

**CITY OF PONTIAC, MICHIGAN
POLICE AND FIRE RETIREMENT SYSTEM**

July 23, 2009

A regular meeting of the Board of Trustees was held on Thursday, July 23, 2009 at the Shrine Room, Main Level, City Hall, 47450 Woodward Avenue, Pontiac, MI 48342. The meeting was called to order at 9:12 a.m.

TRUSTEES PRESENT

Brian Lee
Thomas Miller, Vice Chair
Craig Storum, Chairman

TRUSTEES ABSENT

Mayor, Clarence Phillips (*absent*)

OTHERS PRESENT

Beth Bialy, Plante & Moran
Cynthia Billings, Sullivan, Ward, Asher & Patton, P.C.
Anthony Asher, Sullivan, Ward, Asher & Patton, P.C.
Sharon Almonrode, Sullivan, Ward, Asher & Patton, P.C.
Chris Kuhn, Gray & Company
Ellen Zimmermann, Retirement Systems Administrator
Jane Arndt, M-Administrative Assistant

CONSENT AGENDA

- A. Minutes of Regular Meeting: May 16, 2009
- B. Minutes of Special Meeting: May 20, 2009
- C. Communications:
 - 1. Correspondence from DDJ Capital Re: Monthly Summary April & May
 - 2. Correspondence from ADP Re: Fee Increase
 - 3. Correspondence from Oppenheimer Re: Organizational Changes
 - 4. Conferences:
 - a. Investing in Infrastructure – IREI – Nov 30 – Dec 2, 2009
 - b. 55th Annual Employee Benefits conference – IFEBP – Nov 8-11, 2009
 - c. 60th Diamond Anniversary Fall Conference – MAPERS – Sept 13-15, 2009
 - d. Investment Trade Summit – Opal Financial – Sept 23-25, 2009
 - e. Liability Driven Investing – P&I – Sept 15-17 or 22-24, 2009
- D. Financial Reports:
 - 1. Financial Reports – May & June 2009
 - 2. Securities Lending – April, May & June 2009
 - 3. Accounts Payable – June & July 2009
 - 4. Q2 Due To/ Due From
 - 5. Securities Lending Deficiency
- E. Remove from the Rolls:
 - 1. Robert Rood (deceased 06-24-09) survivor benefit of \$1,206.14/mo to Ruby Lucille Rood
- F. Application for Service Retirement
 - 1. Terri Covington – PPOA 22 years, 11 months Age 50

G.	Final Benefit Calculation		
	1. Eugene McNabb	#2449	\$4,969.07
	2. Torrence Keels	#2452	\$3,517.72
	3. Anthony Turner	#2456	3,949.54
	4. Richard Luxon	#2458	4,277.43
	5. Rolland Thayer	#2459	4,326.52
	6. Charles Brantley	#2474	3,522.68
H.	Longevity Recalculation		
	1. Eugene McNabb	#2449	\$4,959.28
	2. Torrence Keels	#2452	\$3,510.13
	3. Anthony Turner	#2456	3,941.28
	4. Richard Luxon	#2458	4,268.44
	5. Rolland Thayer	#2459	4,317.35
I.	Disability Re-Examinations		
	1. Christopher Young		
	2. Mark Hilborn		
	3. Scott Wedge		

RESOLUTION 09-036 By Miller, Supported by Lee
Resolved, That the consent agenda be approved.

Yeas: 3 - Nays: 0

Chairman Storum asked whether ADP provided details regarding their rate increase. Ms. Zimmermann stated that she only received a notice from ADP regarding the rate increase but it did not include any specifics.

CONSULTANTS

Re: Plante & Moran – 2008 Audit Presentation

Beth Bialy provided an overview of the 2008 audit report. The Independent Auditors Report states that the financial statements have been fairly stated in respect to the financial position of the System. This is a high level of assurance; a clean unqualified opinion which is the best opinion you can receive.

