



GOVERNMENT OF GUAM
RETIREMENT FUND
 STABILITY · SECURITY · REWARDS

Felix P. Camacho
 Governor

Michael W. Cruz, M.D.
 Lieutenant Governor

Paula M. Blas
 Director

BOARD OF TRUSTEES
Regular Meeting
 Friday, October 29, 2010, 12:00 p.m.
 Retirement Fund Conference Room

Trustees:

Joe T. San Agustin
 Chairman

Wilfred P. Leon Guerrero, Ed.D.
 Vice-Chairman
 Investment Committee, Chairman

Antolina S. Leon Guerrero
 Secretary

Gerard A. Cruz
 Treasurer
 Audit & Operations Committee,
 Chairman

George A. Santos
 Members' & Benefits Committee,
 Chairman

Katherine T.E. Taitano
 Trustee

Wilfred G. Aflague
 Trustee

MINUTES

DEFINED BENEFITS

I. ATTENDANCE, QUORUM, AND CALL TO ORDER

After determining a quorum was present, the Retirement Fund Board of Trustees Regular Meeting for the Defined Benefits Plan was called to order at 1:00 p.m. Friday, October 29, 2010, in the Retirement Fund Conference Room. Chairman Joe T. San Agustin officiated.

Board of Trustees Present:

Joe T. San Agustin, Chairman
 Antolina S. Leon Guerrero, Secretary
 Gerard A. Cruz, Treasurer
 Wilfred G. Aflague, Trustee
 George A. Santos, Trustee

Board of Trustees Absent:

Wilfred P. Leon Guerrero, Vice-Chairman
(Off-Island)
 Katherine T.E. Taitano, Trustee

Staff Present:

Paula Blas, Director
 Diana Bernardo, Controller
 Rosalia Bordallo, General Accounting Supervisor
 Jackie Blas, Recording Secretary

Legal Counsel Present:

Joanne Grimes, Carlsmith Ball LLP

II. REVIEW AND APPROVAL OF BOARD MINUTES

A. September 24, 2010 Regular Meeting

Treasurer Gerard Cruz inquired whether the COLA Certificates are being purchased by the individuals who expressed interest in purchasing them.

Chairman San Agustin asked whether the drawdown chart he requested is available. Controller Diana Bernardo stated that Rosalia Bordallo, General Accounting Supervisor, is working on it. Mrs. Bordallo stated that she has the numbers.

On motion of Treasurer Gerard Cruz, seconded by Trustee George Santos, and without objection, the Minutes of September 24, 2010 Regular Meeting were approved, subject to corrections. Motion passed.

III. CORRESPONDENCE

A. September 30, 2010 Letter from Michael D. Carlson, Retiree Advocate Regarding FY2011 Healthcare Negotiations

Chairman San Agustin stated that he received a letter from Mr. Carlson regarding Fiscal Year 2011 Healthcare Negotiations. Mr. Carlson provided his summary of the pre-negotiations, negotiations, and recommendations regarding the FY2011 Healthcare Negotiations. Treasurer Cruz asked whether the percentage of the overall decreased. Director Paula Blas replied, "No, the employees share increased." Secretary Antolina Leon Guerrero inquired about the increase in the government share. Director Blas stated that it is being proposed.

Chairman San Agustin stated that Mr. Carlson indicated in his summary that "The lack of claims data/experience puts the Team at a disadvantage during negotiations. It must rely upon the data provided by the contracted health plan, even though much of the data is collected from government entities, i.e. GMH, DMHSA, Public Health, etc. It is imperative that each branch of government jointly develop a format for data collection and analysis and make that information available to the Team, and possibly to other potential respondents." Mr. Carlson also indicated that "The current plan design continues to use a 'one size-fits all' approach. Retirees are asked to pay for benefit coverage that they have no use for, i.e. well baby care, pre and neo-natal care."

Secretary Leon Guerrero stated that the data is there. Mrs. Bordallo stated that the demographic data is not being provided. Chairman San Agustin stated that the negotiation team could ask the auditor to audit the books. They could also ask the Insurance Commissioner to provide the data. Secretary Leon Guerrero suggested looking at it before the next Request for Proposal (RFP). Director Blas stated that they are looking at life insurance and then the health insurance in January 2011.

IV. INFORMATIONAL ITEMS

None

RECESSED INTO A COMMITTEE MEETING: 1:20 P.M.

RECONVENED: 2:00 P.M.

