issues. The document identified two plans that were headed toward a deficit balance – teachers in December 2010, and Group II in mid-2013. She confirmed that the rates certified for the next biennium had taken into account the projected deficit status of these two accounts. Staff had constructed two options for consideration: allowing the accounts to temporarily run a deficit until the FY '12 and '13 rates made up the projected deficits or recertifying the political subdivision rates to take effect 7/1/11. In her presentation, Ms. Provencher cautioned against the second option because raising rates effective 7/1/11 to recoup deficits in the immediate term would have deleterious effects on towns and municipalities, forcing new town meetings and new budgets. Upon reflection, the Board took no action on the information. Trustee Morrissey asked if the plans could legally operate at a deficit, and Mr. Ingram confirmed the situation was legal. He then inquired if the plans would repay the borrowed funds with interest. Upon confirmation of that question, Mr. Hickey stated he would not vote to recertify the FY '11 rates. In her commentary regarding the certified rates, Ms. Provencher emphasized that the financial downturn of 2009 had not been anticipated when the rates were set and investment losses were not smoothed when accounting for the OPEB plans. Additionally, a greater-than-average number of teachers had retired due to legislation in 2008 and 2009, accelerating the deficit status for that group. The VCP compliance action transferring \$89 million from the Group II OPEB sub-trusts also contributed to the projected deficit for the sub-trust.

Mr. Ingram added that the disconnect between the funding statute provisions and the benefit statute provisions required an actuarial calculation and estimate that resulted in a funding gap for those two OPEB plans.

Ms. Provencher referenced the VCP compliance letter. Staff was working on rules related to the VCP for the Board's approval and would present them at a later meeting. She then turned to the Ethics Survey Report, stating that the Audit Committee unanimously recommended the Board approve the Annual Ethics Report Card, noting the Director of Investments had contacted the service providers who had not responded to the request. Mr. Hickey moved, Mr. O'Brien provided the second, and the motion was approved.

Upon presentation of the Audit Tracker, Rep. Hawkins questioned the Unclaimed Refunds, #57 of the document. He wondered if those funds, like unclaimed funds, did not rightfully belong to the State Treasurer. Attorney Crutchfield answered that the funds had not just originated from State funds, but had also come from political subdivision funds. Ms. Provencher explained that abandoned property is comprised of funds

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from banks, insurance companies, trust funds, stocks, and more, that revert to the state when after due diligence, the provider cannot locate the owner/beneficiary of the property. She asked why unclaimed refunds from the NHRS did not also revert to the State. Mr. Browne stated that he and Attorney Crutchfield had taken the issue to outside counsel. Attorney Crutchfield stated he would research the history of NHRS action on abandoned property and report to the Board, although he suggested the exclusive benefit provision under IRS trust law was at the center of the NHRS position.

Ms. Provencher asked whether Board materials, exclusive of confidential materials, could be posted on the NHRS website once the agenda was publicly available. It was agreed that Board materials would be posted on the website when they became available to Trustees, absent disability and other confidential documents. The posted materials would carry a DRAFT watermark to accommodate any necessary changes between the mailing of the documents and the Board Meeting.

Rep. Hawkins also questioned the correctness of No. 63 in the Audit Tracker and the member's responsibility to pay 50% of purchasing service credit from an employer's oversight. Mr. Browne stated he would verify the statute, but believed the information was correct as presented. Mr. Ingram stated that the application of this statute was specific and narrow.

Following a brief lunch break, Vice Chair O'Brien requested a legal update from Chief Legal Counsel Crutchfield. He referred the Board to his memorandum detailing pending court cases in which the NHRS was a party. In preparation for the annual Statement of Financial Interests, Attorney Crutchfield informed Trustees he would be sending them the forms via e-mail on December 15, 2010, and the completed forms were due in the NH Secretary of State's Office by January 15, 2011. Trustees would be asked to complete them and either return them to Attorney Crutchfield or deliver them directly to the Secretary of State. Ms. Provencher reminded the Board that if the form was not appropriately filed, a Trustee could not vote in the February meeting.

The Chair proceeded to the Benefits Committee Report. Committee Chair Martins provided the Board a brief recapitulation of the IME Review Policy and the clarification statement requested by Dr. Shapiro at the November meeting for a more comprehensive complaint-screening provision. Earlier that morning, the Committee approved the revised policy that incorporated the requested clarification. On a motion by Mr. Martins, seconded by Mr. Morrissey, the Board approved the IME Review Policy as presented by the Benefits Committee.

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Trustee Martins reported to the Board that the Committee was working diligently on a Recoupment policy that would serve members and protect the corpus of the pension trust.