The Management Discussion and Analysis is required under the accounting standards and is a non-financial user statement written by management that provides basic investment information. She reviewed the summary regarding the investments results. It stated that the first half of the year saw good performance and the second half wiped out all the gains. Total fund returns were -21.1% for the year. A report prepared by the Citizen's Research Council of Michigan compared the performance of 138 Michigan pension systems with most reporting performance losses of 20% to 25%. MERS had performance losses of 25% similar to the City of Detroit pension systems.

The Statement of Plan Net Assets noted investments held as collateral for securities lending of \$21.4 million which is offset under liabilities as \$21.8 million due to the loss of value of the

collateral invested. The fund's total liabilities were \$22.2 million. Total assets were \$230 million.

The Statement of Changes in Plant Net Assets is the income statement of the fund. She noted net securities lending income of \$66,000. Net investment losses were \$62 million versus the prior year's \$25 million gain. Pension benefits and retirement incentives were \$14.2 million versus the prior year at \$13 million. At the beginning of the year net assets totaled \$282 million and at the end of the year net assets totaled \$207 million.

The Notes to the Financial Statement include a list of the standard accounting policies. As of December 31, 2007 there were 378 retirees and 199 active employees. She stated that most of this section contains boilerplate language.

She described the interest rate risk section which depicts the risk associated with the maturity of an investment.

She explained the securities lending process. As of December 31, 2008 the fair market value of underlying securities on loan was \$21.4 million.

The reserved balance for employee contributions is \$3.2 million and the reserved balance for retired employees is \$163.3 million.

The Schedule of Analysis of Funding Progress as of December 31, 2007 reported that the funded ratio was 115.3 percent. She explained that the schedule lags one-year behind because the audit report is prepared before the actuarial valuation. Based on an actuarial accrued liability of \$235 million and total plan net assets of \$208 million as of December 31, 2008 the funding ratio is estimated to be 87% using the fair market value versus the actuarial smoothing method.

She reviewed the City's annual required contribution. In 2008 there was a decline in the annual required contributions.

The Results of the Audit is a required communication that conveys their responsibilities under the Generally Accepted Auditing Standards. She stated that they did not encounter any significant audit findings while preparing the audit report.

She explained that accounting estimates are an integral part of the financial statements. Certain accounting estimates are sensitive due to their significance to the financial statements. She noted that alternative investments are hard to value and can directly affect the financial statements because they are based on unaudited financial statements.

After consultation with the System staff, they recorded a write down of \$2.8 million in value of the CAPROC Investment.

Under Other Comments and Recommendations she reviewed the accounting and control matters. She said that as of December 31, 2008 the system had 7.5% of investments that fell within the basket clause category which was within the permissible range before the plan fell below \$250

million per Public Act 314. Currently, based on the total assets of the fund the percentage is out of line with Public Act 314 at 5% and the Investment Policy Statement target of 3% to 7%. She said that there is no requirement to make the change now but it should be brought back inline as soon as prudently possible.

One file could not be located during the audit. The auditors were able to work with the System to obtain the needed information. The missing file was found after the audit had concluded.

She stressed the importance of using more due diligence when investing in alternative investments. Because they are not publicly traded, their value is harder to determine. It is imperative that they provide more documentation and monitoring of their audited financial statements and controls.

She confirmed that the Retirement Office is following their recommendation to move records to a secure storage facility. They are also in the process of drafting a disaster recovery plan and implementing a document imaging process.

She thanked Ms. Zimmermann and her staff for their efforts and cooperation during the audit process.

Ms. Bialy left at 9:28 a.m.

Re: Sullivan, Ward, Asher & Patton – Securities Lending

Tony Asher asked if the Board is familiar with how securities lending works. He would like the record to show that he introduced the subject and briefly reviewed the process with the Board.

He said that there is a pool of securities that can be borrowed by putting up 102% of the value of the security on a short-term basis by the borrower. The custodian enters into the agreement with the party to borrow the securities. It invests the collateral and the profit is split between the custodian and the fund.

Trustee Lee asked if the main reason for securities lending is to acquire proxy voting rights. Mr. Kuhn said that the primary purpose is to short sell the security in anticipation that it may be bought buy back in the future at a lower price. They also borrow treasuries to make their balance sheets look stronger.

