

**CITY OF OWOSSO
EMPLOYEES RETIREMENT SYSTEM BOARD**

OCTOBER 20, 2005

7:00 A.M.

PRESENT: Chairperson Linda Robertson, Vice Chairperson Frances Kukulis, Trustees William Blanchett, John C.M. Davis (arrived at 7:47 a.m.), Wilfred A. Farrell, Mark Mitchell, and James Treadway (arrived at 7:08 a.m.).

ABSENT: None.

ALSO

PRESENT: Merrill Lynch Investment Consultant Marie Vanerian, City Attorney William C. Brown, City Finance Director Richard C. Williams, and City Treasurer Ronald J. Tobey.

CALL MEETING TO ORDER

Chairperson Robertson called the meeting to order at 7:04 a.m.

APPROVE AGENDA

Motion by Vice Chairperson Kukulis to approve the Agenda as presented with the addition of Item of Business to read as follows: Notice to Investment Managers. Consider resolution directing Investment Managers to do all trades through Merrill-Lynch.

Motion supported by Trustee Farrell and concurred in by unanimous vote.

APPROVE MINUTES OF AUGUST 18, 2005 ORGANIZATIONAL MEETING

Motion by Trustee Farrell to approve the Minutes of the August 18, 2005 Organizational Meeting as presented.

Motion supported by Vice Chairperson Kukulis and concurred in by unanimous vote.

APPROVE MINUTES OF AUGUST 18, 2005 REGULAR MEETING

Motion by Trustee Mitchell to approve the Minutes of the August 18, 2005 Regular Meeting as presented.

Motion supported by Vice Chairperson Kukulis and concurred in by unanimous vote.

APPROVE MINUTES OF SEPTEMBER 29, 2005 SPECIAL MEETING

Motion by Trustee Farrell to approve the Minutes of the September 29, 2005 Special Meeting as presented.

Motion supported by Trustee Blanchett and concurred in by unanimous vote.

CITIZEN COMMENTS

There were no citizen comments.

CONSENT AGENDA

Motion by Trustee Farrell to approve the Consent Agenda as follows:

1. Approve Pension Check Reports:
 - a. August, 2005 \$ 91,767.28
 - b. September, 2005 \$ 91,767.28

2. Approve Statements:
 - a. Chemical Bank and Trust Company
July-September, 2005

- b. Fifth Third Bank
August-September, 2005
 - c. City of Owosso Employees Retirement Fund
August-September, 2005
3. Payment Authorizations:
- a. Chemical Bank Trust and Investment
Investment Management Services
For Period 06/01/05 through 08/31/05 \$ 7,829.71
 - b. Ronald J. Tobey, City Treasurer
Report of Checks Written – August, 2005 \$110,172.47
 - c. Ronald J. Tobey, City Treasurer
Report of Checks Written – September, 2005 \$ 93,061.73

Motion supported by Vice Chairperson Kukulis and concurred in by unanimous vote.

COMMUNICATIONS

The following communications, publications and conference announcements were placed on file.

- Gabriel, Roeder, Smith & Company: *News Scan and Research Memo*
- Gabriel, Roeder, Smith & Company: *GRS Insight*
- Lerach, Coughlin, Stoia, Geller, Rudman & Robbins, LLP: *Corporate Governance-Fourth Quarter 2005.*
- Merrill Lynch Investment Managers: Prospectus – July 25, 2005
- Public Safety Employees Pension & Benefits Conference – cancellation notice.
- PlanSponsor: September, 2005.
- Miscellaneous Conference Announcements

Trustee Treadway arrived at 7:08 a.m.

Finance Director Williams arrived at 7:08 a.m.

OLD BUSINESS

Ordinance Rewrite Re: IRS Regulations Update: William C. Brown, City Attorney

City Attorney William C. Brown addressed the Board with an update on the status of the proposed ordinance rewrite. He commented that changes had been forwarded to Miller, Canfield, Paddock and Stone Attorney Campbell and that we are awaiting a revised proposal. He anticipates that the revised proposal will be presented to the Board for the next meeting.

