CITY OF PONTIAC, MICHIGAN
GENERAL EMPLOYEES RETIREMENT SYSTEM
BOARD OF TRUSTEES
SPECIAL MEETING
DECEMBER 9, 2011

A special meeting of the Board of Trustees was held on Friday, December 9, 2011 at the City Council Conference Room, City Hall, Pontiac, Michigan 48342. The meeting was called to order at 10:05 a.m.

TRUSTEES PRESENT

Shirley Barnett
Koné Bowman *(arrived at 10:12 a.m.)*
Charlie Harrison, Chairman
Leon Jukowski, Mayor
Phyllis Long
John Naglick
Tuesday Redmond
Sheryl Stubblefield
Patrice Waterman
Kevin Williams

OTHERS PRESENT

Cynthia Billings, Sullivan, Ward, Asher & Patton
Larry Gray, Gray & Company
Chris Kuhn, Gray & Company *(arrived at 10:09 a.m.)*
Mitch Foltz, Retiree
Sheila Maksuta, Retiree
Larry Marshall, Retiree
Joyce Turner, Retiree
Linda Watson, Retiree

Re: Gray Alternative Partners I, LP

Chairman Harrison stated that the purpose of the special meeting is to obtain more detailed information regarding a proposed investment in the alternatives space.

Ms. Watson distributed a handout to the Board and read her list of issues with regard to this investment. She stated that she is sitting fairly well with her pension. She expressed that the Fund has to last to provide for more than one thousand retirees.

Mr. Gray thanked the Board for the opportunity and told Ms. Watson that he appreciates her concerns. He wished she would have contacted him so she would not have taken so much time on issues that are not accurate. He addressed her individual points.

Ms. Watson said Mr. Gray has been attempting to set up a meeting with an elite group of individuals which he refers to as the Family and that she will call the Billionaires Club for a number of years. In order for this meeting to be held Mr. Gray had to put up $500,000.00 of his own money. These individuals according to Mr. Gray do not deal with public pension funds and this would be their first investment from a public fund.

Mr. Gray stated that he has been working quite awhile to pull this type of investment together. Most of these managers started from modest means. He did not pay for a meeting with these managers. He invested $5 million dollars of his own money in order to open an avenue for his clients.

Ms. Watson is correct that these types of managers do not generally deal with public pension funds.

Ms. Watson is also correct on what fund of funds means.

Most of these companies started with private offerings from families like the Rockefellers. These investments have less risk than stocks. These in no way resemble the Bernie Madoff fiasco. He takes offense to Ms. Watson's accusation.

He has tried to encourage these investment managers to consider working with public pension funds for many years, as these funds represent the hardworking citizens in communities across the United States and the need the benefit from the services they provide.

Ms. Watson said Mr. Gray is asking that the Pension System invest $10 million by which they may receive a return on investment of 20% to 30%.

Mr. Gray stated that not all of the investments will return 20% to 30%. The net internal rate of return is 16% versus the S&P at 0%. Investors have taken more hits in the stock market over the last ten years.

Ms. Watson said the meeting was held in November and the Board has until the end of December to make their decision. She questioned whether this is a direct investment as opposed to an alternative private equity investment.

Mr. Kuhn stated that the System would not be buying an individual portfolio. They would be pooled with other investors. This looks like a mutual fund where you get every stock in the portfolio. It is not like being the sole owner of a building or investment.

Ms. Watson said that the consultant had previously stated that he would not invest more than $3 million into a direct investing fund.

Mr. Gray indicated that this is not a direct fund.

Ms. Watson said alternative investments are not covered under fiduciary liability insurance. The risk level of these types of investments is 40%. There is no liquidity with these investments. There is no recourse for losses.

Mr. Gray noted that these investments are covered under the fiduciary liability insurance.

Ms. Watson said this is not a corporation thus it is an unregulated investment with no safeguards.

Mr. Gray explained that they are a corporation and Gray & Company is responsible. He would not put this much effort into this or his reputation on the line.

Ms. Watson asked who the principals are and are they registered investment advisors under the Investment Advisor Act of 1940.

