December, 2010

POLICE AND FIRE PENSION BOARD
REGULAR BOARD MEETING
WEDNESDAY, DECEMBER 8, 2010, 12:30 P.M.

Michael Dew, Chair
Ken Rudominer, Vice Chair
Richard Fortunato, Secretary
J. Scott Bayne, Trustee
Mark Burnam, Trustee
Dennis Hole, Trustee
Jim Naugle, Trustee
Steve Cypen, Cypen & Cypen, Board Attorney
Lynn Wenguer, Administrator

Also Present
Amanda Cintron, Assistant Administrator
Laurie DeZayas, Pension Secretary
Lynda Flynn, Interim Finance Director
Gregg Gurdak, President, Retirees' Association
Jack Cann, Retirees' Association
Frank Colleran, Retirees' Association
George Farrell, Jr., Retirees' Association
Bill Paton, Retirees' Association
Fuzzy Larkin, Retirees' Association
Linda Soloman-Duffey, Retirees' Association
Fred Nesbitt, Director of Media Relations
Kevin Schmid, CapTrust
Steve Schott, CapTrust
Matt Brown, CapTrust
Phil Dever, Lee Munder Capital Group
Anthony Gnisci, Police Department
Barbara Hartmann, Recording Secretary, Prototype, Inc.

Pursuant to authority of Ordinance C-00-34, Article II, this regular meeting of the Police & Firefighters' Pension Board convened at 12:30 P.M., Wednesday, December 8, 2010 in the Pension Board Conference Room, 888 S. Andrews Avenue, Suite 202, Ft. Lauderdale, Florida 33316.

Communications to City Commission

The Board has signed a contract with its new Investment Consultant, Cap Trust, beginning 1/1/2011.
The Board will be initiating a search for a new fixed income manager.

Chair Dew called the meeting to order at 12:35 p.m.

MINUTES:

Regular Meeting November 10, 2010

Chair Dew noted that Ms. Wenguer had included a supplement to the minutes. He noted a correction on p.8, paragraph 2 of the additional document: should state "there were only four down markets."

Motion made by Vice Chair Rudominer, seconded by Mr. Burnam, to accept the minutes of the November 10, 2010 meeting as amended.

In a voice vote, the motion passed unanimously.

BENEFITS:

Police Department:
New Retiree: Ralph W. Nelson

DROP Retiree: Juan E. Cabrera
Allan S. Lerner
John C. Wright
New Beneficiary: Stephanie Hurt
Louretia Tipton

Lump Sum Refund: Nathan T. Robbins

Fire Department:
Retiree Death: Ronald Mauldin

Motion made by Vice Chair Rudominer, seconded by Mr. Naugle, to accept benefits. In a voice vote, the motion passed unanimously.

BILLS:

Lee Munder:	$43,394.20
Prudential:	$37,629.59
Systematic:	$31,337.43
State Street Global Advisors:	$5,246.75
RhumbLine:	$4,070.71
BNY Mellon:	$2,214.87
Dr. Michael Feanny:	$1,650.00
Holland & Knight:	$225.00

Motion made by Mr. Bayne, seconded by Vice Chair Rudominer, for the acceptance of the payments of the bills as documented.

Chair Dew asked the balance of the BNY Mellon portfolio. Ms. Wenguer said it is approximately $15 million.

In a voice vote, the motion passed unanimously.

The following Item was taken out of order on the Agenda.

INPUT FROM ACTIVE & RETIRED POLICE OFFICERS & FIREFIGHTERS:

Chair Dew said he had spoken to Gregg Gurdak, President of the Retiree's Association, and they are preparing an information packet for a one-on-one discussion with the City Commissioners. One item included in this discussion will be the remarriage clause. He said when he had a presentation on this issue at an earlier date, he had not been able to answer all the Commissioners' questions. He has asked Mr. Gurdak to authorize the Retirees' Association attorney, Alan Eichenbaum, to assist Chair Dew in his preparation for a second discussion.

Chair Dew said there are more retirees than active members. He believed the Retirees' Association could be a strong lobbying unit for this and other issues.

He continued that the discussion will also address the DROP Memorandum of Understanding (MOU) and the difference between an unfunded liability and an unfunded plan.

INVESTMENT REVIEW:
CapTrust Steve Schott, Kevin Schmid, Matt Brown

Mr. Schott said the team has been working on asset allocation and reviewing the plan's managers. They will make a recommendation on asset allocation at today's meeting.

Chair Dew advised the Trustees that the he signed the contract with CapTrust the previous day.