The Board requested copies of the proposal as soon as available (marked up and proposed copy) to review prior to the next meeting. Mr. Brown anticipates presenting the proposal to the Board, and then making a recommendation to the Council for possible adoption by Council in February.

Expense Account Detail Report: Richard C. Williams, Finance Director

Chairperson Robertson commented regarding the need to follow up on the outstanding expense account charges and to resolve the issue.

City Finance Director Richard C. Williams addressed the Board regarding the questions about the outstanding expense account for custody fees. He commented that he agreed with the general statement that the city shall reimburse the system for administrative expenses. He also commented that research showed that choosing to go with Merrill-Lynch for custody of the assets was never made an action item. He commented further about discussion regarding his request, as the employer representative, that the board with a “no cost, low cost” alternative seek that out as opposed to paying fees. He also commented that he had asked for that because he thought it was prudent that someone who had custody of the assets not run the investment of the funds. He further commented that he thinks, on the surface, that the city is responsible, but that the Board has a responsibility to administer the System in a prudent manner and if you have expenses that you could avoid, you

should do that. He said that it was on that basis that the city was withholding payment of the custodial fees because there was the ability of the Board to avoid those costs.

Chairperson Robertson commented that the City Attorney's opinion was that the City should pay the fees. She acknowledged the Board's responsibilities and that action should have been taken earlier. Vice Chairperson Kukulis commented regarding the notice to the Board in June 19, 2003 about the elimination of the funds from the budget. She commented that she doesn't feel that the Board now should waive the fees at this point and that if the money had been paid then, it would have been in the fund and earning interest. She would like to see any outstanding issues resolved each year.

Mr. Williams again reiterated that the Board had been put on notice each year but that it didn't act. Trustee Treadway commented that he recalled prior Chairperson Hood commenting that it wasn't a cost (custody fees) to the system. Ms. Vanerian commented that Mr. Hood implied that it wasn't a cost to the system but there was no mention of it being a cost to the city.

Chairperson Robertson asked what the general feeling was of the Board. Trustee Farrell commented that he was not on the Board until recently but he would like to see a compromise because of issues on both sides. Vice Chairperson Kukulis asked if it was legal to waive these fees. City Attorney Brown responded that the Board could waive the fees. Trustee Treadway commented that he feels that the City owes the fees and that they should not be waived. Trustee Mitchell commented that he "hates cleaning other people's messes up" but doesn't feel that the fees should be waived. He also commented about the loss of interest. Trustee Blanchett commented that he doesn't feel that the Board has the right to waive the fees and that the City is liable to pay the expenses.

The Board consensus is to have the City pay the fees. Mr. Williams feels that the \$22,156 was reimbursable after review of the total amount outstanding. He commented that he had recommended that there be an independent advisor for the Board.

Vice Chairperson Kukulis commented to Mr. Williams about the detailed list of expenses and that Mr. Tobey had been attempting to get the issue resolved during his tenure. Mr. Williams commented regarding Mr. Tobey's expense report being consistent and accurate. He also commented that related to the custodial fees that there is an agreement on file that was signed by the Chair that there are fees related to the portfolio.

Motion by Vice Chairperson Kukulis to have the City pay the full amount of the expenses due of \$66,274.32 and to reimburse the Retirement System for those unpaid expenses as soon as possible.

Motion supported by Trustee Treadway.

Voice vote: 6 yes; 1 no

Motion carried.

Vice Chairperson Kukulis requested of Mr. Williams that if similar issues come up in the future that the whole Board be notified not just one person.

Done Away Fees Resolution Report: Marie Vanerian, Merrill Lynch

Marie Vanerian, Merrill Lynch Investment Consultant, addressed the Board regarding the status of the Done Away Fees. She commented regarding what is involved in custody and commission fees management. She commented that there is an annual fee of \$150 per year that they waive. There are fees related to custody and that commission fees are related to the cost of trading.