Mr. Gray stated that many of the underlying managers are registered investment advisors.

Ms. Watson said there are no employment contracts for principals with non-compete clause and key-man provisions for the principals. No fiduciary responsibilities acknowledged or accepted by principals. No independent audit reports.

Mr. Gray reported that McGladrey which is one of the largest audit firms in the United States and they will be performing the audit.

Ms. Watson said that in the case of Onyx, the initial investment was for manufacturing in the Midwest but ended in car financing, how can the Board monitor the investment strategy. There is no authority relative to type of investments. There is no effective method to monitor investment strategy. This is not an established fund so how would the Board know if there are other commitments? There is no independent audit.

She said it may or may not be subject to Unrelated Business Tax Income (UBTI) based on IRS Section 511 which states that exempt entities will be subject while Section 115 says no tax on public pension funds. What was the IRS's final opinion?

In 2007, it was indicated that the alternative investments along with CAPROC may cause the basket clause to exceed the limits per Public Act 314.

Mr. Gray assured Mr. Watson that the allocation is well below the basket clause.

Ms. Watson said alternative investments are exempt from FOIA requests. The financial consultant's primary salary is $8,106.00 per month and $97,272.00 per year. As there is a discretionary investment advisor agreement with Gray for managing managers who were under the terminated UIM (emerging managers group) and which Gray sold in 2009 when it became a financial burden, the financial consultant is receiving a second salary. This would be the third salary for the financial consultant based on the standard management fee of 2% of committed total capital.

Ms. Watson asked, haven't we learned anything from the Onyx investment, Enron, the Bernie Madoff fiasco and yesterday's news reports about the former Congressman/Governor, the honorable Corzine who resigned just before his company went bankrupt and confessed that he doesn't know where the money went? My concerns and conclusions are based on reading all the GERS minutes relative to alternative investing since it was introduced in 2006. I hope the Board will:

- Not rush to approve commitment because that's what happened with Onyx and there will be other opportunities.

- Be blindsided by the suggestion that there may be a 20% to 30% return.

- Remember billionaires use OPP (other people's money) and their money is always protected.

- Of the 5 alternative investments (including Peritus which is our dedicated "high risk manager") the Board has approved 2 which resulted in legal action.

  Mr. Gray explained that Peritus is the System's high yield manager, not high risk.

- Not take unnecessary and dangerous risks with my livelihood.

Mr. Kuhn told the Board that Gray & Company has been working on identifying these investment managers and how to get their clients into these investments for the last three years. Normally the minimum investment is too high for smaller clients.

Chairman Harrison indicated that twenty-three of Ms. Watson's bullet points out of the twenty-seven were not correct.

He feels comfortable and excited about the investment. State Street is one of the largest banks and they will be handling the back office.

Ms. Watson is concerned that the Board will put the money in blind and will not have control over the investment.

Mr. Gray explained that the System's investments in Invesco and Mesirow are in blind pool with no control. There is more transparency with these managers.

Chairman Harrison stated that these types of investments raise capital then close the fund. The close for this fund is at the end of the year.

Mr. Kuhn said that Ms. Watson addressed the tax issues. He assured her that municipal plans are exempt.

Ms. Billings indicated that there is an IRS provision that states that employee pension plans can be subject to UBTI. However, IRC Section 115 provides that governmental trusts are exempt from tax. There is no real clarification because neither section of the Code references the other and the IRS has not issued guidance.

Chairman Harrison asked if Mesirow and Invesco fit into this category.

Ms. Billings stated that the System may have to pay. There are a lot of questions.

Mr. Gray questioned whether alternative investments are exempt from FOIA.

Ms. Billings stated that alternative investments are exempt based on their proprietary nature.

Mr. Gray stated that some underlying investments are protected. Gray & Company is not protected and is subject to FOIA.

Ms. Watson questioned at what stage the Onyx litigation is in.

Chairman Harrison stated that they need to stick to the agenda.

Mr. Gray stated that as the System's consultant he has never raised the consulting fee.

Ms. Watson asked if this is included in the base or primary salary.

