

CITY EMPLOYEES RETIREMENT FUND BOARD

MINUTES

January 15, 2009

**PLACE:** City Hall  
200 Orange Street  
Dept. of Finance Conference Room  
New Haven, Connecticut 06510

**PRESENT:** Jerry Sagnella, Chairman  
Thomas Cama  
John Varrone, Members' Representative  
Mark Pietrosimone, Secretary

**ABSENT:** Mayor John DeStefano, Jr.  
Anthony Acri

**ALSO PRESENT:** Joann Giri, Benefits Auditor  
Tim Ryor, Hooker and Holcombe  
Art Assantes, Hooker and Holcombe  
Derek Ciampini, Merrill Lynch  
John Beirne, Merrill Lynch  
Erik Scaranuzzo, Merrill Lynch  
Chris Coppola, Merrill Lynch

Mr. Sagnella convened the meeting at 10:23 a.m.

**7. ADMINISTRATIVE MATTERS**

Mr. Sagnella arranged for both CERF and the Police & Fire (P&F) pension trustees to attend this portion of the CERF meeting to address an issue of common interest and concern, namely the securities lending agreements both boards have with Northern Trust. They have been profitable up until the current market environment where the funds have collateral deficiencies (\$800,000 P&F and \$300,000 CERF). The central question is what to do with these agreements going forward. Mr. Sagnella asked the investment consultants to review the options available to both boards.

P&F financial consultant Lawrence Gray stated that several months ago Northern Trust expressed a willingness to sweeten the pot by increasing the Fund's share by 20% in order to pay back their loss more quickly; in terms of the screening process and the securities actually in the pool they have increased the quality of these securities. They froze the USA Core Fund and opened another one and it has higher quality securities. The inferior pool still exists and some of the securities have some pretty long maturities. Many of their clients have been reluctant to take the hit and cease the agreement. He stated everyone who attended these presentations would agree that the risk was not clearly spelled out. The question is if the return is worth the risk. Most of their clients went back since inception and added up what they paid out versus the gain and found it is just not worth it. CERF consultant Derek Ciampini agreed and stated he has a hard time justifying any sort of risk that should be cash collateral, not invested in a comingled fund that has several different buckets of long maturities, student loans, credit cards, etc. Mr. Cama (CERF) asked what our gain is. Mr. Ciampini responded the gross proceeds averaged 4 basis points. Mr. Cama asked what Northern Trust is making on this arrangement. Mr. Ciampini responded that typically it is a 70/30 split.

Mr. Ciampini stated you could pay back the loss in a few ways: one is to write a check for the debit; the other is to wait for the fund to appreciate. Mr. Ciampini discussed another possibility with a Northern Trust representative: cease the lending agreement and every time there is a maturity rather than reinvest it start to chip away at the debit balance.

Mr. Gray stated currently the only two options are to write a check or stay in the agreement and hope for appreciation on the original collateral pool. It is important to note that it is the worst time in history to try to unload this type of collateral pool. Mr. Pietrosimone asked if there is a way to renegotiate the securities lending agreement to increase the quality of investments. Mr. Ciampini stated they already made that upgrade with high quality and short duration.

Mr. Kottage (P&F) asked if the Board can wait for Northern Trust to pursue recouping this money. Mr. Ciampini stated Northern Trust still holds \$18 million of the Fund's money.

Mr. Kottage asked for suggestions from the consultants. Mr. Ciampini stated if you are going to stay in the agreement try to renegotiate and get a better split. Mr. Sagnella asked Mr. Gray if any of their other clients are discontinuing securities lending and cutting their losses. Mr. Gray responded since the old collateral pool is probably at the worst valuation you can get they are hesitant to sell at this time. By resolution they decided to extend it to June or July, hoping that the credit markets start to ease up a little bit and that some of these securities can be traded out. Mr. Ciampini stated the credit market could get worse.

Mr. Cama stated if we took the loss we might be in better control of where the money is invested. Mr. Sagnella suggested both boards send a letter to Northern Trust asking for a definitive answer as to whether they will allow loss to be paid through the arrangement of chipping away at the \$300,000 with dividends. Mr. Ciampini stated he would rather have a dialogue with them. Mr. Kottage asked who would negotiate this type of arrangement. Mr. Sagnella stated probably a combination of the financial consultants and legal counsel. Mr. Kottage stated he needs more information to make a decision and would like to see how other funds handled their agreements with Northern Trust.

Mr. Sagnella suggested both chairmen send a joint letter to Northern Trust indicating they would like to negotiate alternative arrangements. Mr. Kottage would like to hold off on a letter until he has more information. He added they could always schedule a special meeting if they want to take action prior to the February meeting.

Mr. Coppola stated in the presentations that were made there was no communication of the potential risks that were involved. That may be a good argument. Mr. Kottage stated legally they may have grounds for a lawsuit.

P&F trustees voted to table a decision until the next meeting and they left the meeting at 10:55 a.m.

Mr. Ciampini wants the trustees to be aware of the risk in staying with securities lending. However, if you stop the lending agreement Northern Trusts' custodial fee may increase. Mr. Scaranuzzo suggested not rushing to write the check. State Street bank decided to absorb the liability for their clients.

