



June 25, 1986
Room 15
State Capitol

MINUTES of the June 25, 1986 Meeting:

The chair, Senator Donald Moe, opened the meeting at 2:16 p.m.

PRESENT: Senators Donald Moe, Lawrence Pogemiller, Earl Renneke,
Allan Spear
Representatives Terry Dempsey, Gil Gutknecht, Gerald Knickerbocker, Wayne
Simoneau, Steve Sviggum

Senator Moe introduced this second meeting dealing with the report from the Office of the Legislative Auditor entitled Management of Public Employee Pension Funds. Senator Moe set the following order for the funds listed on the agenda to testify:

Duluth Teachers Fund
Duluth Police Fund
Duluth Firefighters Fund and, if time permitted,
St. Paul Teachers Fund

The Commission reviewed the minutes of the June 16 meeting.

Representative Wayne Simoneau moved for approval of the minutes of the June 16th meeting as prepared. Motion carried.

Senator Moe introduced Mr. Ed Blanck, Executive Secretary for the Duluth Teachers Retirement Fund. Mr. Blanck provided the Commission with copies of three handouts titled Duluth Teachers' Retirement Fund Association Statement of Investment Policy, Cash Flow Effect on Dollar Weighted Returns Varying Cash Flow from 1st to Last Day of Year and Duluth Teachers Retirement Fund Association Analysis of Cash Flow. Questions and discussion followed. Some of the points of Mr. Blanck's testimony were as follows:

With regard to the Legislative Auditor report's criticism of the absence of specific goals for the Duluth Teachers Retirement Fund Mr. Blanck responded by stating the goal for the fund is to beat inflation over time within an acceptable risk level and agreed that the goals were not specific.

Mr. Blanck responded to a question regarding the Duluth Teachers Retirement Fund investment in the Duluth Growth Fund by stating the Duluth Growth Fund has the dual purpose of achieving a profit and increasing employment for Duluth. The Duluth Growth Fund invests in proven businesses and is not a high risk investment. Mr. Blanck further stated that the Duluth Growth Fund does fall within the State Board of Investment guidelines.

Senator Moe next introduced Mr. Patrick Alexander, Chairman of the Duluth Police Pension Association. Mr. Alexander introduced Mr. Walt Peterson, Secretary of the Duluth Police Pension Association, and Mr. Les Bass from the Duluth City Auditor's office. At the end of his testimony, Mr. Alexander also introduced Mr. Robert Grytdahl an additional board member of the Duluth Police Pension Association who accompanied them to this meeting. Some of the points of Mr. Alexander's testimony were as follows:

Mr. Alexander responded to a question regarding the delegation by the Duluth Police Pension Association of investment authority to Banker's Trust by stating the Duluth Police Pension Association's six member board has full control of the management of the funds of the Association. He went on to state the Duluth Police Pension Association has an investment advisory contract with Banker's Trust that clearly states the management of the funds rests with the Association. Banker's Trust has some standby authority but the board set the initial guidelines in the areas of investment that the board wants Banker's Trust to conduct business. At this time Banker's Trust does handle all the assets of the Duluth Police Pension Association. Mr. Alexander stated the Duluth Police Pension Association may merge with PERA and, if that occurs, PERA will handle the Duluth Police Pension funds. If the merger does not occur, the board of the Duluth Police Pension Association may look for other investment advisors.

With regard to the low or non-statutory limit on stock investments, Mr. Alexander stated that the board is conservative and operated at an 80% bond and treasury level and a 20% equity level and this was the direction they gave Banker's Trust. Two months ago the board voted to increase the equity level participation to 40%.

Mr. Alexander went on to state that the Duluth Police Pension Association is working to comply with the new state law requiring two voting members from the city to be added to the board.

At this point, Senator Moe moved a resolution commending and thanking Harvey W. Schmidt, Executive Director of the Minnesota Teachers Retirement Association, on the occasion of his retirement. The resolution was adopted.

Continuing with the agenda, Senator Moe introduced Mr. Martin Mehling, Secretary of the Duluth Firefighters Relief Association. Some of the points of Mr. Mehling's testimony were as follows:

Mr. Mehling stated that in January of 1986 the Duluth Firefighters Relief Association board was reorganized. In February 1986 a newly formed investment committee met with Dain Bosworth and advised them that the Duluth Firefighters Relief Association was planning to hire a money manager and performance evaluator. In March and April the board interviewed two performance evaluators, three money managers and two banks for custodial services. In May, the board hired a performance evaluator who did a search on the money managers the board had previously interviewed as well as two others the board will meet with next week. They hope to have board approval to hire a money manager by August 1. At this time they have contracted with a bank for custodial services and the assets of the Duluth Firefighters fund are in the process of being moved from Dain Bosworth.