Mr. Kuhn told the Board that they currently have \$20 million on loan in the securities lending program and have lost approximately \$400,000.00 due to the Lehman bankruptcy and other securities that lost value, including the CIT Group issue which resulted in a \$10,818.00 loss.

Trustee Miller said that he feels it is the Board's duty to put forth an effort to recoup the losses.

Chairman Storum asked about possible class action litigation. He asked how many plaintiffs it would take.

It was determined that the Board would hold off another month before making their decision.

Mr. Asher said the Board is responsible for making this decision but they felt it was their duty to disclose the facts at today's meeting.

Trustee Lee asked if they would be asking for just the losses. Ms. Almonrode said that they would look at everything but they cannot tell if there are other losses at this point.

RESOLUTION 09-037 By Miller, Supported by Lee

Resolved, That the Board this agenda item would be moved to next month's agenda

Yeas: 3 – Nays: 0

Mr. Asher and Ms. Almonrode left at 10:13 a.m.

Meeting Break at 10:13 a.m.

Meeting Resumed at 10:27 a.m.

The Board discussed their options regarding the securities lending litigation. They felt obliged to explore the options and whether it was prudent based on what they could recover.

Trustee Miller asked if the actual net loss from the CAPROC investment was \$2.8 million. Chairman Storum questioned why the \$2.8 million write down was booked back against capital gains. Ms. Zimmermann said that the distribution was already received and distributed against capital gains. She will look into the issues and report back to the Board.

Re: Gray & Company

Investment Policy Statement Revision

Mr. Kuhn distributed revisions to the Investment Policy Statement with an updated format for the fixed income guidelines including one that contains language allowing futures and one without the futures language. He reviewed the changes with the Board and asked if they had made a determination whether to let Gerry Thunelius and Oppenheimer utilize futures in order to potentially add approximately 25 basis points of performance per year.

Trustee Miller asked if using futures to hedge opens up additional risk. Mr. Kuhn said the current problem is that they are not hedging. They would use futures to mitigate interest rate risk.

Trustee Miller asked how much of their portfolio would be affected. Mr. Kuhn referred to the futures language in the IPS which states that the average duration of an actively managed portfolio shall not be 30% greater than or 50% less than the benchmark. Currently, 17% to 20% of the portfolio is allocated to treasuries. It is better to hedge them out than to convert that portion of the portfolio to cash which would not realize any yield. By using futures they would offset the duration and potentially gain approximately 25 basis points of performance per year.

RESOLUTION 09-038 By Miller, Supported by Lee

Resolved, That the Board approve the revisions to the Investment Policy Statement guidelines to allow active fixed income managers use interest rate futures into their portfolio in order to manage duration.

Yeas: 3 – Nays: 0

International Equity Search

Mr. Kuhn distributed an international equity manager search book. He explained that there were five firms in the original international equity search. They have encountered an issue with the structure of the Thornburg commingled fund that would make it part of the basket clause under PA 314. However, they have come up with a work around for the System by setting up a separate account. The fees would be higher due to custody costs. Thornburg has offered a discount on their fees during the first year to offset the higher custody costs. With a separate account they would be able to customize their emerging market exposure and have more flexibility.

He told the Board that during the original search Hexavest had the lowest fees. He referred to the updated performance numbers for the managers. Discussion followed by the trustees.

RESOLUTION 09-039 By Miller, Supported by Lee

Resolved, That the Board retain Thornburg Investment Management as the international equity manager pending contract approval.

Yeas: 3 – Nays: 0

DDJ Capital – High Yield

Mr. Kuhn said that during the second quarter of 2009 high yield manager DDJ Capital had their largest investor move out of the fund into a separate account. That left the system the only investor in their commingled fund.

Ms. Zimmermann said there was no contact from DDJ and that Ms. Munson noticed the irregularity which showed a \$6 million realized gain and a \$6 million unrealized loss on a \$4 million investment. When she questioned them on this they indicated the only other investor had moved out of the fund and the entry was related to that.

