# Fort Myers General Employees Pension Board

Quarterly Board Meeting Minutes
June 15, 2011
Fourth Floor Conference Room
2200 Second Street
Fort Myers, Florida

PRESENT: Leif Lustig, Vice-Chairperson; Donna Lovejoy, Secretary; Barbara Carlson, Board Member; Richard Griep, Board Member; Thomas O'Malley, Board Member; Eloise Pennington, Board Member; Debra Emerson, Pension Manager. Guests: Grant Alley; Tom Burt; W.J. Carnes; Scott Christiansen, Christiansen & Dehner; Aurelio Gongora; John McGee, Tim Nash, Bogdahn Consulting; Mike Seagle

ABSENT: Cecile Mazzio, Chairperson

The Fort Myers General Employees Pension Board Meeting was called to order at 9:01 O'clock A.M.

## Item I – Approval of Minutes

*Mr. Griep motioned to approve the May 18, 2011 meeting minutes, seconded by Ms. Pennington, and unanimously approved by the Board.*

## Item II – MorganStanley SmithBarney ~ Thomas Burt/John McGee

Thomas Burt, First Vice President and John McGee, Financial Advisor, provided a presentation about MorganStanley SmithBarney's review of the General Employees' Pension Plan investment program utilizing documentation titled, *City of Fort Myers Pension Fund Investment Plan Review*.

Mr. Burt stated that MorganStanley SmithBarney was requested by the City of Fort Myers to review the General Pension Plan after its review of the Police and Fire investment plans. The goal is to make Fort Myers aware of some issues that are occurring and offer suggestions to add value to the pension plan. Part of his expertise is to bring information and offer advice to pension boards and other fiduciaries to ensure that they are involved in the most prudent practices and fulfilling their obligations. MorganStanley SmithBarney compiled the report by utilizing Fort Myers' investment policy statement, investment management

agreement, Comerica statements, and service provider agreements.
Mr. Burt stated that the investment manager fees are as follows:

Lateef - 100 basis points plus commissions of 4-5 cents per share.

Moody Aldrich - 100 basis points plus commissions of 2-3 cents per share up to $10 million. If Fort Myers exceeds $10 million in assets, the fee becomes 80 basis points plus commissions of 2-3 cents per share. To reach this, Fort Myers would have to increase the pension's value and this is not necessarily attainable.

Atalanta Sosnoff – 80 basis points plus commissions of 4 cents per share.

Manning & Napier – 75 basis points plus commissions of 5 cents per share or their own proprietary mutual fund fees 1.14% or 1.2%.

Galliard – reasonably priced at 25 basis points on bonds, 15 basis points on TIPS. It is not clear on the Comerica statements whether Fort Myers is paying for markup or markdown on the bonds, which is essentially a hidden commission.

Fort Myers also has the following pooled investments:

RBC Polaris International – 100 to 110 basis points.

Morgan Stanley Prime Real Estate – 90 basis points plus 1% incentive
fee therefore Fort Myers could be paying 2% if they are do well.

Russell 1000 ETF – 20 basis points plus transaction costs.

There are two fee sources other than investment fees. The custody fee paid to Comerica is four basis points up to $50 million and 2 basis points over $50 million; this is a reasonable fee. The fees on the investment are high. Fort Myers is paying 17 basis points for the cash management fee to Comerica. Bogdahn is charging $25,000 annually for services.

In MorganStanley's opinion, the arrangement of fees and manner in which they are paid appears unusual. They are paid quarterly in arrears which is common however the valuation date is the last date of the quarter, which is not the industry standard. This provides the opportunity for the investment manager to assess fees on a higher asset level which is more advantageous to the investment manager, not the client. He recommends payable quarterly in arrears with the valuation date being the first date of the quarter. Fort Myers would then save money because investments rise more often than fall.

Mr. Lustig questioned if this involves a one day difference. Mr. Burt confirmed that it is a three month difference. Mr. Lustig stated that if the process changes from valuing backwards from the end of the quarter to valuing forward, this would be the same as choosing the next day's business for that following quarter. Mr. Burt stated that it would be 90 days prior. Mr. Lustig stated if making a fundamental change going forward and changing it one time, it would be a difference of one day for one period of time. Mr. Burt stated to imagine the quarters as a block of time. If the investments increase, the fee can be assessed on day one or day ninety. He recommends assessing on day one so that starting the next quarter the pension plan would not be assessed the next day. It would be 90 days from then however the valuation date would be this date and it would save money over time moving forward. Mr. Burt reviewed the investment fee structure example in the report which illustrates that if the fee is assessed on the quarter's beginning value it generates a lower fee than if assessed on the ending value.

Ms. Carlson questioned if MorganStanley has a chart to show the difference in costs for Fort Myers' pension plan. Mr. Burt stated that he does not because many other pressing matters where discovered such as a dramatic underreporting of fees. After careful review, MorganStanley discovered all of the fees. The actual 12 month investment fees include: commissions, expenses, and fees. Fort Myers is paying $34,234.40 in commissions, $490.64 in miscellaneous trading expenses, and $418,024.07 in fees for a total annual cost of $452,749.11 to administer the pension plan investments.

The cost was broken down further to review the non-fixed and fixed income investments. The total cost for non-fixed income investments was $376,228.37 or 114 basis points on an average quarterly balance of $33,223,037.80. The investment fees which include commission, expenses, and management were $340,999.19. The Comerica fee was $20,284.18 and Bogdahn's fee $14,945.

The cost for fixed income is much more reasonable at 32.7 basis points or $76,520.74. The average quarterly balance was used, not the beginning or ending balance. The actual fees reported on the Bogdahn's September 30, 2010 report were $260,100.00. The actual cost documented on Comerica's annual statements totaled $452,749.11, a difference of $192,649.11. The discrepancy exists because of a poor fee arrangement and Bogdahn is not reporting: commissions or trading expenses, management fees for Russell 1000 ETF, Morgan Stanley Prime, RBC Polaris International and any fees after June 30, 2010.