Mr. Schmid recalled that they had previously given the Board a broad overview of asset allocation, and would narrow this focus today. He said it would be difficult to achieve the 7.75% actuarial rate of return without adjusting this allocation, based on current capital market assumptions. This gap could be achieved, however, through active management, consistent rebalancing, adding value over static allocations, and tweaks.

Mr. Schott said there will be places where the team recommends passive indexing, as the opportunities tied to risk management do not give much opportunity for outperformance; there will also be places they want to be sure active management will add value. In order to maintain a similar return profile while reducing risk, he recommended that any allocation alternatives come from equity as opposed to fixed income. He felt fixed income should continue to act as a force of security, stability, and liquidity in the portfolio.

Mr. Schott said when the return is being considered, volatility is very important; the less volatility a plan has, the more money it will have in the end with the same return. The team has sought alternatives that will be transparent, biased toward liquidity, and will reduce volatility.

Mr. Schmid referred the Board to p.4, which shows the return strategic allocation for the plan, including a 30% target in core fixed income. On the equity side, the biggest hole they have identified is the lack of direct exposure to mid cap. The plan is currently targeted for 20% alternative investments. He noted that the plan's real estate allocation is underweight as compared to the target 10%. The plan also has 10% in long/short equity.

The recommended asset allocation would keep a similar return profile, but would lower the expected risk on the portfolio and increase the income yield. This reduces the burden on which the plan must rely for capital appreciation to meet the 7.75% goal. The more income that can be brought into the portfolio, the less reliant the plan is on fluctuations in the market.

He continued that the current fixed income exposure is significant and has passive bond index managers including Mellon and SSGA. While there are environments in which the Board would want to hold the benchmark in fixed income, the current environment does not qualify, and fixed income should rely on active management instead. With regard to security selection, the fixed income benchmarks are heavily weighted toward treasuries, which have a low yield at present. With regard to duration management, the plan is already at historically low interest rates; when these rise, there will be a negative impact on bond prices and there could be negative total returns in the bond markets. CapTrust is seeking to mitigate this risk in the bond portfolio.

Mr. Schott moved on to show the assumptions for equity and fixed income under a different alternative. Focusing on long- and intermediate-term fixed income, the portfolio is overweight on the core side, which includes longer-term bonds going out to 30 years. While this has worked well in the past, when rates and yields turn this could become a difficult situation for the Board. Projected returns for long-term fixed income are 4.9%, and 4.6% for intermediate-term. Traditionally, more yield can be gained from longer bonds; however, Mr. Schott said the big difference is that the risk associated with these is nearly 9%. If rates increase and the bonds are short- or intermediate-term, there will be a lesser downside for the plan. He advised the Board should take down some of the risk in the portfolio by getting away from parts of the index, such as the aggregate to government/corporate bonds. These would perform particularly poorly in a rising rate environment.

With regard to the equity side, Mr. Schmid said there would be a reduction in total equity, bringing down figures from equity managers across the board. The major difference would be placing this allocation in mid cap. Increasing alternatives from 20% to 25% and diversifying the alternatives would also be helpful. CapTrust recommends reducing exposure to K2 by bringing this allocation down from 10% and reassigning some sort of income-producing vehicle.

Chair Dew said he learned there was some confusion between CapTrust's and Asset Consulting Group's (ACG) recommendations with regard to the $5 million that was allocated to K2 and that we wanted it back. Mr. Schmid said when the City made its contribution in November, which was prior to the signature of the contract with CapTrust, recommendations were made on how to best allocate that contribution. He noted that ACG had allocated money to K2, while CapTrust did not. He recommended putting in a redemption for approximately half of K2's value prior to the December 31, 2010 deadline.

Mr. Cypen explained this is an issue because K2 doesn't have the money to give it back, and wants the fund to hold out until January 31, 2011 at no interest, although the money was not invested. He advised that this should be dealt with immediately. Ms. Wenguer said she had spoken to Jason Pulos of ACG, who plans to try to recall these funds. She explained that CapTrust should be aware of the redemption cycle, which can be a complication for the plan.

Chair Dew requested an update on this issue. Ms. Wenguer said Mr. Pulos would be in touch with the Board to let them know what the resolution will be. He was unaware of the letter sent from K2 to the Board, which stated the January 31, 2011 date due to its redemption policy, and said there would be no interest earned on the money.

It was noted that the money was allocated to K2 under the Board's old asset allocation; they then decided instead to accept CapTrust's asset allocation, which did not include K2, not realizing that the money had already been allocated. Ms. Wenguer said the Board would be kept apprised as this issue is resolved.