Mr. Gray stated that his firm has been in business for twenty years and he has been in the industry for thirty years. It is a big deal to be invited to these meetings especially as a black man from rural Georgia.

Carl Thoma does not go out and sell his investment. He compared this to buying IBM stock which is too risky, so instead you buy a mutual fund with IBM included.

He told these managers that they should help the people who protect their homes and families.

He did ask the System to investment $10 million. Perhaps the Board will take a different approach after the presentation.

He asked if there are further questions from the Fund participants.

He explained that there are concerns with China and unemployment and that the economy will not get better because unemployment is still too high. People are concerned about their jobs which will not help spur the economy. These investments have low correlation to what is going on but with the same duration and a higher quality level.

Trustee Waterman asked Mr. Gray to explain that the Board is only looking to invest the assets that would be allocated to Mesirow or Invesco to a similar type of investment.

Mr. Kuhn stated that Invesco and Mesirow were the System's first private equity investments. These managers make capital calls and send the money back. In order to get the money back at the end, the investments have to be sold. All the capital to private equity has never been allocated. They were looking for the next round of managers. It will take two to three years to be fully committed. Their strategy was to bring in another group of managers.

Chairman Harrison said that the Board was looking to invest $10 million in this space giving $5 million each to Invesco and Mesirow. In the meantime Mr. Gray brought in this deal. The Board did not open up another asset class. They now have an alternate investment idea.

Mr. Gray stated that with the money left over they will carefully monitor the basket clause.

Retiree, Mitch Foltz asked how many years the System would be locked in.

Mr. Gray stated that all private equity investments are locked in for ten years.

Chairman Harrison stated that this is the part of the portfolio that is illiquid. This money has the potential to perform better than the traditional investments. It is good to have a diverse portion within the asset allocation.

Mr. Foltz stated that he monitors the minutes and the Fund's activity monthly.

Chairman Harrison asked if there were any questions.

Retiree, Larry Marshall confirmed that he understands the investment and does not have any questions.

Retiree, Joyce Turner stated that she is satisfied with what she has heard. She asked if the worst case scenario would be that the investment is insured or protected.

Mr. Gray and Trustee Williams indicated that the FDIC protects bank accounts up to $250,000.00, but that protection is not available to the System's investments.

Mr. Foltz asked if this will have any bearing on paying income tax at the State level or whether the Fund is being taxed.

Chairman Harrison stated that this will add a level of diversification to the portfolio.

Mr. Kuhn provided an overview of the managers that would be in the fund.

Edgewater Funds is based in Chicago and was founded in 1991 by Jim Gordon who is part of the "Who's Who". Their focus is in the private equity space looking for middle-market and family-owned companies at lower price multiples and sell the company at double the price.

Mr. Marshall & Mr. Foltz left at 10:56 a.m.

They have delivered a gross internal rate of return of 54.5% and 2.66 times the gross multiple on invested capital of realized and partially realized investments. Some of the firm's investments have been exited at multiples as high as eight times.

Energy & Minerals Group is a privately held investment firm that invests in the minerals, coal and energy sectors. Senior partner, Lee R. Raymond is the former Chairman and CEO of Exxon Mobil and he ran Mobil Oil before the merger. His son John T. Raymond was the former CEO and President of Plains Resources/Vulcan Energy and came out of the Texas Oil Board.

Their firm partners with the leading people in the industry. They are currently looking at a deal to build a rail system in Australia in order to move coal to China.

Their first fund raised $1.4 billion and they are looking to raise $2 billion in this fund. They are personally putting in $250 million of their own money.

They also have a couple of public fund investors including the State of Maryland and the State of Wyoming which are billion dollar funds.

Freeport Financial LLC is an opportunistic manager. They are a leading provider of corporate and leveraged finance solutions to middle market companies. They serve the financial needs of private equity managers and the management teams with whom they invest. They look for companies that need money to take their business to the next level. Most banks and hedge funds have left this space. They can lend at interest rates of 12% to 15%. This fund gets some SBIC support. They will return income the first quarter after the investment.

Millennium International Ltd. is a global hedge fund firm. They identify strategies to make money using arbitrage.