Fort Myers paid $20,000 to make investment manager changes; this is a hidden cost because it is not accounted for in the reports. All of the names were in the Russell 1000 Growth therefore essentially the same stocks were bought and sold over and over at a tremendous cost to the pension plan. An example of this is Boeing. The issue is that Fort Myers had to pay commissions on the buying and selling of stock and it is not being accounted for; it is just being debited out of the account.

A commission recapture program is a form of institutional discount brokerage that rebates a portion of trading commissions directly to the pension plan, which helps reduce expenses saving money for the fund. Unfortunately the commission recapture is a small percentage of what is being paid, approximately 20%. As Fort Myers' investment managers have been fired and new ones hired, the new managers have not been put into the commission recapture program. They are required to by the investment management agreement however it appears the investment consultant is not confirming that the managers are subscribing to the program. The issue is that the majority of the investors do not pay commissions. They pay a flat fee because they need flexibility in being able to get in or out of management styles or make allocation changes without paying commissions.

MorganStanley did not see a fee plus commission arrangement in Fort Myers' plan. Mr. Christiansen requested clarification about the fee plus arrangement. Mr. Burt stated that Fort Myers is paying an investment management fee. Whenever managers buy and sell they charge a commission, which is an added cost to the investment management fee. A flat fee is paid for purchase of an average mutual fund. There is no additional cost for the trade. It is not netted out of the return.

Mr. Christiansen questioned who pays the commissions inside the mutual fund. Mr. Burt stated that when subscribed to an investment manager, a flat fee of 1%, for example, is paid. The fee covers the commission and trading expenses so when an investment manager is hired, no commission should be charged through the investment manager or the people traded through. When investment managers buy and sell, the commission is paid for by them because it comes out of their fee. That actually affects the investment managers' profits; it should not come out of the client's money. This is what is generally seen in the majority of institutional accounts.

Mr. Burt stated that MorganStanley invented investment consulting in 1957. It is the largest investment consultant firm in the world. The fee based platform where there are no commissions was invented in 1973. Mr. Christiansen stated that this is a wrap program. Mr. Burt stated that a wrap program is typically referred to as mutual funds and this is a pure institutional investment management program.

The City of Fort Myers Firefighters Fund does not pay commission; this is managed by Bogdahn. The General Plan is paying much more fees than Fire. Mr. Nash stated that this is incorrect; Fort Myers Fire is set up exactly the same as the General Plan and commissions come out of the account as they always have. Mr. Burt disagreed stating that the Bogdahn statements do not reflect this, only individual commissions being charged for sales of stocks inside the portfolio. Mr. Nash stated that there are several inaccuracies in MorganStanley's report. The Bogdahn statements do reflect the commissions for every single purchase and sale. Mr. Burt responded that it is documented and he can show accounts that do not pay commissions and do pay lower fees. FRS is not paying commissions. There are platforms that do not pay fees plus commission and Fort Myers Fire is one of those not paying commissions. He would be happy to sit down individually with the Board members to show the information because MorganStanley conducted a large analysis on the Fire Plan as well.

Mr. Burt stated Bogdahn utilizes the Rogers Casey Performance Measurement System to construct its performance reports. This requires manual data entry which exposes the report to the possibility for human error or omission as seen with the underreporting of fees. If an understatement of fees and overstatement of values is input, any type of data will be flawed. Some of the reporting irregularities discovered during the review involve the pooled investments. On the September 30, 2010 Bogdahn reported $2,173,303 for the value of the MorganStanley Real Estate Fund and the MorganStanley statement value was $2,128,291.47, an overstatement of approximately $45,000. Bogdahn also over-reported Polaris' value at $7,649,221 versus $7,625,298.72 on the Comerica report, an over-reporting on approximately 24,000. Morgan-Stanley's analysis of incorrect reporting was only limited to the pooled investments, which two of them were held for the year. Unfortunately Comerica does not break down the individual accounts on the statements.

Morgan-Stanley still reviewed the performance numbers even with the incorrect data. Under-reporting fees and over-reporting the value will increase the return inaccurately. Three goals were listed upon review of the Investment Policy Statement: outperform the blended benchmark, perform in the top 40% of peer group, and absolute returns. With respect to Bogdahn's progress and how it outperformed the benchmark, the General Employees Pension Plan has underperformed for three years and outperformed by .22% for 5 years on a "net" basis. Net is in parentheses because of the under-reporting of a significant amount of fees and also the over-reporting of the investment value.

The plan has not performed in the top 40% for the one year, three year, and five year and the peer group is never defined. In addition, it has not even performed in the top 60%. In the one year, it performed in the bottom 61$^{st}$ percentile, in the three year bottom 73$^{rd}$ percentile, and five year bottom 62$^{nd}$ percentile. Out of the last seven years, it has performed in the top 40$^{th}$ percentile only one year missing its target 86% of the time.

On an absolute return basis, there is an 8.4% actuarial assumption. This is a very difficult target to hit especially given the returns over the last couple of years. The "net" return is 2.98% for five years and 2.42% since inception, which did not meet the goal. This is standard because of the current market. The Consumer Price Index (CPI) +3% has been missed in the three year performance (-2.65%), five year (2.98%) and since inception (2.42%). The CPI is a gauge of inflation and it is desirable to keep up with or beat inflation.

