Revised 12/17/08

CITY OF NORWALK
MUNICIPAL EMPLOYEES' PENSION BOARD
WEDNESDAY, NOVEMBER 12, 2008

ATTENDANCE: Michael Sweeney, Chairman; Gerald Moran; Frank Nash

STAFF: John Schlosser, Personnel Administrator; Fred Gilden, Comptroller

OTHER: Laura Kunkemueller, EAI, Senior Consultant; Ellen Petrino, EAI, Principal/ Senior Consultant; MaryAnn DiMaggio, EAI, Fixed Income; Etta Jones, Custodial; Tom O'Shea, Northern Trust; Bob Vernille, Northern Trust; Bill O'Meara, Northern Trust; Frank Maceachern, Advocate

CALL TO ORDER

Chairman Sweeney called the meeting to order at 6:00 p.m.

APPROVAL OF MINUTES FOR OCTOBER 7, 2008

**** MR. NASH MOVED TO APPROVE THE MINUTES OF OCTOBER 7, 2008 AS SUBMITTED.**

**** MR. MORAN SECONDED.**

**** MOTION PASSED UNANIMOUSLY.**

APPROVAL OF PENSION APPLICATIONS

Margarita Nikolis, Board of Education Administrative Secretary II, 23 yrs, 2 mos service, 62 years of age, regular pension, final average salary $39,470.40, Option 3, annual benefit $17,691.00, monthly benefit $1,474.25, commencement date November 1, 2008.

**** MR. NASH MOVED TO APPROVE THE PENSION APPLICATION LISTED ABOVE.**

**** MR. MORAN SECONDED.**

**** MOTION PASSED UNANIMOUSLY.**

PERFORMANCE AND FIXED INCOME MARKET REVIEW - EAI

Ms. Mary Ann DiMaggio is a Fixed Income Specialist/Bond Specialist and heads up Fixed Income Research for EAI. She said the market has exhibited record volatility with a decline in asset values across asset classes. She said some of it is a result of de-leveraging by the banks, hedge funds, and structured investment vehicles. There is a lot of technical selling pressure in the marketplace, which is driving down prices. Over the next few quarters, it is expected that there will be negative economic contraction. The government programs instituted by the Treasury Department and the FDIC provide liquidity to the money markets, capital injections to the banks, bridge loans, etc. These programs are designed to stabilize markets and provide some level of investor confidence to the markets. Investors are not totally confident to date. It may take some time to take effect. 4th quarters earnings could come in worse than 3rd quarter earnings. She spoke about GM and Ford being on the brink of bankruptcy. She explained they are junk-rated companies in the high-yield segment. They were downgraded to junk status in 2005. They sold off their finance units to gain cash, but that cash quickly disappeared at a fast rate when oil and gas prices soared, the recession hit, and car sales declined. GM and Ford approached Congress and predicted that they would run out of cash by 2009. The auto companies have asked for $25 billion in bridge loans to help them.

Mr. Sweeney asked about Pimco Total Return and how they are big on agency bonds. Ms. DiMaggio explained that Pimco was invested in government bonds and mortgage bonds backed by agencies. Those bonds are experiencing a level of spread widening because of interest rate volatility and low purchases. Pimco saw some value in bank bonds that were bought early but didn't do well in the 3rd quarter. She said the overall high yield market (junk bond) is yielding 18%. She said the bank loan market is under pressure, and bank loans are being sold by hedge funds that are levered. Lehman Brothers went to default in September and had many bank loans on their balance sheet. They are now in bankruptcy protection, and they had sent out a bid list of $750M in loans to try and sell them to raise cash. Bank loans were down -5% or -6% percent for quarter end September. In October, they were down -12%. The default rates for corporate credits are still low. She said the default rates are expected to increase. Bank loans make for a better investment.

Some discussion took place regarding bank loan yields and calculations. Ms. DiMaggio said that the Lehman Brothers bankruptcy on September 15, 2008 was not anticipated and is the result of tumultuous market activity to this day. A company's enterprise value deterioration will directly affect the recovery on a bank loan. Interest rates are not expected to increase during these difficult market times, but at some point interest rates should start to increase and bank loans would benefit from that due to their floating coupons.

NORTHERN TRUST – CUSTODY AND SECURITIES LENDING UPDATE – TOM O'SHEA

Mr. Tom O'Shea, Relationship Manager, and Mr. Bob Vernille, Division Manager from Northern Trust presented their information on Custody and Securities Lending. Mr. Bill O'Meara, Securities Lending RM, joined the meeting by phone.