Mr. Gray commented that this manager can make money when the market is going down. In the 2000's their performance was in the 12% range when the S&P performance was 0%. They employ over ninety different investments teams and their models work well.

Mr. Kuhn described Parmenter Realty Partners as a real estate investment firm that acquires distressed in-fill office properties in the Southeast, Southwest and Mid-Atlantic markets. They get buildings back to a Class A standard to sell into the institutional core market.

There are a lot of attractive properties in the real estate space. There are currently lots of properties with a substantial amount of leverage to buy at distressed prices.

Third Point LLC is an event driven investment adviser based in New York. They have a little higher correlation to the equity market. They have an interesting portfolio and they are not afraid to move across capital structures.

Mr. Gray stated that the bulk of the System's portfolio is built on an equity strategy with performance based on the stock market.

They are looking to put together a group of managers that will make money regardless of the stock market performance.

Mr. Kuhn stated that their portfolio is more concentrated than Mesirow's or Invesco's which helps them to diversify risk. The Mesirow and Invesco portfolios end up with a lot of duplication and redundancy.

Chairman Harrison commented that this investment would provide access to managers that the System would not otherwise have access to.

He also welcomed new trustee Sheryl Stubblefield and noted that at her first meeting she is getting on the job training.

He told the Board that they have until December 31, 2011 to invest in this fund.

Ms. Billings stated that Gray & Company has acknowledged their fiduciary level of care. She does not see any deal breakers based on what she has reviewed so far. Gray & Company is having their lawyers put together documents to protect their firm. As the General Partner or principal he can be removed with a two-thirds vote of the Limited Partners. Mr. Gray has agreed to remove the language that would require that he also be convicted of fraud in order to be removed.

Payouts are distributed 100% to the Limited Partners than 100% to the General Partner.

Mr. Gray said that they will take care of their clients first, then they will pay expenses, then profits will be distributed.

Ms. Turner & Ms. Maksuta left at 11:18 a.m.

Ms. Watson inquired on how the money will be distributed.

Mr. Gray indicated that they will close the funds because they have a finite date of offering.

Trustee Naglick noted the funding ratio of the System and how it is one of the best run plans he as ever seen. It is a bright spot in the City. Gray & Company is a wonderful investment advisor. However, are you concerned that all this good could come crashing down? He has worked on some financial train wrecks. To him it is a red flag when an investment has a limited time offering.

It is not like there will be a large group of new employees going forward. However, the over funding will protect the current retirees. The City is not in a position to make up the contributions if the funding ratio drops. It could be a disaster for this Fund.

This Board does not have a good track record in alternative investments. It will take a long time for this investment to pay off. Why take the chance? He would personally invest but it is different when you are protecting pension benefits. He recommended that the assets be shifted into guaranteed annuities or put money into a super safe investment. He understands that the System has a huge pot of money but they just voted to get out of securities lending because of the risk. He noted that Gray & Company has been an awesome investment advisor.

Mr. Gray stated that they are not plowing new ground. State Street, Goldman Sachs, Merrill Lynch and J.P. Morgan have invested with these firms. They are making good decisions on set policy, not paving new territory in business.

Trustee Naglick questioned whether this type of investment should be brought to a Fund that is 150% funded.

Chairman Harrison explained that this allocation has already been made to this investment space. The System has the opportunity to add alpha without increasing risk. They would be taking the low road with a guaranteed annuity. The Board can stay the course or keep the current allocation.

Trustee Naglick questioned whether the Board should hire managers that are on the edge who are swinging for the fences.

Mr. Gray said that the Board could reduce the risk in the Fund by reducing active managers and moving to index funds. The rest of the portfolio could be more conservative if they are receiving the income from other managers.

Trustee Jukowski asked if the assets would be allocated to other managers within the alternative space.

Mr. Gray indicated that State Street will be providing the performance statement for the Fund.

Mr. Kuhn stated that the reporting would be the same for all managers.

Trustee Naglick asked if Gray & Company is already locked in.

Trustee Jukowski stated that he is more of a risk taker. It is a small enough percentage of the portfolio that he is comfortable with putting in $10 million or a little less. Based on the over funding he feels it is a good opportunity.