Mr. Kuhn said that DDJ submitted a letter suggesting they would defer their management fee while they wait for new investors to join the fund and the system could cover the costs of the audit (\$55,000) and the (\$50,000) custody costs. He said this would translate into a fee of 200 basis points. If and when the fee is less than 125 basis points, they will start to recoup their management fees for the quarters that were not paid. Ms. Billings said that DDJ cannot deviate from the contract language. Mr. Kuhn said that he thought the contract would allow them to bill administrative fees.

Mr. Kuhn said that the second issue is their second quarter performance. Their performance was up 20% versus the benchmark at 23%. Their estimates predict that the portfolio should be up

30% to 40%. The portfolio has a lot of low quality positions which could have impacted their performance. They are looking into what happened.

He provided manager search documentation which was updated from a recent search they performed for the City of Southfield.

Their recommendation would be to terminate the relationship and replace DDJ Capital.

He reviewed the high yield manager search information with the trustees.

MacKay Shields is located in New York and is the most conservative of the three managers. In contrast, DDJ Capital has been very aggressive in the space. They are owned by New York Life. Most of MacKay Shields issues are in B and BB rated securities. They are the biggest player in the space and have a long track record. They are the most diverse having 116 to 200 securities. This is a commingled fund with fees of 50 basis points.

Artio Global Management is owned by Julius Baer and is located in New York. The firm has \$56.3 billion in assets under management with \$965 million in the high yield space. They are a bit more aggressive and are one step up from Mackay Shields. They offer up a more global approach investing in Canadian, European, United Kingdom and Australian bonds. Non-U.S. is capped at twenty percent. Their investment approach is to identify great securities using analysts versus Mackay Shields' qualitative approach. Artio is idea-oriented, tapping the equity team for information as well. They have a slightly more concentrated portfolio consisting of 100 securities. Their management fee is 75 basis points.

Penn Capital Management is an employee-owned firm located in New Jersey. They are an opportunistic high yield manager that is the most aggressive of the three managers but not as aggressive as DDJ Capital. They run a high yield, small cap equity and mid cap equity shop. They have three to four high yield strategies. In the period we are entering today they would structure their portfolio to shift to a greater risk/reward strategy into B- credits. They are more opportunistic and willing to shift their portfolio more than the other firms. They have approximately 125 to 200 issues in the portfolio. Their management fee is 70 basis points. They would be most flexible working with you in the current situation.

Trustee Miller asked if Penn tries to time the market. Mr. Kuhn said that they are looking to shift their portfolio based on the market conditions. Chairman Storum said that based on their performance results it has not paid off the past three years.

Trustee Miller said that Artio takes less risk and produces more returns.

Mr. Kuhn said he likes Artio's global opportunistic approach. Penn would be the most easy to work with compared to MacKay Shields and Artio. He is not sure if DDJ would transfer the holdings to another manger or whether they would liquidate the portfolio. It could take the other manager six months to work out the transition details. He is not sure how this will play out.

Chairman Storum said that Penn did not manage the 2001 fire storm very well. Their performance moves up and down more than it should if they are using an all-weather strategy approach.

Trustee Miller said he likes Artio because of their global exposure, performance numbers and risk reward.

Chairman Storum asked Mr. Kuhn how it would affect the basket clause if they moved some of the high yield allocation to RMK Timberland.

Mr. Kuhn said that the flash report currently shows \$2 million allocated to RMK Timberland. There is \$5 million allocated to the DDJ Capital portfolio and \$5 million toward the Mesirow International Real Estate investment. He said that if they only have \$1 million available for RMK they will have to pick one fund. If there is \$2 million to allocate they can allocate a portion to each fund.

Mr. Kuhn said they recommend keeping the investment in high yield right now. The Board can move the money into RMK from the high yield portfolio as the assets are called from the Timberland manager. Chairman Storum said he would like RMK at \$2 million and shift the high yield.

Chairman Storum said that he likes Artio and feels Penn's performance has fallen off. Trustee Lee said that Artio would be his choice.

RESOLUTION 09-040 By Lee, Supported by Miller
Resolved, That the Board terminate high yield manager DDJ Capital and retain high yield manager Artio Global Management pending review of the contract documents.