In addition to the poor fee arrangement and high fees associated with the non-fixed income investments, the asset allocation is another reason why the pension plan has underperformed. There is zero exposure to common asset classes that have done very well over the last five to ten years including: convertible bonds, foreign bonds, REITs, hedge funds, preferred securities. There is also an underweight in small cap stocks and emerging markets (.7%) such as China,

India, Brazil; those countries have done very well.
Poor manager selection is another reason for underperformance. They have value composites, growth, international equity, fixed income, TIPs, and real estate. The report provides information on performance over the last three years. There is no five year history because none of the investment managers have been around for five years. Value and growth have been 0-3 with respect to being in the top 40% for the past three years. International equity has performed fairly well at two for three years. Fixed income, TIPs, and real estate were in the top 40% one out of three years. Against peer groups, value has been in the bottom $62^{nd}$ percentile, growth in the bottom $81^{st}$ percentile, international equity bottom $61^{st}$ percentile, fixed income bottom $69^{th}$ percentile, and TIPS $94^{th}$ percentile. Real estate does not have a peer group ranking for the three years. One percentile is the best performer and $100^{th}$ percentile is the worst.

The Investment Policy Statement includes a lot of good language that would trigger red flags such as big inflows or outflows of the portfolio or investment manager changes. Fort Myers is already triggering some of its investment manager review red flags. One hundred percent of the managers with track records of three years or greater have underperformed their peer group including: Manning & Napier, Lateef, Polaris, Galliard FI, and Galliard TIPs. Four of the investment managers are triggering IPS review criteria. Galliard has been below its benchmark. All of these returns are gross of fees therefore if the high fees are added in it will reduce the level of performance and lower the numbers.

All of the investment managers are required to notify Fort Myers if they are providing a more advantageous fee schedule to another client. He has never seen this language before however it is good language written in the contract. Unfortunately, the managers are not subscribing to it. MorganStanley has access to all of these managers at a 30% to 40% discount of what Fort Myers is currently paying with no commissions. As a result, he guarantees that Fort Myers is not receiving as advantageous of a fee structure as it should be. Fort Myers is paying full cost for its investment managers.

Two of the investment managers are incorrectly classified. Atalanta Sosnoff is a Large Cap Core Manager, which uses a benchmark of Russell 1000 and Bogdahn is using the Russell 1000 Growth. Manning and Napier is a U.S. Core Manager which uses the Russell 3000 benchmark and Bogdahn is using the Russell 3000 Value.

The Investment Advisory Service Agreement, which was signed July 2, 2010, identifies twelve services to be provided:

1. Investment Policy Development – completed
2. Investment Policy Review – not updated in five years
3. Asset Allocation Consulting and Modeling – allocation has not been updated in five years, there was no proof that a risk/reward model has

been found

4. Investment Style Analysis – $13,300,000 of investments incorrectly benchmarked
5. Performance Measurement – incorrect benchmarks and over-reporting of investment values
6. Monitor Investment Manager Compliance – at the time of the report four investment managers were triggering red flags, six investment managers not reporting better pricing agreements/all are in violation of their contracts
7. Monitor and Report Transaction Cost – not reporting any transaction costs
8. Investment Manager Searches – accomplished
9. Investment Manager Recommendations – 100% of the recommendations have underperformed their peer groups
10. Attendance at Board Meetings – accomplished
11. Educational Seminars
12. Other Services

In summary, Fort Myers is paying high fees and commissions. The fee arrangement is unfavorable to Fort Myers' situation. Bogdahn is under-reporting fees and not reporting commissions. It is not enrolling investment managers into the commission recapture program when hired. There is overstatement of values on 100% of the two they tracked, lack of exposure to asset classes, and lack of increased diversification and/or changes in the asset allocation. In addition, it is a different world than it was five years ago and perspectives on the world economy have changed.

MorganStanley's recommendation is for Fort Myers to go out for an RFP as it has been five years since Bogdahn's hiring. Fort Myers may after hearing this report have questions and want to determine what is available with respect to investment consulting. He also suggests that Fort Myers look very closely at the fee arrangement, actual fees being paid, the investment managers' performance and value received. MorganStanley provides drastically lower fees, increased transparency, local and consistent contacts, greater disclosure, deeper resources, and greater flexibility.

Ms. Carlson questioned if Mr. Burt has MorganStanley's fee structure for comparison. Mr. Burt stated that he will provide it the early part of next week. Ms. Pennington stated that she would like a copy of the summary. Mr. Burt stated that he will provide a copy.

Mr. McGee reiterated that the summary basically recommends for Fort Myers to go out for an RFP to determine what is being offered in the market because not only has it has been five years since Bogdahn was hired but Fort Myers is not receiving the best deal. Ms. Lovejoy questioned where MorganStanley obtained the information to compile the report. Mr. Burt stated that Comerica is Fort Myers' custodian and documents every single transaction that occurs inside the account including checks, dividends, and fees. Therefore, the primary source was the Comerica annual statement, which is 1,000 pages. In addition, they reviewed the investment manager agreements, investment policy statement, and service provider agreements. The results are not opinion, they are fact. MorganStanley has Excel spreadsheets, which could be shared with Board members that reference the source pages, fees, and dates.

Ms. Lovejoy questioned what reports SmithBarney was comparing when it discovered the discrepancies. Mr. Burt confirmed that he was comparing the data to the Bogdahn quarterly reports received by the Board. Ms. Lovejoy questioned if they were the final and not preliminary reports. Mr. Burt responded that they were the final reports. The date used for the documentation was September 30, 2010 and it is nearly June 30, 2011; it was the final documentation. They actually waited until it was the final documentation because there are a certain number of investments that take a while to process such as the Morgan Stanley Prime fund. Mr. Nash stated that the Morgan Stanley Prime fund has a one quarter delay in the market value and those market values come directly from Morgan Stanley. When looking at the September 30$^{th}$ Bogdahn report, this is the June 30$^{th}$ Morgan Stanley value. Mr. McGee stated that Bogdahn's corrected statement was used.

Ms. Carlson stated that the MorganStanley Real Estate Fund is below the benchmark for the three year return. She requested information on how Morgan Stanley will be valued with the rest of the items on the report. Mr. Burt stated that he can provide a full proposal about what they would go through, how much it will cost, and how much Fort Myers would save at a later date. Ms. Lovejoy stated that if Fort Myers goes out for a formal RFP, MorganStanley will not be eligible as consultant if it provides a presentation prior to the RFP process. Mr. Burt agreed stating he could provide a hypothetical fee structure.