Mr. Schmid said if the Board chose to move to a slightly higher return with slightly higher risk, alternatives could be added and funds could be moved away from the fixed income side. He pointed out that this is not CapTrust's recommendation but purely for illustrative purposes. Mr. Schott added that rebalancing could make a sufficient difference to bring the plan closer to its goal of 7.75%.

Mr. Schmid noted that changes could not be expected to occur overnight; they hope to establish a schedule to accomplish these changes. On the fixed income side, he felt changes could be made quickly and as a higher priority; they would also reduce exposure by eliminating passive bond strategies, such as the Mellon strategy, which is only remaining due to liquidity constraints from securities lending. As this is no longer an issue, this money can be reallocated.

He continued that it may make sense to keep a small exposure to the SSGA strategy for easier liquidity without disrupting active managers. CapTrust would recommend significantly reducing passive bond exposure and allocating these monies to an active bond manager, particularly one with a focus on duration management as part of its strategy.

They have also spoken with Agincourt, which has done a great job for the plan. Mr. Schmid assured the Board that they would take no money away from this manager. While some duration management is part of their process, they remain more focused on security and sector selection. They tend to be somewhat defensive with regard to duration and are not expected to be more risky than the benchmark. Agincourt is presently benchmarked against the aggregate bond index, but are willing to reduce this mandate to a more intermediate duration over time. This would remove some of the interest rate risk. They plan to run some scenario analyses in terms of various interest rate movements to determine the best duration target for the needs of the plan.

With regard to diversifying equity exposure by adding mid cap, Mr. Schmid noted that this is a lower priority, and could be accomplished by putting an index manager in place. Mr. Schott added that in small cap, it is possible to find an active manager that will add value over time; mid cap is a little trickier, and it is difficult to find managers that can add significant value over the benchmark. This is why they have a bias toward indexing on the mid cap side.

Mr. Burnam observed that ACG's philosophy was to get rid of mid cap because small cap could add value; they had found little value in mid cap. Mr. Schott said a large cap manager will have some mid cap in its exposure, but cap weighting represents a smaller percentage. He noted in the last few years mid cap has significantly outperformed the large cap side and in some cases has exceeded the small cap side.

Mr. Schmid said that ACG's philosophy was a typical institutional philosophy toward mid cap, which is often the first area to be cut from an asset allocation. He agreed, however, that mid cap represents a robust area of the stock market. He characterized it as an interesting area of the market, as it shares qualities with declining large cap companies and growing small caps.

Mr. Cypen asked the team to define small, medium, and large cap. Mr. Schmid said large is typically anything over $10 billion in market cap; mid cap is $2-10 million, and small cap is below $2 million. He noted that these definitions may fluctuate over time.

Mr. Burnam noted that long bond funds have declined 8-12% since September 2010, and asked if the team would recommend making a change in this area to earn more money in a rising rate environment. Mr. Schott said they would go all asset fund and include natural managers that will adjust according to fluctuations in the market.

Vice Chair Rudominer said the Board had made a decision to move into more opportunistic bond funds. Mr. Schmid said preferred stock is included in the current portfolio, but more opportunistic bond funds could replace this allocation, as it would be a flexible income-producing vehicle.

Mr. Schott said there are several programs: one is a tactical program, which could go all different asset classes adjusting to the market; the active management would replace Mellon; and CapTrust has internally discussed using a program which could act opportunistically as a duration manager.

Mr. Schmid said CapTrust's research analysts have completed their due diligence regarding NorthPointe, which has rebounded solidly thus far in the fourth quarter and outperformed their benchmark by roughly 2.5% in November. They are now slightly ahead of the benchmark year-to-date. He noted, however, that from an organizational standpoint, it does not make sense to continue using the firm over the long term. He advised that their primary issue was they bought themselves back from their parent company in 2007, which placed financial strains on the organization, and had to cut a good deal of staff in 2008-09. They are now offering too many strategies with too few investment professionals. He added that their performance record in small cap growth will not help them attract new assets and grow their business once again. Mr. Schott agreed that in the long or short term, NorthPointe is not the type of manager in which they have confidence for the future.

Mr. Schmid continued that Artio remains on the watch list, and CapTrust recommends that the Board interview them as well as some potential replacement managers. This would allow them the chance to compete to maintain their business. He recalled that the primary issues with Artio was that they were spun out from another firm, then held an IPO, both of which are organizational changes that caused them to be on the watch list. These changes also coincided with a difficult performance period for Artio in which they failed to distinguish themselves above the benchmark and locked in some underperformance. Although this has since rectified itself, it served as a red flag for CapTrust, although a less urgent one than NorthPointe.