In response to whether the Duluth Firefighters Relief board delegated unmonitored investment authority to Dain Bosworth, Mr. Mehling stated that a four person investment committee comprised of the four officers of the Duluth Firefighters

Relief Association did meet with Dain Bosworth periodically to go over the investments the fund held and did approve verbally any investment activity. The Duluth Firefighters Relief Association dealt exclusively with Mr. Vlasie Solon, a broker with Dain Bosworth.

Mr. Mehling provided the Commission with copies of a booklet prepared by the Association's performance evaluator, Mr. Dean Derby, President of Standard Valuations, Inc. Mr. Derby stated that he received all the figures shown in the booklet from Dain Bosworth the evening before the Commission meeting and up to 7:00 a.m. the morning of the meeting. Mr. Derby went on to say the Legislative Auditor's report figures went from 12/84 through 6/85 whereas the figures in the booklet he prepared went from 12/84 through 12/85 which will cause some discrepancy between the figures. Discussion continued regarding the discrepancy between the figures in Mr. Derby's booklet and the Legislative Auditor's Report. It was determined that further investigation of the figures would be necessary to determine the correct rate of return for the Duluth Firefighters Relief Association.

Senator Moe introduced Mr. Wayne Fadden, Sr. Vice President of Dain Bosworth, in charge of branch offices including the Duluth office of Dain Bosworth. Some of the points of Mr. Fadden's testimony are as follows:

Mr. Fadden clarified the difference between a broker and an advisor. A broker doesn't determine the objectives of the client, he makes recommendations to help the client meet their objectives. If the client acts upon the recommendation of the broker and invests, a confirmation spelling out the terms of the transaction is mailed to the client on the date of the transaction. Dain Bosworth also provides a monthly statement to a client if there has been activity in that month. Quarterly statements are sent out regardless of activity. For these services, brokers receive a commission. Dain Bosworth does not have discretion with any client and has a stated policy against allowing discretion between their brokers and clients. An advisor is a hired money manager who through a contractual relationship is paid a fee to manage the money for the fund based on the overall objectives of the client. An advisor typically does have discretion on individual transactions prior to conversing with a client. An advisor will always confirm a transaction to a client after the fact. An advisor cannot execute trades for a client as a broker can. An advisor also gives portfolio performance reports on a regular basis. Dain Bosworth acted as a broker for the Duluth Firefighters Relief Association starting in late 1977 or early 1978 when the account was first opened.

Mr. Fadden went on to state that the numbers Dain Bosworth supplied to Mr. Derby for the booklet given to the Commission came from the Duluth State Auditor's end of the year numbers. Mr. Fadden gave the Commission copies of customer monthly statements for the years 1980 through 1985 as well as copies of the individual transactions or confirmations for the same time period. Mr. Fadden did not have brokerage fee expenses available at this time but he noted that most of the fees for the Duluth Firefighters Relief Association were paid by the issuer.

Senator Moe recognized Mr. Burek who commented with regard to the Legislative Auditor's report and Mr. Derby's booklet that he believes the numbers must be based on very different valuations of the assets. He questioned Mr. Fadden on his statement that the numbers provided in Mr. Derby's booklet were based on State Auditor's data. The returns in the Legislative Auditor's report are the State Auditor's data using the

formula the State Auditor uses. Mr. Derby used a formula that is almost identical. He questioned the difference in results. Mr. Fadden stated he believed the Duluth Firefighters Relief Association kept their own books from 1980 to 6/1981. At that time, their portfolio was predominantly bonds and they kept their books on a par value basis as opposed to a cost vs market value. This may be the cause of the significant difference between the Legislative Auditor's report and the report Mr. Derby distributed.

Mr. Long stated that their source from the Duluth Firefighters Relief Association was Mr. James Heim, the former secretary of the Association, who had told him and Mr. Burek at the time of the audit that the relationship with the Dain Bosworth broker was such that trades were executed without formal prior approval.

Senator Moe introduced Mr. Les Bass representing the City of Duluth. Mr. Bass stated that it is the desire of the City of Duluth to have two representatives from the City actively participate on the board of the Duluth Firefighters Relief Association as soon as possible. He went on to request that the Commission keep the City informed when the figures from the Legislative Auditor's report and Mr. Derby's booklet for the Duluth Firefighters Relief Association are reconciled.

Senator Moe recognized Mr. Martin who questioned the high 1984 expenses for professional services for the Duluth Firefighters Relief Association. Mr. Mehling responded that the expenses reflected legal fees and court costs resulting from the loss of a suit brought by retirees against the Association.

The meeting adjourned at 5:06 p.m.

Wayne Simoneau
Commission Secretary
Jean Liebgott
Staff Secretary