## Item III – Investment Report ~ Tim Nash

Mr. Nash stated that conditions were strong during the time period. Fort Myers' target is 8.4% and although there was a slight decline, the May numbers are still up more than 11% fiscal-year-to-date.

Mr. Nash reviewed the *Bogdahn Group Quarterly Review Report* for the first quarter ending March 31, 2011, which was provided to Board members.

*Major Market Index Performance – Page Three.* The EAFE index was up 3.4% for the quarter, S&P 500 5.9%, small and midcap stocks 7.6% and 7.9% respectively, and Barclays US Agg Bond Index .4%. Good performance out of all asset classes.

*Domestic Equity Style Index Performance – Page Four*. In general, value performed better than growth on the large cap side. Growth outperformed value on the smaller cap side largely due the technology names that performed well. *GICS Sector Performance & Quarter-End Sector Weight – Page Five.* Energy for large cap comprises nearly 13% of the portfolio. In only one quarter, energy names were up 16.8% and for the year 40.96%. Those without a fair amount of energy in the portfolio would have a difficult time meeting the benchmark.

*International and Regional Market Index Performance – Page Seven.* The EAFE index was up 3.4%. Japan was one of the only countries that was down at 4.9% for the quarter largely due to the earthquake and tsunami. Fort Myers has some exposure to Japanese stocks in its Polaris fund.

*Domestic Credit Sector & Broad Market Maturity Performance – Page Nine.* The returns for AAA, AA, and A bonds ranged from 20 to 90 basis points for the quarter. BBB were up 1.4%. Bonds below BBB, junk bonds, for the quarter and one year were the strongest performers up 3.9% and 14.2% respectively. Junk bonds have rallied over the past two year time period with the exception of June 2010 when treasury bonds outperformed. The bond market can give clues about what is occurring in equity market and this implies that investors were not mindful of risk. The market had been rallying very strongly. Treasury bonds outperformed only one quarter over the last two years. Junk bonds were doing extremely well however they were one of the largest decliners in May when the market started declining. Investors may be moving toward being more mindful of risk and paying more attention to earnings and growth capital.

*Total Fund Composite – Page Eleven.* The fund value as of December 31, 2010 was $66,579,360. The value grew half way through the fiscal year to $69,333,478. Domestic Equity and International hold 58% of the portfolio, which is in line with the longer term target and IPS at 60%. Core bonds and TIPs hold 33% of the portfolio, Real Estate 3.7%, and Cash 4.7% which is used to pay out pension payments on a monthly and quarterly basis.

*Asset Allocation – Page Thirteen.* Bogdahn believes that transparency is important and Fort Myers should be able to see all of its transactions, investments, and commissions appropriately paid to purchase and sell securities. All transactions with the exception of Morgan Stanley Real Estate Fund and Polaris can be found as well as fees paid on a quarterly basis, which will directly correspond with each manager's written fee agreement. Fort Myers' attorney has reviewed and approved the fee agreements. Fort Myers also has the opportunity to review the quarterly bills.

Polaris International and Morgan Stanley Real Estate are two comingled funds that have separate accounting. Fort Myers' custodian Comerica shadow accounts the Polaris fund however there can also be a delay. Polaris sends an official statement that is audited; this is the statement that Bogdahn uses in its reporting. Comerica also includes the information however there can be a one or two month delay in reporting. Bogdahn waits for the official document statement from both

Polaris and Morgan Stanley which provide all market values and fees as of the effective date. Mr. Christiansen questioned if the fees are reported on the Comerica statement. Mr. Nash responded the fees are not. He believes Comerica is only reporting the change in market value; he would have to confirm. Mr. Christiansen stated that the fees are at the fund level; basically they are taken out of the fund. Mr. Nash agreed stating Bogdahn receives an official statement as a legal subscription holder for both of those funds. Morgan Stanley is provided on a quarterly basis and Polaris monthly. The beginning and ending market value, all expenses, and all activity for Fort Myers' individual accounts are provided.

*Financial Reconciliation – Page Fifteen/Sixteen.* Provides the cash flows. This information comes directly from the Polaris, real estate statement, or Comerica. These are the transactions from the trust statements. The first column is the market value. The next column, net transfers, provides money moving as a result of rebalancing. Contributions and distributions reflect dollars coming into the plan out of the employees' paychecks. It could also be any returns of a class action lawsuit or State of Florida contributions.

Distributions include pension and/or fees paid for other providers. The fee column reflects the actual money management fees charged by the managers and paid by Fort Myers during the time period. This information is taken directly from the custodial statements. Two fee payments could be recorded if the Board does not approve the fees in the same quarter or the manager does not get it to Fort Myers in that quarter. All payments will show when paid out of the account to reflect 100% transparency. The expense line accounts for all expenses other than investment management fees including: custody fee, Bogdahn, attorney, actuary costs, FPPTA.

Mr. Christiansen questioned why Polaris and Morgan Stanley have a dash under the fees column. Mr. Nash stated the fees come out of the comingled fund therefore Bogdahn does not actually see that through a report. It is not paid through the custodial account; it comes directly out of the fund. Bogdahn confirms accuracy based on the fee schedule and subscription agreement. When the investment performance is reviewed, the gross of fees line is slightly understated because the fees are already taken out of the real estate and Polaris funds. They cannot manipulate the performance system or change any data coming out of the custodial statement for Fort Myers' protection; those funds are net. The net number is 100% correct as it reflects any of the money management costs and other fees paid directly out of Comerica.