Mr. Schmid said they are now confident that Artio's business side and portfolio management side have been sufficiently separated, but noted that there are other strong international managers with whom they work, and the Board may wish to take a closer look at them.

Mr. Schmid said in addition to the reduction of K2, he would recommend further diversification. Alternatives include tactical asset allocation funds, which can be obtained in a mutual fund format. This prevents liquidity issues as well as the heavy incentive fees that would be paid for hedge funds. They also offer easy access to a wide variety of asset classes. He recommended preferred stocks as another vehicle for diversification, as well as a way to add income yield to the plan. Finally, he reiterated that this was a good time to get back into real estate, and the fund is already in the entry queue for this category. Mr. Schott said core real estate can deliver an income yield in the 6-7% range.

Mr. Burnam noted that preferred stocks had performed poorly in 2008. He said he tended to feel stuck in this category in any sector, even with only a 5% allocation. Mr. Schmid said this is a fair point, and advised that CapTrust is always looking for additional diversification to avoid concentrating in any single income-producing category. He said the point of the preferred stock allocation is to have something that is generating income. Mr. Schott added that preferred stock represents an increase in the capitalization structure, moving from regular equities higher up the cap with slightly more yield.

Mr. Schott said in a static asset allocation, there is a projection based upon capital market assumptions. It does not, however, consider rebalancing, which can get lost in many discussions but has a significant impact. He noted that this could feel counterintuitive, as it would involve buying into a down market, when it might not feel comfortable.

He noted over the long term, there is less downside for the plan by almost 2% when it is rebalanced. He felt this is often a missed part of the opportunity of managing a portfolio, and would be a large part of CapTrust's recommendation. He noted that when funds did not rebalance, they left a lot on the table and suffered more risk.

He continued that there will be searches on managers that CapTrust would recommend, as well as a specific asset allocation recommendation or strategy. Mr. Schott said the team would be happy to take as much time as necessary to delineate this plan.

Chair Dew asked if the first recommendation would be to adjust fixed income. Mr. Schmid said yes, as this area offers an opportunity to add value; they could bring fixed income managers to the Board's January meeting to facilitate a quick decision. While NorthPointe has been discussed at length, he said this change is less urgent, as it is performing relatively well at the moment and they could wait until later in the new year to make this change. Mr. Schott agreed, pointing out that the plan has much more money in fixed income than in NorthPointe.

Vice Chair Rudominer asked if step one would be to keep the money in cash. Mr. Schmid said this could be rolled into SSGA, as long as there are no liquidity constraints, while further researching the fixed income side.

Mr. Schott said if the Board opts to make changes in its managers in January or February 2011, he would recommend that they maintain their current portfolio rather than incur additional transaction costs before the change. He said there was nothing to suggest there will be significant changes in either equity or fixed income.

Chair Dew asked how many managers CapTrust would bring before the Board in January. Mr. Schmid estimated there would be two to three, whicheverthe Board prefered. Typically he said they bring three managers. Chair Dew said this is what has been done in the past.

Mr. Schmid said given the length of the cycle in terms of asking for money back from K2, he would recommend beginning the redemption process now. Ms. Wenguer said the $3.6 million in question is sitting in cash, although K2 is technically holding onto it.

Mr. Schmid continued that they could also present alternatives to NorthPointe at the January meeting. Chair Dew advised it would be best to stay with one issue at a time.

Mr. Schmid said K2 is currently targeted at 10%; however, they would recommend a 5% target, which would leave 5% allowable.

Motion made by Mr. Burnam, and duly seconded, to get K2 from 10% to 5%.

Vice Chair Rudominer said the Board would need to know when they can expect access to the money from K2. Mr. Cypen said it would be one year; Mr. Burnam stated, however, that it could be the end of March. Mr. Cypen explained that while redemption can take a certain number of months or weeks, it can also be held up as long as a year. He said if these funds are invested and drawing interest, the Board should also get this interest back.

Vice Chair Rudominer recalled that the Board is currently allowed to draw money from Mellon, and asked if there is reason to believe that their queue may be reinstated the following month. Mr. Schott said this was not expected based on their securities lending program in which Mellon was involved. Mr. Cypen said it was possible the queue could be reimposed, but not likely.