Mr. Sagnella stated he would have Sharon Freilich work with Merrill Lynch to compare the list of investments to the actual securities lending agreement that was signed and determine if there is any breach in contract with the quality of loans. Mr. Coppola urged that, no matter what the Boards decide, they make a joint decision or it is going to show a divided front. Mr. Sagnella stated that is why both Boards met together to discuss their options in a unified effort. He stated the trustees will wait to see what information Mr. Gray provides this week. At the next meeting both boards will look at the issue and determine what action should be taken.

## **1. APPROVAL OF MINUTES**

Mr. Pietrosimone moved the approval of the minutes from the meeting of December 18, 2008; Mr. Varrone seconded, and the vote was unanimous.

## **2. DEATH AFTER RETIREMENT – INFORMATION ONLY**

- a) Carusone, Joseph
- b) Pilato, Ruth

**3. DEATH OF SURVIVOR – INFORMATION ONLY**

a) Pilato, Ruth

The Board reviewed the information in Item 3.

**4. WITHDRAWAL – INFORMATION ONLY**

The Board reviewed the information under Item 4.

**5. AGE RETIREMENTS – INFORMATION ONLY**

Mr. Sagnella stated these retirements are a product of agreements negotiated between Labor Relations and the unions. They were given enhanced benefits similar to recent layoffs. It was part of the collective bargaining process.

The Board reviewed the information under Item 5.

**6. PAYMENT OF BILLS**

Mr. Pietrosimone made a motion to approve payment of the bills in Item 6; Mr. Cama seconded and the vote was unanimous.

**8. INVESTMENT REVIEW**

Mr. Beirne stated they think there is an opportunity to get equity like returns from bonds. They have a firm, Penn Management that they want to bring in and introduce to the Board. Mr. Scaranuzzo stated it is a high yield fixed income fund. They have three versions of the fund: Defensive High Yield where it is a little bit less risky than the index, the Opportunistic High Yield getting into riskier issues, and Distressed Fund that are companies that are risky.

He stated in the 2003 rally the Defensive High Yield moved up about 24%, the Opportunistic High Yield went up about 42% and the Distressed High Yield went up about 70%; the opportunity for gains in principle could be interesting at this point. The High Yield fixed income should be put in the stock side of the ledger. They do not want the fixed income side of the portfolio to consist of high yield bonds but rather low risk, high quality bonds. High yield bonds are correlated to the equity market and move with the equity market. Mr. Scaranuzzo stated you would want to hire an active manager for high yield bonds. Mr. Beirne stated he would like to bring Penn Capital in for a presentation to the Board. Mr. Sagnella stated they could make arrangements for the next meeting.

Mr. Ciampini stated since a year has passed since the hiring of large cap international managers it is time to bring them in within the next few months. You may want to create a subcommittee for this meeting.

Mr. Cama asked how the asset allocation is affected if these bonds are put on the equity side. Mr. Ciampini stated the guidelines allow for an allocation in high yields. They would not be counted as an equity position but would be funded from the equity portion of the portfolio.

Ms. Solomon asked if any other companies offer a similar product. Mr. Ciampini responded in the affirmative but found Penn has done a good job and has over 20 years of experience in that category which is pretty rare. In this strategy he thinks they are one of the best. Mr. Scaranuzzo stated they will manage a portfolio for you for \$5 million. You will own the bonds directly; it is not a mutual fund. Ms. Solomon asked what their fees are. It depends on the strategy. Assuming it is \$10 million or under the Defensive High Yield is about 75 basis points, the Opportunistic is about 85 basis points and the Distressed is about 1.25%.

Mr. Ciampini referred to the performance report stating that 2008 was not a good year; December returns were an improvement. Aletheia was up 5.5% versus 1.4% for the index. Neuberger Berman was up 1.4% versus 1.4% for the index. In large cap growth Aletheia was up 4.9% versus 1.8% for the index. Neuberger Berman was up .9% versus 1.8% for the index. In mid cap growth Munder Capital was up 3.1% versus 3.7% for the index. NCM returned 6.8% versus 4.3% for the index. Paradigm was 5.2% versus 5.8% for the index. In sector equity metals & mining was up 2.1% versus 2.1% for the index. Powershares agriculture was 7.1% versus 7.2% for the index. SPDR energy was -3.1% versus -3.1% for the index. In international Artio Global Investors was 5.6% versus 5.7% for the index. Wentworth Hauser was -1.8 versus positive 5.7% for the index. In fixed income Pimco was up 3.8% versus 3.3% for the index. Ishares TIPs was 5.1% versus 5.0% for the index. Israel Bonds up .5% versus .1% for the index. Government Short Term Investment Fund was up .1%. For the month of December the fund was up 3.28% versus 2.86% for the index. For the year the fund was down 26.5%.

Mr. Scaranuzzo noted that if you were just invested the way your policy reads you would have been down 32% so there was outperformance if we just indexed the money and stayed where the asset allocation targets are.

Mr. Sagnella distributed reports from Milberg Weiss, the attorneys who track class actions for CERF. The losses the fund is involved in total \$250,000. They do not charge until they recover money and get a percentage of the recovery payment. We have a contract with them; they do due diligence to determine if our fund is involved with any company that is in trouble. Mr. Sagnella stated these losses add up over time.

The meeting adjourned at 12:00 a.m. on a motion by Mr. Cama and seconded by Mr. Varrone and the vote was unanimous.

## **9. MEETING SCHEDULE FOR 2009**

The next meeting is scheduled for Thursday, January 15, 2009 at 10:00 a.m.

ATTEST:

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Secretary