*Comparative Performance Trailing Returns – Page Seventeen.* For the quarter, the gross of fees return was 3.70% versus a 4.15% benchmark for a difference of 45 basis points. This would be higher if the two comingled fund fees were included in the numbers. The median manager had a 4.10% return in the Rogers Casey Plan Sponsor Universe of which there are 429 institutional public pension plans. Fort Myers ranked 69% among those pension plans. Money managers from varying consulting firms populate the data base; Bogdahn as well as many other nationally known investment consultants are included. The plans range from a total market value of one million dollars up through well above one billion dollars. Multi-billion dollar Sonoma County in California has more latitude in its investment plan than Fort Myers such as investing in hedge funds. It also has private equity, which Fort Myers does not. Although not perfect, the database provides a reasonable idea of how public plans are doing across the U.S.

The total fund gross fiscal-year-to-date is 10.15% versus an 11.29% index for a difference of -1.14%. Fort Myers' target is 8.4% therefore the return is exceeding the assumption. Fort Myers is in the range of the median universe as it was 10.41% and placed in the 59th percentile. The longer term target as indicated in the Investment Policy Statement is to be in the top 40th percentile for the three year and five year. Fort Myers is not there; however the trend has been improving. Bogdahn changed out some managers who were underperforming and violating the Investment Policy Statement. The three and five year numbers are the actual returns and the managers who underperformed are included. Net of fees fiscal year-to-date the return was 9.91% versus an 11.29% index.

There has been strong performance from the value managers. Manning and Napier does have a broad core mandate however it tends to have a value bias. Bogdahn works with their managers all of the time and is comfortable having the Russell 3000 Value as their benchmark. The combination of the two value funds earned a 20.72% return fiscal year-to-date versus an 18.09% index placing Fort Myers in the top 39th percentile. Bogdahn added Moody Aldrich to the portfolio, which has done very well.

*Comparative Performance Trailing Returns – Page Eighteen.* Growth manager Atalanta Sosnoff was added to the portfolio on October 1, 2010 and Lateef in 2006. Both managers do a great job long term; they have great track records. Lateef outperformed for the quarter at 6.78% versus the 6.03% index. The return was slightly behind the index fiscal year-to-date at 17.88% versus 18.57%. This is because Lateef has a slightly lower allocation in the technology sector.

Atalanta Sosnoff has been struggling both in the short and long term. It was behind the benchmark at 4.00% versus 6.03% for the quarter and 14.38% versus 18.57% fiscal year-to-date. This is the one component of the portfolio that is lagging in the quarter and fiscal year.

The combination of the two growth funds was up 16.30%; the index was up 18.57%. Fiscal year-to-date Fort Myers was in the 73rd percentile.

Polaris International has done an excellent job longer term. It was up 3.13% for the quarter versus the 3.45% EAFE index and 13.13% for the fiscal year versus 10.33%. Polaris' exceeded the index in the one year return at 16.78% versus 10.90% placing Fort Myers in the top 21st percentile. They also did a nice job

preserving capital when the market was declining.
*Comparative Performance Trailing Returns –Page Nineteen.* Galliard is Fort Myers' fixed income manager and TIPS (Treasury Inflation Protection Securities) was added in 2006. TIPS has added value to the portfolio. Galliard's core bond portfolio was up .83% for the quarter versus Barclays' .48% and positive .18% versus a negative .28% index for fiscal year-to-date placing the fund in the top 22nd percentile. The allocation to TIPS earned Fort Myers 2.33% versus its 2.35% index.

Real estate has been difficult over the last couple of years however the Morgan Stanley Real Estate fund was added because Bogdahn believes it is prudent from a long term investment perspective to have an allocation to real estate. Direct real estate is preferred, which Fort Myers owns, versus REITS because Bogdahn believes it will not get the 5% to 6% that it has historically achieved in the bond market. Direct real estate is a great place to garner income because it has lower volatility than REITS and provides a good solid income return of over 6%.

The Morgan Stanley fund is one of the largest funds across the country; it earned 3.82% for the quarter. The Odyssey Index was up 3.98%, which is an open end core fund that includes 22 different real estate managers including Morgan Stanley. Fiscal year-to-date from an absolute perspective the core bonds barely earned 18 basis points. TIPS earned 2.29% and Morgan Stanley Real Estate 8.79%. It is slightly below the benchmark however it is a good fund and has done a nice job for the plan. He believes it will continue to do well.

*Comparative Performance Trailing Returns – Page Twenty.* As of September 2010, Fort Myers earned 9.18% net of fees. Years 2008 and 2009 are still being worked through. Fort Myers was positive 25 basis points in 2009 when the benchmark was negative. Anyone invested in equities in 2008 could not escape the declining market; Fort Myers was down 15.7%. The previous year the return was up 15.43% beating the benchmark. In 2006 the return was 8.75% exceeding the policy target of 8.22%. Finally in 2005, the return was 13.08% versus the 10.95% benchmark.

*Investment Compliance Checklist – Page Forty-One.* There are items on the checklist which have been addressed that have not been accomplished. No public pension plan has exceeded the 8.5% assumption over the trailing three and five year periods due to the market environment. The total plan return has not ranked within the top 40th percentile of its peer group over the trailing three and five year periods. Bogdahn has made manager changes to address this issue. Fort Myers is currently in the 76th percentile for the three and five year, 62nd percentile for the one year, and 59th for the fiscal year. The trend appears to be improving as a result of those changes.

Fort Myers' equity funds combined have beaten the benchmark on the three and five year. It was not in the 40th percentile. The allocation was less than the 75%

limit and total foreign equity was less than 20% of the total plan assets at market. Fixed income returns did meet or exceed the benchmark over the three and five year periods. It is not currently ranked in the top 40$^{th}$ percentile over trailing three and five year periods. The quality of the portfolio is in line.

Mr. Nash stated that there are no recommendations for change at this time. All of the managers are doing a great job and have good long term track records.

Mr. Nash provided Board members with an investment update through May 2011 stating that April was a very strong month. The total fund net of fees was down 96 basis points for the month. However it is still at 11.08% fiscal year-to-date. The market will likely fluctuate through summer however there are a lot of fundamentals that indicate a decent ending to the year. The probability that the return will exceed the assumption is strong.