Yeas: 3 – Nays:0

Ms. Billings reported that she has the final RMK Timberland Agreement including a revised Side Letter Agreement. She requested the Chairman's authorization on the agreement.

Flash Performance Report

Mr. Kuhn reviewed the flash report as of July 21, 2009 stating that the performance numbers have not been audited. Performance in June was flat but quarter-to-date domestic equity numbers were strong. Fixed income did not see much performance for the month, but quarter-to-date numbers for Oppenheimer were good. The second quarter total fund was up 8.9% driven by equities. Real estate has not reported yet.

Trustee Lee asked when the audit fees would hit for DDJ. Mr. Kuhn will check; he hopes they just give us securities.

RESOLUTION 09-041 By Miller, Supported by Lee
Resolved, That the Board approve the performance report as presented.

Yeas: 3 – Nays: 0

Mr. Kuhn said he will begin working on the contracts for Artio and on an exit strategy for DDJ Capital. Trustee Lee asked if the system has already paid for the audit report. Mr. Kuhn said that being it is well into the year he is sure their audit has been prepared.

REPORTS

Re: Chairman

Chairman Storum said that whoever is appointed Finance Director will be able to sit on the Board. To date it appears that there will not be a Finance Director, so it is important for the trustees to make the meetings because it takes three trustees to make a quorum.

Chairman Storum also asked if the actuary had prepared the experience study. Ms. Zimmermann said that the actuary will be presenting the 2008 valuation at the next meeting.

Re: Secretary – None

Re: Trustees

Trustee Lee asked if there is anything new to report on Roy Johnson. Ms. Zimmermann explained that the Retirement Office received a subpoena from the workers' comp attorney. However, Roy Johnson objected to some of the information they requested. He came into the office with an order to quash the subpoena. He felt that they should only have access to his medical records and nothing else. She forwarded the information to legal counsel who contacted the workers' comp attorney. The workers' comp attorney rescinded their request.

Re: Staff

Chairman Storum said that he is still in favor of the looking at the possibility of the Retirement Office separating from the City. He does not know if they will get any cooperation from the other system at this time. He would be interested in looking at what it would take to provide staffing for just this Board. That would need changes to the Ordinance.

Ms. Billings said that compensation of the staff is set by City Council according to the Ordinance and the Board has authorization over hiring. The Retirement Office staff are members of GERS. There was discussion of what was allowed under the provisions of Public Act 314. Chairman Storum and Trustee Lee are on the Personnel Committee. Chairman Storum would like them to meet and look at the issue.

Ms. Billings said that the Emergency Financial Manager would have to assume responsibility to adopt and amend the Retirement Ordinance. She said that the statue would appear to grant him this authority. Chairman Storum said he would like to proceed and have the committee meet. There is no rush but he would like to continue to take steps. Discussion followed.

Chairman Storum said they may lose their quorum so he would like to move agenda items up that necessitate a vote.

RESOLUTION 09-042 By Miller, Supported by Lee

Resolved, That the Board approve to move up all agenda items requiring trustee approval.

Yeas: 3 – Nays: 0

NEW BUSINESS

Re: Ratification of Capital Calls

Ms. Zimmermann requested that the Board ratify the capital call for Mesirow Financial International Real Estate investment.

RESOLUTION 09-043 By Miller, Supported by Lee

Resolved, That the Board ratify the capital call for Mesirow Financial International Real Estate for \$174,074.00.

Yeas: 3 – Nays: 0

Re: Death Audit

Ms. Zimmermann reported that the bi-annual death audit was run in June, 2009 which returned one member. This member's death had been reported to the Retirement Office.

Re: Placement Agent Policy Draft

Ms. Zimmermann referred to a draft of the Placement Agent Policy that will be incorporated into the Investment Policy Statement prohibiting the use of third party marketers without full disclosure. The SEC has investigated pay-to-play activities into the illegal use of placement agents to acquire investments and is in the process of putting regulations in place that would include public pension funds. She asked if the Board if they have had sufficient time to review the policy and whether they were ready to vote.