Vice Chair Rudominer asked if there was a limit on how much money could be withdrawn from K2. This amount was not known. Mr. Schmid asked when money was put into K2, explaining that there is often a requirement for 91 days' written notice once outside a lockup period. He felt the issue with the money recently put into K2 is that it would be considered new money; if so, there may be a 12-month wait to withdraw it.

Mr. Cypen said the issue was not that K2 has not invested the money, but where is the money and what is it doing? If it is not invested, he said, it should be returned; if they cannot return it, they should pay interest on it. Mr. Schott agreed these were fair questions.

In a voice vote, the motion passed unanimously.

COMMUNICATION DIRECTOR'S REPORT:

Mr. Nesbitt said there is nothing significant to report.

Mr. Hole noted at this time that the City Commissioners had accepted his re-election to the Board.

ADMINISTRATOR'S REPORT:

2011 Board Meeting Dates Proposed

Ms. Wenguer asked the Board members to let her know if there were any conflicts with the proposed dates.

2011 Proposed Budget Draft

Ms. Wenguer noted that 2011 is a nine-month budget year. She noted that some Board services are paid quarterly, some annually, and some on different schedules. The budget includes a large allocation toward software, which has been determined to be a necessary expense due to the demands on the plan. If an automated system is not put into place, more staff would eventually be needed. Ms. Cintron added that there may be a large initial outlay, depending upon the complexity of the desired program. The ballpark figure for this expense is $100,000, depending upon what is listed in the RFP. Ms. Wenguer said the software would be brought before the Board before a final decision is made.

Vice Chair Rudominer asked if $100,000 would be enough to start with a new software program. Ms. Cintron said it is possible to start small with a basic program and add to it.

Mr. Cypen suggested using a particular company, Pension Gold, as a measuring stick to select a software provider.

Ms. Wenguer continued that they would like to add funds for printing and other related expenses for the Communication Director. These expenses were estimated to be $100 per month at minimum, which meant an additional $1200 was added to the budget, bringing this figure to $2400. Vice Chair Rudominer proposed that this figure be listed simply under Communications.

Mr. Bayne asked if this was a nine-month figure. Ms. Wenguer adjusted the proposed increase to $900, bringing the total amount to $2100.

She noted that the average cost of one disability examination is $5000. There are presently two upcoming disability exams.

She added that the Board has done a good job keeping expenses down over the past year.

Motion made by Vice Chair Rudominer, seconded by Mr. Burnam, to accept the proposed budget as corrected. In a voice vote, the motion passed unanimously.

Retiree Frank Colleran Letter dated November 12, 2010

Ms. Wenguer said the letter is related to Mr. Colleran's request for the Me Too increase. She had learned from Randall Stanley that Mr. Stanley has all the information, including calculations of benefits, although he could not provide this information without researching his files. She said Mr. Stanley asked which pool of people Mr. Colleran is in. She had asked that this Item be deferred to the following month so this information can be collected. It had also been requested that the Board research whether the Ordinance stated there was a cap. No mention of a cap was found.

Pending Items:

New Business:

Chair Dew said the IRS Voluntary Compliance Program letter was signed by both himself and the Mayor.

He requested an update on the status of the auditor RFP. Ms. Wenguer said she and Vice Chair Rudominer had agreed since the upcoming audit will cover only a nine-month period, they will not seek a new auditor until the short year is complete. Once the 2010 and 2011 audits are complete, a determination will be made on whether or not to seek a different auditor.

Chair Dew asked for an update on the Policy and Procedures Manual. Ms. Wenguer said Ms. Cintron has done a good job in updating this manual, but it has not yet been finalized. They are working to automate all files, plan documents, and forms.

Chair Dew reported that the Pension Ordinance Amendment had its second reading on December 7 and there were no issues.

He asked for an update on office space. Mr. Naugle said there is no update at this time.

Chair Dew recalled that the Board had previously discussed presenting Mr. Cypen with a plaque in recognition of his years of service. He and the Board members gave Mr. Cypen the plaque at this time and recognized his work with a round of applause.

Mr. Hole requested an update on the SPD and investment workshop. Ms. Wenguer said now that the contract with CapTrust has been signed, they will begin putting the investment workshop together. It was decided that this issue would be revisited in June 2011.

Ms. Wenguer said they are currently working with Share and regular benefit statements and will begin work on a new SPD in January or February 2011.

Old Business:

Chair Dew requested input for Communications to the City Commission, noting that one item should be the signed contract with CapTrust, effective 1/1/11. They will also begin a new manager search for fixed income managers.

There being no further business to come before the Board at this time, the meeting was adjourned at 2:07 p.m.

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