She reported that as of September 30, 2005, a credit of \$6,870.00 was made to the system. She commented about "what happens now?" There was general discussion regarding what is normal trading and what the investment managers feel is a reasonable amount of trading.

Trustee Davis arrived at 7:47 a.m.

Ms. Vanerian commented that she would like to develop a history of the Fifth Third Bank trading activities.

City Clerk will distribute to Board Members a copy of the done away fees credit resolution.

Ms. Vanerian asked if the Board would allow her to negotiate with Fifth Third Asset Management regarding resolution of this matter as it goes forward. City Attorney Brown advised that the final agreement had to be approved by the Board. The Board gave general consensus for Ms. Vanerian to negotiate with Fifth Third Asset Management and report back to the Board.

Mr. Tobey asked Ms. Vanerian "when Old Kent had custody, these fees were never showing up. Does that tell me that they were always trading at their desk and possibly paying the premium that you spoke about? Is that why we were not charged these before?"

Ms Vanerian responded that they may have been acting more as an agent in a transaction than they were as a principal in the transaction or trading out of their own inventory more – but that they were also charging you between \$20 and 25,000 a year to custody your assets and could have imbedded those charges into that as well.

There was Board discussion regarding Mr. Mullins comment at the last meeting that he had never seen done away fees like that.

Chairperson Robertson asked for clarification of the done away fees as listed on the statements. Merrill-Lynch consolidates the information on the individual investment managers' statements into one statement. There was Board discussion regarding the statements that the Board receives. Chairperson Robertson commented that Mr. Mullins told her that Fifth Third wasn't charging the system; that Merrill Lynch was charging the Retirement System.

Chairperson Robertson asked what initiates the \$25 charge and how does Merrill-Lynch know to charge this fee. Ms. Vanerian responded about what initiates the charge of \$25 out of our account and that the charge is made during the reconciliation of the trade process by Merrill-Lynch.

Chairperson Robertson commented that for the short term Merrill-Lynch has it set up so that done away fees may still be on the statement but that at the end of the month an amount will be credited. Ms. Vanerian commented that she will absorb the done away fees until the end of the year.

Chairperson Robertson commented regarding the "original" document with Merrill-Lynch regarding the fees that would be charged. There was discussion regarding an agreement with Merrill-Lynch that addresses fees. Ms. Vanerian commented regarding custodial and commission fees. She will look for agreement and bring back to next meeting.

City Attorney Brown commented that in June 2004 Ms. Vanerian agreed to absorb done away fees. Ms. Vanerian commented that her agreement was based on Mr. Lee's comment that the fees should be minor. Vice Chairperson Kukulis feels that the amount of trading done by Fifth Third Asset Management should be researched.

Ms. Vanerian agreed to absorb the fees through the end of the year.

Vice Chairperson Kukulis commented about her concern regarding John Schmitz and his name not being listed in Mr. Mullins' handout.

Chairperson Robertson commented that in her recent communications with Dennis Mullins that he was very responsive.

NEW BUSINESS

Notice to Investment Managers: Consider resolution directing Investment Managers to do all trades through Merrill-Lynch

Chairperson Robertson reported that Dennis Mullins, Senior Relationship Manager-Fifth Third Asset Management, requested a written communication regarding direction for trading through Merrill-Lynch.

Ronald J. Tobey, City Treasurer, had provided Chairperson Robertson with copies of letters from Brian T. Lee of Fifth Third Bank dated September 27, 2004 and November 15, 2004 regarding the matter of Fifth Third directing all trades through Merrill-Lynch.

Motion by Vice Chairperson Kukulis to endorse the letters from Brian T. Lee of Fifth Third Bank dated September 27, 2004 and November 15, 2004 and ask that the City Clerk send a copy of this motion and the above referenced letters to Dennis Mullins of Fifth Third Asset Management with the expectation that they follow the terms of those letters*.