Dr. Shapiro addressed the Legislative Committee Update, noting that the Trustee Koontz, the Committee Chair, was absent. Mr. Giarrusso asked for a tally of time and expense for Staff in working on any and all legislative changes. Mr. Ingram stated that he would also be tracking the technology requirements driven by legislative action. The Chair asked him to discuss his plans in how he staffs the legislative issues, both internally and at the State House. Mr. Ingram acknowledged that the legislative session ahead would be a busy one for Staff on call, specifically himself, Larry Johansen, Tim Crutchfield, Marty Karlon, and Jack Dianis, depending on the proposed legislation and its effect on the System. Mr. Dianis would be integral to preparing the fiscal notes for the bills before the Legislature. He noted that Staff kept track of the Legislature's consideration of the proposals and its recommendations on those proposals in the Legislative Tracker, regularly reporting to the Board and making specific recommendations for Board action where appropriate.

Dr. Shapiro referenced a summary sheet included in the Legislative Tracker to track any legislation with potential fiduciary impact on the System. She noted there would be outside legal costs associated with that analysis, as well as actuarial evaluation. Mr. Giarrusso noted that some legal costs would be triggered by legislation and added a burden to the System and participants. In closing, the Chair emphasized that despite the careful tracking of pending legislation by Staff, there were very few bills on which the NHRS formally expressed an opinion. Rep. Hawkins stated that he had signed off on all LRS's he had sponsored.

Following the discussion of the 2011 Legislative Term, the Chair requested a report from Mr. Johansen, Director of Investments. He opened his remarks by stating that based on Board direction, the Accountability Matrix would be forwarded to the Governance Committee for review.

Moved by Mr. O'Brien, seconded by Mr. Hickey, the Board unanimously adopted the Proxy Voting Policy as presented in the Board book.

Mr. Johansen informed the Board that on November 30, 2010, Northern Trust had announced that clients could elect to completely exit the securities lending program. He confirmed that NHRS had filed the appropriate documents to exit the securities lending program, and that final exit was expected to occur in January 2011. The Investment Team had been continuously reducing the balance available for lending in the

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separate accounts at Northern Trust, and as of Monday, November 15, 2010, the loan cap had been reduced to approximately \$5 million. This amount represented a substantial reduction in the July 1, 2010, loan cap of over \$471 million. He hoped to confirm with the Board at the January meeting that NHRS was out of the securities lending program.

In his general remarks, Mr. Johansen confirmed that uncertainty in equity markets continued. He distributed a chart that revealed the uncertain path of the S&P 500 over the calendar year. Noting the decline of late November had been reversed in early December, he stated that as of late Monday afternoon, December 13, 2010, the broad equity market was up 11.2% for the calendar year. The transition of assets from the Russell 2000 index to Netols and the four new managers was complete, and the transition of assets from the S&P 500 index to AllianceBernstein, L.P. and Thomson, Siegel & Walmsley, LLC was also complete. He asserted that a pre-trade and a post-trade analysis of both transitions would be reviewed at the December Investment Committee meeting.

He referred the Board to the November and December Investment Committee highlights found behind Tab 8 in the Board book. He concluded his remarks with a brief overview of portfolio performance for the periods ending October 31, 2010, as follows: for the three months ending October 31, 2010, total marketable investments returned 7.0%, out-performing the blended benchmark by ten basis points. For the one year ending October 31, 2010, total marketable investments returned 14.3%, under performing the blended benchmark by 20 basis points. For the three years ending October 31, 2010, total marketable investments out-performed the blended benchmark by 20 basis points.

Mr. Johansen addressed a query from Mr. Giarrusso regarding the transaction costs of investments and why the NHRS had never been below the mean. Dr. Shapiro asked Mr. Johansen to offer a tutorial on transaction costs. He began by explaining that transaction costs are measured relative to the 20 or 30 day history of similar transactions in the marketplace and based on the average cost of moving similar transactions from point *a* to point *b* over the same 20 or 30 day period. When the transaction is actually made, events work either in one's favor or against one's favor. He emphasized that it was a dynamic environment and the transaction costs were measured against the historical average over a finite number of days. The decision of the Investment Committee to move from *a* to *b* was based on the number of managers substantially underperforming the market, and the transaction costs were appropriate for the changes made. He concluded by stating that for the three-year period ending October 31, 2010, NHRS was 20 basis points ahead of the market.

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Dr. Shapiro reminded the Board that the Investment Committee Meeting was scheduled for Friday, December 17, 2010. January would bring a return to the standard IIC meeting schedule. She referred the Trustees to the committee membership listing in the back of the Board book, noting that assignments would need to be reviewed in January.

On a motion by Mr. Hickey, seconded by Mr. Giarrusso, the Board approved the travel request by Trustee Crombie to attend the public pension trustee forum in Florida from January 30 to February 2, 2011.

On a motion by Mr. Morrissey, seconded by Mr. Martins, the Board adjourned at 1:55 p.m.

Respectfully submitted,
Shannan Hudgins