Mr. Vernille explained that Northern Trust started out over 100 years ago as a small, personal trust bank in Chicago. During that time, it has grown to be a recognized leader in trust and custody investment services throughout the world. He said they have a unique business model. They offer asset servicing and asset management. Asset servicing includes trade settlements, third party investment managers, stock splits, mergers, security litigation, class action settlements and proxy voting. He said that 80% of Northern Trust employees own their stock. He said he, Mr. O'Shea, Mr. O'Meara, and the 12,000+ other employees have a vested interest to meet and exceed client expectations.

Mr. O'Shea said that over the last few years, they have experienced tremendous growth. They have 17 global locations, 12,420 staff worldwide, services in 94 markets, and clients in over 40 countries.

He said they have $3.5 trillion in assets under custody; $1.07 trillion in assets under administration, and $652.4 billion in assets under management. He said they took a hit on their balance sheet, and they were able to give that money to clients who participated in securities lending. For the first time in over 20 years, they reported a loss. It was their choice to take $561M off their balance sheet with the $150M to securities lending clients affected by the market, and $321M additional monies to support a capital agreement to protect the integrity of the dollar valued funds. Even though they took a huge hit, they still came out favorably with the credit rating agencies.

Mr. O'Shea then presented some client servicing information, saying there are two funds for the City of Norwalk. They are the Norwalk Municipal Employees' Pension Fund, and the newly created Retiree Medical Trust that they funded this year, for about $3.5M. Northern Trust is providing custody, securities lending, financial reporting".

Mr. O'Meara presented information on securities lending. He explained that the rebate rate is based on the federal funds rate, which is federal funds minus a certain percentage. Mr. Nash asked what the percentage is, because the federal funds are so low now. Mr. O'Meara said that it typically would be from 10 basis points for something that would be easy to borrow, to federal funds minus 1%, which wouldn't leave much of a rebate back to the broker. He explained that they have a very strict policy and process that borrowers have to go through to be part of their securities lending program. He said the non-cash collateral is 10%. He said they have to keep at least 20% of their investments in Core USA, overnight vehicles. He explained that 20% is the minimum they have to keep in overnight liquidity.

Mr. Gilden asked how many clients decided to opt out after September 30. Mr. O'Meara said that clients did discuss it with them, and they were offered the following three options: do nothing; go through staged withdrawal; immediate in-kind withdrawal. They had one client, not in Core USA but in another pool, go through with the full in-kind withdrawal. They have about 20% of their clients in Core USA that are in the process of the staged withdrawal. It is Northern Trust's goal to have all clients treated fairly and equitably in the withdrawal process. He said from September 18th, the NAV decrease is 98.81 without the receivable from the clients. Mr. Gilden asked what the current unrealized loss for Norwalk was. Mr. O'Meara said that the total deficiency is $239,117, and $208,000 is unrealized. The net minus for the year is approximately $100,000 for the year. The current market value of securities on loan is less than $22,000. The volumes have come down. 2% of the portfolio matures after 3 years. The majority of the portfolio will mature within the three years.

Mr. Sweeney asked what the split was between the Northern Trust investment earnings and the client investment earnings, and if the allocation had changed. Mr. O'Meara explained that a $150M support agreement put in place that has been allocated to all Northern Trust clients impacted by the deficiency, and he said that Norwalk received $28,288.77 on 10/29/08. He said the fee split was adjusted for the next 12 months; the adjusted split has 68% going to Norwalk and 32% to Northern Trust.

Ms. Petrino asked if they had changed their strategy, saying they were not a high volume lender or a specials lender. Mr. O'Meara said the hope was that the low margin trades will go away, and there will be more of a focus on securities that have a high intrinsic value, to achieve more returns for a lesser volume.

After more discussion, the general consensus was to stay in the pool and generate earnings, but to continue to review in one year.

Mr. O'Shea said that he and his colleagues are looking forward to continuing to provide services and maintaining the relationship with the City of Norwalk.

FURTHER DISCUSSION ON INVESTMENT ENVIRONMENT, ASSET ALLOCATION

Some discussion took place regarding the Northern Trust presentation, and the investment environment and asset allocation.

OTHER BUSINESS

The next pension meeting will be on Wednesday, December 10, 2008.

ADJOURNMENT

**** MR. NASH MOVED TO ADJOURN.**

**** MR. GILDEN SECONDED.**

**** MOTION PASSED UNANIMOUSLY.**

The meeting was adjourned at 8:55 p.m.

Respectfully submitted,

Carolyn Marr
Telesco Secretarial Services