Mr. Burt questioned how the total domestic equity returns are confirmed to have met or exceeded the benchmark over the trailing three year period when it indicates on page seventeen that the net total fund composite return over three years is 2.8%. Total fund policy is 3.17%. Mr. Nash stated that he compares gross for a like comparison because the Plan Sponsor Universe uses gross.

The plan earned 3.25% gross for the three years versus its 3.17% index for a positive difference of .08%. The five year return is identical to the index at 3.94%. Mr. Christiansen stated that this includes the netted numbers out of the two funds. Mr. Nash agreed stating that the number would be slightly higher. Mr. Burt questioned if the fees on pages fifteen and sixteen refer to investment management fees; Mr. Nash agreed. Mr. Christiansen confirmed that expenses include costs related to the actuary, attorney; fees unrelated to the investment program.

Mr. Burt questioned where the commissions are accounted for. Mr. Nash stated that the commissions are detailed in all of the Comerica statements where they record every transaction, the amount paid. That information also feeds to commission recapture brokers. Bogdahn does not list a line item for commissions in this report because Fort Myers receives the information in the Comerica statement as well as a summary from the money managers at the end of every fiscal year. These show all commission activity and average trading costs for the pension plan. In general the cost should be between two to three cents per share for most of these funds. Commissions reduce the returns. If money managers are paying commissions that are too high, this will result in a lower return. Therefore the total plan return includes the commissions because they were a cost of trading as part of the performance calculation.

Bogdahn likes the transparency aspect of being able to look at the custodial statements, which are the official record of activity for the plan and being able to follow and see those commissions on every single trade. If commissions are included, how would the plan know it is getting the lowest commission dollars. If trading at 5 cents per share for large cap stocks that is much too high. There may be a reason for a money manager to do that but some of the commission dollars above 3.5 should be coming back to the plan.

Ms. Pennington questioned if Fort Myers receives the Comerica reports. Ms. Emerson stated that she receives the quarterly reports. The Board members do not receive the entire report however the Finance Department does. Ms. Pennington confirmed that the reports are reviewed by Finance; Ms. Emerson agreed. Ms. Lovejoy questioned whose responsibility it is to reconcile the Comerica statement with the manager reports and is this necessary. Mr. Seagle stated that Finance receives the Comerica and manager monthly statements for all three pension plans. The statements are reconciled and general ledger adjusted however every detail is not reviewed. Finance's main function is to ensure that the City's general ledger is in line with the plan statements.

Mr. Nash stated it is Bogdahn's responsibility as Fort Myers' consultant to review the transactions and statements every month to ensure policy compliance. The commissions are also monitored, which feeds to the commission recapture broker. If Fort Myers has commissions that are in excess of specified amounts, those dollars come back to the plan. Mr. Christiansen responded, if they use the commission recapture program. If not required to use it, they can trade at 2 cents per share then a lot of the managers would do the straight trade at 2 cents per share and not deal with trading at a higher rate and getting something back.

*Mr. Griep motioned to request a formal response from Bogdahn Consulting to address MorganStanley's report, seconded by Ms. Lovejoy, and unanimously approved by the Board.*

Mr. Lustig stated he would like to include in the motion a response date of no later than July 20, 2011, which is the next board meeting date. Mr. Nash agreed.

*Mr. Griep motioned for the formal response to be delivered by July 20, 2011, seconded by Ms. Lovejoy, and unanimously approved by the Board.*

Ms. Emerson stated that she needs the report one week prior in order to include it with the meeting agenda packet. Mr. Burt requested a copy. Ms. Emerson agreed.

Mr. Nash reviewed the *Fort Myers General Employees' Retirement Plan Fee Review*, which was provided to Board members.

Mr. Nash stated that the investment managers are listed by style. The annual fee is listed by basis points, which comes from each investment management contract. The fee is calculated on a quarterly basis using the ending market value. Some money managers will calculate on the beginning market value. He believes it is a wash; he has not seen a study to indicate otherwise. If the managers grow their assets during the quarter they do have a higher amount but they are only allowed to charge 90 basis points. For 2008 and 2009, Fort Myers has seen its pension plan go down almost every quarter not because of bad manager performance but largely due to the market. The fee is based on a percentage therefore Fort Myers pays less in dollars every time the plan value decreases; he does not see this as an issue.

Manning & Napier's market value as of March 31, 2011 was $8,485,328. At an annual fee of 75 basis points the cost is $63,639.96. Fort Myers' managers bill quarterly. Therefore the market value and fee calculation are available at any time. Once approved by the Board, the payment out of the trust can be seen on the Comerica statements. All of these are easy to track.

It is slightly more difficult to identify the fees for Polaris International comingled fund and Morgan Stanley's Prime Real Estate if not familiar with the documents. Mr. Christiansen stated that these would not be on the Comerica statement. Mr. Nash stated that there is not a line item for the fee. As a subscriber to this fund, Bogdahn receives an official statement on a quarterly basis. He used the maximum fee that would ever be charged (1%) on the Bogdahn statement, which is not what Fort Myers is paying.

When referring to the signed subscription agreement, which defines the fees, Polaris charges 75 basis points per year in investment management fees. In addition to that, as a subscriber, Fort Myers agreed to pay other expenses incurred by the plan such as the official independent audit by the accounting firm. All of the investors share in that cost. Therefore when it happens in any given quarter, the fees could be slightly higher. They will always be 75 basis points per year for the money management and depending on when the other fees occur it may be slightly higher. Polaris guarantees in Fort Myers' document that it will never exceed 1% and if it does, Fort Myers receives a rebate of any dollars above that in the next time period.