Motion supported by Trustee Blanchett and concurred in by unanimous vote.

*The text of the letters from Brian Lee follows:

November 15, 2004

*Mr. Ronald J. Tobey
City Treasurer
301 W. Main Street
Owosso, MI 48867*

R/E: City of Owosso Employees Retirement Plan

Dear Ron:

As a follow up to my letter of September 27 and e-mail last week, Marie Vanerian and I were finally able to meet and discuss ways to make the management of Fifth Third's portion of the retirement plan more efficient and effective. The following issues were discussed and agreed upon at the meeting:

- 1) I proposed that the current large cap core equity strategy be replaced with a quality core large cap equity strategy. Marie agreed that this did not overlap with the current managers and would be a good fit for the portfolio. Historical performance has been excellent and the concentrated (approximately 40 stock) portfolio will have substantially less turnover of holdings than the current quantitative based strategy. It is our intention to meet jointly with the Board at the December meeting to discuss and request approval for this strategy. Prior to that time, the current strategy will remain in place.*
- 2) Marie and I discussed the role that commissions plan in the funding of your soft dollar fee offset. It was agreed that all equity trades will be place through Merrill Lynch in a manner that Marie receives credit for your soft dollar arrangement. Regarding our fixed income holdings, Marie informed me that you do not receive a soft dollar credit due to various legal restrictions for Merrill Lynch acting as Principal. As a result, it was agreed that fixed income trades may be placed in a manner that results in the most effective net cost to the retirement plan, even if those trades are not executed through Merrill Lynch.*
- 3) Marie and I discussed our respective roles as consultant and investment manager. We agreed that, to the extent the Board has approved an overall strategy within the context of the Investment Policy Statement, it is acceptable for us to invest our holdings in a manner that we believe to be appropriate. However, it was agreed we will keep Marie informed in a timely manner regarding our activities to help her carry out her role in the most effective manner possible.*

Please let me know if you would have any questions at this time. We will plan on seeing you on December 16th

Very truly yours,

*Brian T. Lee
Director — Portfolio Management
248-603-0509
briant.lee@53.com*

September 27, 2004

Mr. Ronald J. Tobey
City Treasurer
301 W. Main Street
Owosso, MI 48867

R/E: City of Owosso Employees Retirement Plan

Dear Ron:

I appreciated the opportunity to meet with you, Rick, and Greg on Friday to discuss your concerns regarding the relationship between Kristi Tice and Marie Vanerian. You can be sure we will act immediately to improve our communication with Marie and do what we can to eliminate the operational problems the city has been experiencing.

In this meeting, we specifically agreed to the following:

- 1) Effective immediately, Fifth Third will direct all future trades on the City of Owosso Employee Retirement Plan to Marie at Merrill Lynch until such time that the City advises us otherwise in writing. No outside brokers will be used. This should eliminate "done away" fees and missing cost basis information. It is our understanding that Merrill Lynch and the City of Owosso have reached an acceptable agreement on commission levels. Although I believe this was clear from our discussions, we will not monitor commissions and will make no attempt to place trades (through electronic or block trading) at lower commission rates.
- 2) At our earliest convenience, we will provide to Suzanne Luck at Merrill Lynch the cost basis information she is missing for previous trades to outside brokers. Having visited with Suzanne on Friday, it is our understanding that this will not be an issue in the future if we trade solely with them. However, if this is a problem in the future with Merrill Lynch trades, the City will need to communicate directly with Merrill Lynch to resolve any issues. It is their responsibility to provide you with cost basis information for all of the purchases they settle as custodian.
- 3) We will work with Marie to a) come up with a large cap equity investment strategy that results in satisfactory return expectations and lower turnover and b) to clarify our roles as consultant (Marie) and money manager (Fifth Third). I have a call in to Marie to discuss this, but have not heard back from her yet.
- 4) Karen Bluhm will replace Kristi Tice as the Fifth Third Administrative Officer for the City of Owosso accounts. I will have her contact you to arrange an introduction.