Mr. Gray said that the standard deviation is better than the S&P and more conservative. People are moving in this direction because these investments are not susceptible to global news and issues.

They are looking at returns that would be in line with the actuarial assumption. This could allow the Board to make the rest of the portfolio more conservative.

Trustee Naglick questioned if Gray & Company would be using Pontiac's investment to minimize their risk.

Mr. Gray said that he already has more than $10 million in committed capital.

Trustee Jukowski stated that he has found the funding advice differing around 100%. He is more concerned that it will drop.

Trustee Williams asked if the System has to commit $10 million. He is concerned with the conflict of interest. He leans toward being conservative but does not mind taking some risk. The System is currently 150% funded but he does not want it in the portfolio.

Ms. Billings addressed Trustee Williams' concern about a conflict of interest. She stated that the consultant cannot consult for themselves. In this regard the System technically would not have a consultant over the assets invested in this program.

Mr. Gray said that he would use different wording. Part of their function is to bring three to five managers to the Board. At the end of the day the Board selects a manager. It is a fully transparent investment. The City of Atlanta did not have a problem with this arrangement.

Chubb considers Gray & Company as a fiduciary of these investments and holds them at a higher level because they bring the names. If there is an issue they can increase their fiduciary liability.

Trustee Bowman felt that being the System's consultant and investor would create a conflict.

Chairman Harrison left at 11:44 a.m.

Mr. Gray stated that they are the same as their other managers using Loomis Sayles as an example. They will look at these managers the same as a sub advisor and also invest in them.

Trustee Bowman did not feel that equated to being the same as the consultant, the manager of managers and an investment manager for the System.

Ms. Billings stated that there is no legal conflict when the Board hires a manager that Gray & Company recommends and also invests in. They will have the resources in place to track the General Partner, the Limited Partners and have authority over what managers are being invested in.

The Board had to have a consultant over the alternative investments because the assets are locked up for ten years. It is exactly the same thing as what he is currently doing but it is not liquid.

Chairman Harrison returned at 11:47 a.m.

Ms. Zimmermann indicated that this investment looks more like a mutual fund than a single stock.

Chairman Harrison stated that the question is whether the Board wants to pursue this investment.

Mr. Gray stated that they do not want to cram this down the Board's throat. The trustees can change the investment amount or adjust the rest of the portfolio using a more conservative approach.

Trustee Waterman stated that if it would make the reluctant trustees more comfortable the investment if the amount was reduced to $5 million. She does not feel that Gray & Company would bring an investment to the Board that would harm the System.

Mr. Kuhn reported that the current allocation to the basket clause is 8.23%. Peritus is currently 1½% over allocated and 3% is allocated to Invesco and Mesirow with $1.9 million left to allocate. He suggested scaling Peritus back to 5%.

Trustee Bowman asked how Peritus became over allocated.

Chairman Harrison stated that they are being penalized for making money.

Mr. Kuhn stated that international and private equity are under allocated and the allocation is $13 million over in domestic fixed income.

Ms. Zimmermann noted that the portfolio will be rebalanced in February, 2012.

Trustee Long noted that she would be in favor of reducing the investment. She has no reservations and is confident in investing in something that Gray & Company is also investing in.

Trustee Stubblefield stated that she feels the same as Trustee Long. The Board has trusted Gray & Company with the assets and setting the direction so she is comfortable.

Trustee Redmond indicated that the System doesn't want the assets to sit in the bank. Gray & Company is currently taking care of the returns and they are also investing in the fund. Sometimes the Board has to make difficult choices.

Mr. Gray stated that their current commitment to Edgewater Funds is $5 million. They will minimally put in 1%. Mr. Gray clarified that he made a personal commitment to invest $5 million with one of the underlying funds; he would only be responsible for this commitment if he was unable to raise assets in the fund to cover the commitment. He and Mr. Kuhn confirmed that if they obtained $10 million in commitments then Gray and Co would not have to invest $5 million but would only be investing the amount as required in the operating agreements.

Ms. Zimmermann explained that in order to get into Edgewater Funds Mr. Gray had to put up $5 million.