Mr. Burt stated that the subscription agreement does not provide for any guarantee nor does it mention fees. Mr. Nash stated that Mr. Burt is only holding Exhibit Three and the official subscription agreement is several sections. The Board attorney would have the executed copy and the City should have a copy as well. The fees are listed on page sixteen which specify 75 basis points for investment management plus additional expenses. Mr. Burt stated that he would like to see the agreement. Mr. Nash stated that he can request a copy from the Board. Mr. Lustig requested that Morgan Stanley make formal requests for any other information. Mr. Nash stated that the Morgan Stanley Prime Real Estate Fund charges 90 basis points in investment management fees per year. The subscription agreement also states that if the fund beats a 9% rate of return every year, it can charge an additional .0004 basis points; this has not occurred in the last few years.

The total investment management fees are 66 basis points, including the maximum 1% Polaris fee, which was only at 90 basis points last fiscal year. The dollar fees would be $456,936.71. This includes all fees that paid for investment management; they can be tracked.

The review also details custodial fees. Comerica is paid through its recordkeeping. The contracted fee is 4 basis points for the first $50 million and 2.5 basis points for the next $50 million. Fort Myers pays 3.6 basis points for Comerica to provide all of the work it does. This would still keep the custody and investment management at 69.6% which is a very low reasonable fee in the institutional investment world for a plan in the $50 to $70 million range.

The Bogdahn fee is also included. It was raised last year from $20,000 to 25,000, which is guaranteed for three more years. This equates to 3.6 basis points. It is always a hard dollar fee and includes as many searches as requested and/or other information.

Annual investment management, custodial, and consulting fees total 73 basis points per year or $506,769.82, all transparent.

## Item IV – Attorney Report ~ Scott Christiansen

*Financial Disclosure Forms*

Mr. Christiansen stated that the Financial Disclosure forms are due by July 1st and the trustees will be fined if the forms are not returned by the deadline.

*Records Management Liaison*

Mr. Christiansen questioned if the resolution was completed for the Records Management Liaison position. Ms. Emerson stated that Marie Adams informed her that she is the Records Management Liaison. Mr. Christiansen stated that as a separate legal entity the Board can decide if it wants to appoint Ms. Adams. Mr. Lustig stated that the Board already confirmed this. Mr. Christiansen questioned if it has been reported. Ms. Emerson stated Ms. Adams has indicated that she is listed with the State of Florida however she will confirm.

*Legislation*

Mr. Christiansen stated that Senate Bill 1128 circulated through the committees and became more advantageous as it moved through the channels. It went to the governor on June 8, 2011, who has 15 days to sign it. Ms. Emerson stated that the governor's office informed her that he has until June 23rd. Mr. Christiansen stated that Christiansen & Dehner has been preparing although it has not yet passed.

Mr. Christiansen confirmed that Bill 1128 impacts 175 and 185 pension plans--

Police, Fire and General Employees. It does not pertain to the Florida Retirement System. With respect to the General Plan, the bill requires the Florida Department of Management Services to do an analysis and designate a financial strength number for each defined benefit plan in the State of Florida. The actuary will be required to do a separate analysis in each actuarial report restating all of the assets and liabilities utilizing a 7.75% investment return assumption. This additional analysis will not be for funding purposes, just for comparison. The State is attempting to compare all Florida pension plans however it will be difficult to get a true comparison because of the plans' varying assumptions, methodologies, etc.

The benefit item in the legislation that applies to General, Police and Fire Plans is that as of the effective date, no more than 300 hours of overtime per year is to be included in the salary calculation nor can lump sum payments of sick and vacation time. The effective date will be the date that the new union contract is signed after July 1, 2011. Ms. Emerson confirmed that the union contract is currently under negotiation. Mr. Christiansen stated that the additional significance of the negotiations will be that this bill will become effective with the signing of the new contract.

Mr. Christiansen stated that as of the effective date, if an employee has 500 hours on the books and retires one or two years later, he/she will still get credit for lump sum payments existing as of the effective date. This still leaves it open to interpretation for many different issues; this is being worked out with the Division of Retirement and he will get more clarification. Mr. Christiansen stated another issue is whether it is going to be per fiscal or calendar year. He has already submitted approximately fifteen questions to the State for clarification. If guidance is not provided then he will have to interpret it.

There is also a provision that affects the Fort Myers Police and Fire Plans allowing for a change in board composition. Currently, the two boards have seven positions including the mayor, chief, and police officers/firefighters. The issue has been that the mayor is on the boards and does not attend the meetings therefore the City has asked to change the requirement. The Mayor, who occupies the City representative position, can now be removed. Mr. Alley stated that the position will be designated for a Finance Department representative on each of the three boards. Mr. Christiansen confirmed that the General Plan is not subject to the provision. Mr. Alley stated that the goal is to have a finance employee on all three boards. Ms. Emerson stated that the General Plan has a finance employee. Mr. Christiansen stated that there is a potential conflict of interest as the trustees have a fiduciary responsibility to the pension plan. A finance director has a responsibility to oversee the City's finances and could have a conflict of interest as fiduciary of the pension plan and its members.

Ms. Lovejoy stated that she understands why the boards have non-employee trustees. Mr. Christiansen stated that it could be more general such as the position will be appointed by the City Manager or City Council. Mr. Alley stated that this was requested as a result of the change in Fort Myers' form of government. The thought was to have the City Manager replace the Mayor because he was not attending the meetings however the Division of Retirement refused the request. With the change in legislation, he is unsure if the City Manager intends to sit on the board. He may expect the Finance Director or possibly an individual who understands the financial component to occupy the position.

Ms. Lovejoy stated when Mr. Donlan presented the changes, one of the pieces that the employees paid for was to have the salary included in the calculation. Now the amount that was paid for has been taken away by the State. She questioned what this means with respect to the employee contributions paid; should the employees be refunded. Mr. Christiansen stated that legally it does not have to be refunded. It could be negotiated however legally the Board must follow legislation. Mr. Lustig stated in this case employees will continue to pay it. Ms. Carlson stated that employees still get 300 hours. Mr. Christiansen stated if the cutoff is 300 hours, employee will not make any contributions beyond that. Ms. Carlson stated that the contributions paid included overtime, sick and vacation time. Ms. Emerson stated that employees did not pay for W-2 wages. Mr. Lustig requested that Ms. Lovejoy research this.

