City of Rockville Retirement Board

June 10, 2011

PRESENT: Alex Espinosa, Chairperson; Mark Pierzchala, Councilmember; Jack Rodgers, Citizen Representative; Anita McCombs, AAME Representative; Cpl. Chris Peck, FOP Representative; and Carlos Vargas for the City Manager. Also in attendance were Gavin Cohen, Executive Secretary to the Board; Tim Peifer, Financial Systems Manager; Daisy Harley, Personnel Administrator; Mary Beth Evans, Prudential; as well as Amy Heyel and Taylor Benson, Segal Advisors.

ABSENT: Kyle France, Union Representative

The meeting commenced at 10:00 a.m. with introductions.

I. Approval of Minutes February 18, 2011:

Councilmember Pierzchala stated that there are a couple of corrections to be made. He pointed out that in Item V, the word unfounded should be changed to unfunded. Mr. Espinosa said that under Item V as well the word ration should be changed to ratio. Councilmember Pierzchala moved to accept the minutes pending the corrections are made. Cpl. Peck seconded. All were in favor.

II. Appointment of New Member, Jack Rodgers:

The Board welcomed Mr. Rodgers. Mr. Rodgers stated that it was a great opportunity for him and said he feels the Board has done very well. Mr. Cohen thanked him for his involvement in the RFP process of searching for an actuary. Mr. Cohen said that the RFP had been approved by the Mayor and Council and Mr. Espinosa asked if Mr. Rodgers had any more questions. Mr. Rodgers said that Councilmember Pierzchala and Mr. Cohen have provided him with a lot of background of the accomplishments of the Board and still feels he has a lot to learn.

III. Investment Performance Review 1st Quarter End March 31, 2011:

Ms. Heyel and Ms. Benson reviewed and discussed the first quarter Pension and Thrift Reports, and investment strategy review for the Pension Fund and the updated Thrift Investment Guidelines.

As of March 31, 2011, the Pension Plan was valued at $59.9 million and returned 4.4% for the recent quarter. For the one year period, the Plan returned 17.1%, outpacing the Policy Index return of 14.8%. All of the market segments contributed to the performance. Ms. Heyel reviewed a May Flash report, which included the City's annual contribution of $3.4 million. At the end of May 2011, the assets including the contribution were valued at $64.0 million. The small cap and fixed income managers continued to outpace their respective benchmarks for the year-to-date period.

Next they reviewed and discussed the Thrift Report. As of March 31, 2011, the assets were valued at $18.0 million. Most of the assets continued to be invested in the Money Market portfolio as the former default and most conservative investment. However, approximately 9.7% of the assets moved to the dynamic target date solution, Goal Maker (replacement for the Lifecycle Funds). This was the first quarter's performance with the new investment line up with Prudential as record keeper. Segal reviewed performance with the longer annualized periods and it is important to note that for the five year period, all the Funds outpaced their respective benchmarks and peer universe medians.

The Board accepted both performance reports

IV. Investment Strategy Alternatives:

Ms. Heyel and Ms. Benson reviewed and discussed the Board's investment strategy. They discussed the impact of the Benefit Index required reserve amount and alternate options for moving assets away from Principal as investment manager into other asset classes in order to diversify the Plan. They recommended a $25 million Benefit Index reserve (which is a 20% premium over the current required $18million) with Principal. Mr. Vargas moved to approve the reserve amount of $25 million and the investment policy of 18% Large Cap, 12% Small Cap, 25% International Equity, 22.5% Fixed Income, 12.5% Real Estate, 10% Inflation Hedge/Real Return. Cpl. Peck seconded. All were in favor. Segal recommended to the Board that

the Board add an additional asset class called Inflation Hedging, and that the Board allocates 10% of the portfolio to this asset class. This would be a change from the current asset allocation mix. Segal recommended that this 10% come from reduction in allocation to equities. They discussed two ways to implement the real return option, either through the PIMCO Real Return Fund (on the Principal platform to take advantage of satisfying a portion of the Benefit Index) or through an outside manager. The Board provided direction to Segal Advisors to conduct a manager search for an Inflation Hedge Product. Segal will present the search results at the next meeting and the Board will decide on the implementation at that time. They will also update the Pension Plan Investment Guidelines for consideration and adoption at the next meeting. Mr. Vargas moved to accept the draft of the Pension Plan Asset Allocation. Cpl. Peck seconded. All were in favor.

Mr. Rodgers noted that Section 15-87 Powers and Duties Item (b) of the Rockville Code of Ordinances states "In no event shall the grant of power contained herein be construed to include direction by the {Retirement} Board of the investment of funds of the Pension Plan nor…both of which powers shall remain in and be exercised by the Council". This suggested to Mr. Rodgers that the Board could only recommend to the Council concerning Pension Plan investments rather than issue investment instructions directly to Prudential Retirement. Mr. Cohen assured Mr. Rodgers that Mr. Rodgers' interpretation was not correct and that the Retirement Board has always directed the vendor with regard to investments. Mr. Rodgers requested that the Board ask the city attorney to review the ordinance section in question and provide an e-mail opinion to Board members confirming the Board could direct Prudential with regard to direct investment of the funds.

V. Thrift Plan Statement of Investment Policy:

The major reason for changing the policy is that the manager has changed from Principal to Prudential. Segal presented the draft of the Thrift Plan Guidelines, with a change to delete the performance standard for the Goalmaker option. After a discussion of the redline version and the updated version, suggestions were made for other changes. Mr. Rodgers moved to have Segal make the changes to the Thrift Plan Statement of Investment Policy. Councilmember Pierzchala seconded it. All were in favor. Segal said they would revise the guidelines and send a clean version for execution. Ms. Benson notified the Board that this would be her last meeting. The Board thanked her for all of her time spent serving the Board.