RESOLUTION 09-044 By Miller, Supported by Lee

Resolved, That the Board approve the Placement Agent Policy and authorize its incorporation into the Investment Policy Statement.

Yeas: 3 – Nays: 0

UNFINISHED BUSINESS

Re: Semi-Annual Rebalancing

Ms. Zimmermann requested that the Board approve the semi-annual rebalancing to maintain the asset allocation and to provide for benefit payments and expenses.

RESOLUTION 09-045 By Miller, Supported by Lee

Resolved, That the Board approve the transfer of \$1,950,000.00 from Northern Trust R1000 Intermediate Fixed Income fund to fund benefits and operations for the next six months.

Yeas: 3 – Nays: 0

Re: Notice to Retirees – Federal Withholding

Ms. Zimmermann reported that in February, 2009 the IRS changed the withholding tables per the stimulus bill. A notice was sent out to inform retirees of this change. Since that date, the IRS has changed the withholding tables for pension systems but the change would have to be applied each month.

Actuarial Software Search – Tabled to next meeting

Re: Disaster Recovery Plan – Tabled to next meeting

Re: HELPS Program – Draft Notice to Retirees

Ms. Zimmermann referred to a letter she drafted to the retirees regarding the HELPS Program. She said based on the likelihood that retirees will be paying for a portion of their healthcare; there may be a number of retirees interested in utilizing the program. Chairman Storum asked if a sample test had been run. Ms. Zimmermann stated that Lon Britton had volunteered but to date it has not been tested because he has not selected a provider yet.

Chairman Storum felt that if the letter went out now it would cause confusion for the retirees and result in a large volume of phone calls.

It was determined this item would remain on the agenda.

Re: Legal

Fossil, Inc.

Ms. Billings reported that the Court has not issued a ruling on the Defendants' motion to dismiss.

Gildan Activewear, Inc.

Ms. Billings reported that a hearing for the Defendants' motion to dismiss has not yet been scheduled.

Maxim Integrated Products

Ms. Billings reported that the Court has not issued a ruling on the Defendants' motion to dismiss.

UBS/AG Securities Class Action

Ms. Billings reported that the securities litigation is in the initial states of litigation.

Merrill Lynch Bond Litigation

Ms. Billings reported that the matter is still pending.

Joju-Rimal LLC

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Ms. Billings reported that the tax bill has been paid and the amount of their tax escrow will be increased going forward.

IRS Application for Determination Letter

Ms. Billings reported that the matter is currently pending with the IRS.

Coughlin Stoia Portfolio Monitoring Report, Fourth Quarter 2008

Ms. Billings reported that the report provides a summary of losses during the claim period and information needed to file a proof of claim.

DDJ Capital Management, LLC Form ADV

Ms. Billings reported that each investment firm is required to file an ADV Part 1 to register with the SEC. The ADV Part II has been requested. This manager has no criminal issues

Memorandum Regarding F Bar, Filing Tax Form

Ms. Billings reported that the IRS has taken the position that any person or investor with a financial account that exceeds \$10,000.00 in a foreign country must file a Report of Foreign Bank and Financial Accounts Form on or before June 30th each year. Because this was a recent ruling they extended the filing period to September 23, 2009. She will work with the consultant to insure the form is filed for investments in the portfolio that include Mesirow Financial International Real Estate and Wentworth, Hauser and Violich. Severe penalties are being assessed at \$100,000.00 for civil and \$500,000.00 for criminal plus five years in jail.

Miscellaneous Articles

Ms. Billings stated that the articles are for the trustees' information.

Re: Union Representatives - None

PUBLIC DISCUSSION

SCHEDULING OF NEXT MEETING

Regular Meeting on August 27, 2009 at 9:00 a.m., Lower Level Board Room, Affinity Group Credit Union, 144 E. Pike Street, Pontiac, Michigan.

ADJOURNMENT

RESOLUTION 09-046 By Lee, Supported by Miller
Resolved, That the meeting be adjourned at 11:32 a.m.

Yeas: 3 – Nays: 0

I certify that the foregoing are the true and correct minutes of the meeting of the Police and Fire Retirement System held on July 23, 2009.

As recorded by Jane Arndt