Mr. Gray stated that they will be investing $500,000.00.

Trustee Redmond asked if Ms. Billings is reviewing the documentation.

Ms. Billings told the Board that the contract is ninety pages long and she has reviewed the first forty pages and has not found any major issues and does not anticipate any.

Chairman Harrison assured the Board that the investment is contingent on the contract review.

Mr. Kuhn confirmed that the investment is subject to the attorney's approval of the contract.

Trustee Williams would like to reduce the amount of the investment. He is still concerned about the appearance of a conflict of interest since the System has not done well with their previous alternative investments.

Trustee Bowman stated that he is a big risk taker but when it is other people's money he is more conservative. He would be more inclined if the amount of the investment was reduced.

The Board discussed how much to reduce the investment. They agreed to invest $6 million into GrayCo Alternative Partners Fund I, LP.

Ms. Watson asked if the Board is comfortable with the investment and whether all their questions were answered.

RESOLUTION 11-089 By Bowman, Supported by Waterman
Resolved, That the Board approve a $6 million investment in GrayCo Alternative Partners Fund I, LP pending legal review.

Yeas: 8 – Nays: 1 (Trustee Naglick)

Re: Retirement Office Healthcare Proposal
Trustee Bowman indicated that at the last meeting Ms. Zimmermann was instructed to move forward on obtaining healthcare information for the Retirement Office. However, it was not his understanding that she was allowed to make the decision and sign the contract.

There was a question regarding the coverage mirroring that of the City.

Trustee Redmond thought that the information was going to be brought back to the Board.

Trustee Bowman noted that it only takes approximately seventy-two hours to get a quote from Blue Cross.

Ms. Zimmermann indicated that some of the numbers in the previous quotes were inaccurate.

Ms. Billings stated that she recommended Doris Clarkson based on her association from another Board. There was a deadline to submit the contracts so Ms. Clarkson hand delivered them.

Ms. Watson left at 12:13 p.m.

Chairman Harrison indicated that the draft should have provided clarity.

Trustee Jukowski stated that at the last meeting the Board voted to authorize Ms. Zimmermann to get the quotes and take the appropriate action to secure healthcare coverage for the Retirement Office staff.

Ms. Billings confirmed what transpired at the last meeting.

Trustee Bowman reiterated that it only takes seventy-two hours to obtain a quote and approximately two weeks to enroll.

Trustee Williams left at 12:18 p.m.

Chairman Harrison said that this is not the time to begin a new quote process because we are up against the clock. The Board needs to make sure that the staff has insurance.

Trustee Stubblefield stated that she is not comfortable voting on something when she is not familiar with the details.

Ms. Billings reported that at the last meeting it was Ms. Zimmermann's understanding that the Board voted to allow her to obtain the quotes and to secure insurance coverage comparable to the City's. She also noted that there is a deadline.

Trustee Waterman stated that she would like more time to go over information in the packets before the meeting and before voting on an issue.

Trustee Bowman would like to use local providers.

Chairman Harrison said that this is a simple issue. There is a cut off date and the staff cannot be without coverage. There is no time to let them send quotes and start the process over. The Board cannot come back and meet to vote on this.

Ms. Zimmermann explained that she could get a quote and bring it back to the Board by Wednesday, December 14, 2011.

Chairman Harrison stated that the contract was already signed. He suggested bringing the issue back to the Board at the end of January.

Trustee Long stated that the staff should be allowed six months experience with Humana and then they will have some data to work with, with regard to this group.

Trustee Redmond recommended that Ms. Zimmermann start researching other companies in four months so the Board does not have to make a rush decision.

RESOLUTION 11-090 By Redmond, Supported by Long
Resolved, That the Board authorize Ms. Zimmermann to continue with the current healthcare contract with Humana.

Yeas: 7 – Nays: 0

RESOLUTION 11-091 By Barnett, Supported by Bowman
Resolved, That the Board adjourn the meeting at 12:38 p.m.

Yeas: 7 – Nays: 0

I certify that the foregoing are the true and correct minutes of the meeting of the General Employees Retirement System held on December 9, 2011

As recorded by Jane Arndt