VI. RB Trust Investment Performance Review 1st Quarter End March 31, 2011:

The Board discussed and reviewed the performance report. It was discussed that there are no investment policy guidelines for the Trust. Councilmember Pierzchala reminded the Board that the Retirement Benefit Trust is the only fund where a divestment from Sudan policy would currently apply. If so, it has minimal exposure. It was discussed that if the Mayor and Council adopt legislation prohibiting investments in Sudan then the Board would have to change its policy accordingly. It was discussed that the age for retirement for new hires after July 1, 2011 is changed to 65, which would mean that the loss of this benefit should decrease cost over time as no need to bridge the gap from normal retirement age of 60 to Medicare age of 65.

The Board accepted the Retirement Benefit Trust performance review.

VII. Contract Award Actuarial Services RFP #40-11:

Mr. Cohen gave a brief history of prior actuarial services. He said that a sub-committee of Board members and staff had received and reviewed eight proposals and decided to interview three finalists. He stated that the Board will be better served going from two to one actuary for services for both Pension and Thrift plan and recommended the Hay Group as they came across able to do the best job. Out of three vendors interviewed they seemed the best able to present complex information to the Board and the Mayor and Council in a way all could understand. The information they presented was professional and easy to understand. The subcommittee weighted them on value and not lowest bid. Mr. Espinosa thanked the subcommittee for their hard work on this. The Board recommended that the contract for actuarial services be awarded to The Hay Group. Cpl. Peck made a motion to approve a contract with the Hay Group for actuarial services. Councilmember Pierzchala seconded. All were in favor. The Hay Group will begin as soon as the Mayor and Council award the contract on June 20, 2011.

VIII. Segal Advisors, Inc. Contract Extension:

After a brief discussion Mr. Rodgers motioned for Staff to recommend to the Mayor and Council a one year extension to Segal Advisors, Inc. for pension plan investment consulting services. Cpl. Peck seconded. All

were in favor.

IX. Employee Supplemental Contributions:

At the Mayor and Council meeting held on April 25, 2011, the Mayor and Council approved the Plan amendment to include the Police as part of the ESC provisions of the Plan. The Mayor and Council requested that the ESC be discussed at a future agenda meeting. At the Mayor and Council meeting held on May 12, 2011, the Mayor and Council deferred their decision on whether to implement ESC for FY2012 and requested that the Board take up the question and provide a response to the Mayor and Council.

After much discussion, the Board decided that additional information may be provided by the new actuary to the Mayor and Council in order for them to make a decision going forward, and that the Mayor and Council should be informed that the Board would like to see the results of the experience study, the valuation reports from the new actuary before deciding on employee supplemental contributions.

Mr. Rodgers observed that the issue of whether to implement an employee supplemental contribution was prompted by the continuing projected shortfall between Pension Plan assets and long term liabilities. He noted that projected fund assets are based on an investment return assumption of 7.75% and the projected shortfall also does not reflect whether and when there would be an actual cash shortfall in any year during the projection period. Mr. Rodgers suggested that an alternative projection of assets and liabilities be prepared based on actual Pension Fund investment return experience-perhaps the last ten years. Further he suggested that projected annual actual benefit payments (cash flow) be compared to projected available annual assets to determine when the Fund would run out of money. Mr. Rodgers proposed that this information be included in material to be prepared by the new actuary and presented to the Council during its consideration of whether to implement employee supplemental contribution payments.

X. Retirement Eligibility Requirement Modification:

Mr. Cohen started this item explaining that the Board recently made a series of recommendations to the Mayor and Council that included changes to the early retirement reduction formula and increases to the early and normal retirement eligibility requirements for administrative and union employees hired on or after July 1, 2011. On April 25, 2011 the Mayor and Council accepted many of the Board's recommendations, but decided to use higher age levels for retirement eligibility purposes, specifically age 58 for early retirement and 65 for normal retirement. Police employees were not part of any of these recommendations.

During the April 25, 2011 discussion, two councilmembers expressed interest in a way to lower the age requirement for eligibility purposes for more physically demanding positions. However, the plan or retirement law does not treat plan members as individuals but places individuals into groups making this distinction almost impossible to structure under the current plan.

The union employees are all required to perform at a level that is physically demanding, unlike administrative employees whose positions are predominately sedentary in nature. An early retirement age of 55 and regular retirement age of 62 for union workers may be more consistent with work demand requirements of their positions and still provide the necessary savings to the retirement fund to preserve its long-term financial health. After much discussion, the Board did not think it necessary to make another recommendation since one had already been made to the Mayor and Council. The Board decided to defer any action on this item.

Discussion Options for Future Agendas:

Councilmember Pierzchala brought to the Board's attention regarding investments in Sudan. Mr. Cohen said the Retiree Benefit Trust would be the only area that there could be investments that currently applied and it would be minimal. Ms. Heyel said that it would have to be prohibited in the investment policy. Councilmember Pierzchala also asked if everyone saw the article in the Gazette from a former employee and asked who makes the decision regarding the COLA and Mr. Vargas responded the Board makes the recommendation to the Mayor and Council. Councilmember Pierzchala also stated that the two future items that have not been discussed yet are the Ethics Policy and Liability Coverage and he would like them to be discussed in the near future.

The meeting was adjourned at 1:00.