We will attempt to work directly with Marie on issues to improve efficiency and communication. You, Rick and Greg had offered your assistance to coordinate a meeting at your office between the bank and Marie if we are not able to accomplish the goals referenced above. I will contact you if we determine your assistance would be beneficial.

Thank you for the opportunity to work with the City of Owosso Employee Retirement Plan. We will make every effort to maintain your continued trust.

Very truly yours,
Brian T. Lee
Director — Portfolio Management
Fifth Third Bank — Eastern Michigan
248-603-0509
briant.lee@53.com

Application for Retirement – Bruce I. Hall, Jr.

Motion by Trustee Mitchell to approve the Authorization for Retirement request from Bruce I. Hall, Jr. effective October 9, 2005.

Motion supported by Vice Chairperson Kukulis and concurred in by unanimous vote.

Process for Review of Investment Managers

Ms. Vanerian distributed copies of a Manager Identification Search Sample report to the Board.

She commented regarding the documentation of the process of selecting an investment manager. She said that Merrill-Lynch looks at both qualitative and quantitative measures when looking at different managers. She outlined some of the points that are considered in an investment manager search: company has been in business for at least five years, the size of operation, and the size of client base. She also said that they visit the company for 2-3 days and video tape the due diligence process. The process also involves monitoring companies on an annual basis. If they find issues that "look odd", i.e. changes in ownership, employees leaving, and deterioration in results, the company is visited by Merrill-Lynch. The interview is the last step in the process.

Chairperson Robertson commented regarding the estimated cost of \$12,500 for the manager search. She inquired if this is a cost to the System or to the City. Ms. Vanerian responded that the cost could be spread over three years.

City Treasurer Tobey responded that this is an expense would be turned over to the City for payment as an administrative expense. Finance Director Williams agreed and wholeheartedly encouraged a manager review every five years.

Chairperson Robertson commented regarding the due diligence process that must be followed during a manager search. She reported that it was recommended, at the recent MAPERS' conference, that the Board visit the prospective managers during the search.

Ms. Vanerian inquired if the Board felt that it should start the process and bill it out over three years. She recommended beginning in 2006 due to possible changes in board structure after the City Council election.

Trustee Farrell commented that he felt that we should move forward with the search. Trustee Mitchell asked if it was smart to do the search if we ended up with the same managers. There was Board discussion regarding the value of doing a search.

Motion by Trustee Farrell to move forward with the search process.

Motion supported by Vice Chairperson Kukulis and concurred in by unanimous vote.

INVESTMENT CONSULTANT REPORT

Merrill Lynch Investment Managers

Ms. Vanerian reported that the Third Quarter report was not finalized at this time. She did report a "positive" quarter. There was further discussion regarding Chemical Bank being the lead manager this past quarter and that Fifth Third Asset Management had negative returns. She also commented regarding rising interest rates, higher oil costs, the effects of the hurricanes, the terror attack in London, and auto company bankruptcies.

She reported that overall year-to-date, the fund is up a couple of points. She also commented regarding automotive companies, bankruptcy options, reduction or elimination of dividends to shareholders; privatization of Ford Motor Company, and a Merrill-Lynch Report called "Recapitalization of Detroit".

Trustee Davis commented that he felt it was a good to move ahead with the manager search.

The Board expressed their thanks to Trustee Davis for his service to the Board during his term as Mayor.

CITIZEN COMMENTS

Vice Chairperson Kukulis asked if the Investment Managers had received a copy of the Investment Manager contract.

NEXT BOARD MEETING

The next Board Meeting is scheduled for December 15, 2005 at 7:00 a.m.

ADJOURNMENT

Motion by Trustee Davis to adjourn the meeting at 8:54 a.m.

Motion supported by Trustee Blanchett and concurred in by unanimous vote.

Gail L. Schultz, Owosso City Clerk