Mr. Christiansen stated that when the definition of salary is changed to state that anything over 300 hours is not included in salary and lump sum payments of sick and vacation are not included in salary, the employee will not pay member contributions on those dollars. Ms. Pennington stated that members will not pay the 3.1%. Mr. Christiansen agreed stating that employees only pay pension on whatever is included in the salary definition. Ms. Emerson stated that she has already spoken to payroll about implementing a system that will track the hours up to 300. It will likely be based on fiscal year because City records are based on fiscal year.

Mr. O'Malley questioned if there are cost of living adjustments as part of the new law. Mr. Christiansen stated he informed the board about all that is included. Mr. O'Malley questioned about additional insurance. Ms. Lovejoy stated that this is for the State of Florida system.

## Item V – Additional Business

*Airtime*

Ms. Carlson stated that employees are questioning why the airtime purchase is limited to five years. They are also asking if the City goes to a 1.6% multiplier and employees choose to buy airtime after that, can they purchase sufficient airtime to cover it back to the 3.1% for those years. Mr. Lustig confirmed that the 1.6% is the proposed multiplier change for the City's General Plan. Mr. Christiansen stated he believes the five year restriction for airtime is a federal limitation. Mr. Lustig stated that the other issue is related to union negotiations.

*Independent Review*

Ms. Lovejoy questioned about the status of the independent review and pension workshop. Ms. Emerson questioned what workshop. Ms. Lovejoy questioned if the City is working with a consultant to find another actuary to do the pension. Ms. Emerson agreed however stating that she has not been told anything about a workshop. Ms. Lovejoy stated that there was discussion about it in the May budget workshop.

Ms. Emerson stated that the review is going well; she is getting the requested information. Ms. Lovejoy questioned when Ms. Emerson expects to have the information and what information was requested. She can do a public records record request to get the information if necessary. Ms. Emerson stated the City received the information and that Ms. Lovejoy should probably do a public records request. Ms. Lovejoy stated that Ms. Emerson told the Board members at the previous meeting that she would be their source and keep them informed.

Ms. Emerson stated that she just received the information. Before it can be released it must be reviewed and she has to get with the City Manager. Mr. Lustig questioned when this will occur. Ms. Emerson stated that she should be able to provide copies at the next meeting therefore it will be in the minutes. Ms. Lovejoy questioned if any Board members are in favor of requesting the information through a public records request as she would like to be able to review it before the July meeting. Ms. Emerson stated that she always provides the information to the trustees ahead of time. As soon as she can release it, which should be in a week or two, the board members will have it. She questioned if one week is sufficient. Ms. Lovejoy and Ms. Pennington agreed.

*Pension Related Contract Negotiations/Attorney Review*

Mr. Christiansen requested to see any pension related items under contract negotiation so he can ensure that the potential changes will not violate the Internal Revenue Code or make the plan non-tax qualified. Mr. O'Malley stated that his union attorney is working with him on the contract. Mr. Christiansen stated that the union attorney may not be familiar with pensions; he just wants to confirm that there are no issues prior to the two parties signing the contract. Ms. Pennington questioned if this is the City Attorney's job.

Mr. Griep stated that the trustees previously discussed about the Board being subject to what the union approves. He believes it is a good idea for Mr. Christiansen to review the changes prior to being agreed upon. Mr. Christiansen stated that he is not intending to negotiate; he would simply call attention to any potential issues to both parties. Mr. O'Malley agreed stating that there is a process however it would be wise to have someone check. There is not an agreement until the members and City Council agree. Mr. Christiansen stated that it would be prudent to let him review any changes to ensure compliance before the entire agreement process is complete. Mr. Alley stated irrespective of the formalities, it is a reasonable request; he will share the information with Mr. Christiansen.

*Independent Plan Administrator*

Mr. Griep stated that a couple of meetings ago he mentioned the possibility of the Board seeking an independent plan administrator. This is not to take away from what Ms. Emerson is doing however the Fire Plan has recently hired an independent administrator for its plan. He questioned whether he should pursue the idea. He believes that the Board should consider doing an RFP for a private administrator, independent of the City, who could handle the recordkeeping and pension calculations. This pension administrator is handling all of Cape Coral's pension plans and the Fort Myers Fire Plan. They perform pension calculations at no additional cost and can have the numbers in real time given they are provided the real numbers from payroll. Foster & Foster charges $100.00 or more. The independent plan administrator takes care of all the records and has local offices for employee accessibility. Their home office is in Palm Beach. He is not saying the Board should select this company; it is an example of a firm independent of the City. He believes they provide a lot of services that the board does not receive now. This could also involve a cost savings for the employees because the calculations could be done on the website.

Mr. Christiansen recommended that the Board do an RFP if it is going to pursue an outside administrator. He was uncomfortable with MorganStanley's presentation today because the Operating Rules and Procedures dictate that the Board will not bring anyone in to do a presentation unless it is through the RFP process. Fort Myers did not do that and basically got a proposal from a consulting firm. If the Board is going to consider this he recommends doing an RFP, which could be sent to the company Mr. Griep spoke about in addition to the other firms. The result could be that the Board decides to make no change. Mr. Griep stated that Fire had three or four presentations. Ms. Pennington stated that the RFP would be like a proposal; Mr. Lustig agreed stating the responses would be from multiple entities who are interested in working for the Board.

*Ms. Pennington motioned to do an RFP for an independent plan administrator, seconded by Mr. Griep, and unanimously approved by the Board.*

Mr. Christiansen confirmed that he is to do the RFP; Ms. Pennington agreed.

There being no other business to discuss, the meeting adjourned at 10:56 O'clock A.M.