V. DIRECTOR'S REPORT - EXECUTIVE SUMMARY

1. *Candelaria Rios, et al. vs. Joseph Ada, et al. (Special Proceeding Case No. SP206-93)* –

Director Blas stated that no additional appropriation for the outstanding COLA principal and interest has been provided.

2. *Global Custody Services* – Director Blas stated that at the September 24, 2010 Board meeting, the Board reconsidered participation in Securities Lending. Director Blas stated that the Board requested for additional information from Northern Trust and the Retirement Fund's Legal Counsel. Director Blas stated that this matter will be discussed under Legal Counsel's report.

3. *Public Law 28-38: Interest Only Payments* – Director Blas stated that the monthly interest payments for the Department of Education (DOE) and Guam Memorial Hospital Authority (GMHA) due on October 10, 2010 were paid based on the new rate. Treasurer Cruz asked what the new rate is. Director Blas replied, "5%." Director Blas stated that the Retirement Fund continues to process retirement applications for DOE.

4. *GMHA Outstanding Contributions* – Director Blas stated that the total amount due from GMHA is \$1,889,518.20 up to pay period ending October 9, 2010. This amount does not include payment for today. GMHA retirement applications will be suspended until GMHA is current with their employee and employer contributions. Trustee George Santos mentioned that at the last Board meeting, Director Blas was instructed to send a letter to GMHA and if this issue still persists, we will have Legal Counsel proceed with filing the Writ of Mandate. Director Blas asked whether to proceed with the Writ even if a partial payment is made. Trustee Santos replied, "Yes."

Trustee George Santos, seconded by Secretary Antolina Leon Guerrero, moved to approve to have the Retirement Fund's Legal Counsel file a Writ of Mandate against Guam Memorial Hospital Authority. Without objection, the motion unanimously passed.

5. *Bernstein Litowitz Berger and Grossmann (BLBG)* – Director Blas stated that time period that securities fraud cases are typically resolved is between 2-5 years. Securities litigation cases are highly complex, involve substantial expert testimony, extensive investigations, and voluminous discovery (both documents and depositions). Director Blas stated that Federal courts take 6-10 months to appoint lead plaintiff(s) before any litigation is allowed to proceed, which adds substantial time to the process.

- **Lehman Brothers** – Director Blas stated that BLBG is waiting for the court's decision on the motion to dismiss. It has been pending before the courts for months, but all they can do is wait until the court rules.
- **Wells Fargo** – Director Blas stated that the court granted in part and denied in part defendant's latest motions to dismiss. The Order is favorable in that it rejects most of the defendant's arguments and sustaining BLBG's claims for false statements about underwriting. Director Blas stated that BLBG will proceed forward with the claims that were sustained. A case management conference was held on October 7, 2010 and BLBG was supposed to push for entry of a pretrial schedule with a trial date. Director Blas stated that the court set a schedule with a jury trial date of August 27, 2012.

- **Genzyme Corporation** – Director Blas stated that BLBG filed motions for a jury trial in March 2010. Defendants filed for motion to dismiss. Director Blas stated that BLBG is waiting for the court’s decision on the motion to dismiss.
- **Countrywide** – Director Blas stated that BLBG submitted the request for exclusion from the Countrywide securities class action on behalf of the Retirement Fund and other prominent institutional investors who suffered losses as a result of the fraudulent conduct at Countrywide. BLBG started the direct negotiations with defendants’ counsel in September 2010. Director Blas stated that BLBG provided a status report of the Countrywide direct action.

6. ***Mercer Investment Consulting, Inc. (Mercer)*** – Director Blas stated that on October 8, 2010, the Retirement Fund received verbal and email communication from Mercer regarding their desire to terminate the Agreement with the Retirement Fund for Investment Consulting Services effective March 31, 2011. Treasurer Cruz asked what inspired their desire to terminate. Legal Counsel Joanne Grimes stated it is regarding liability insurance. The fees are not reasonable. Director Blas stated that an official letter dated October 18, 2010 is attached for the Board’s information. Director Blas stated that RFP’s for Defined Benefit (DB) Investment Consulting Services (RFP No. GGRF-001-11) and Defined Contribution (DC)/457 Investment Consulting Services (RFP No. GGRF-002-11) were issued on October 27, 2010 and will close on November 29, 2010. Treasurer Cruz asked where the ads are placed. Director Blas stated that it is being published in the Pacific Daily News, the Retirement Fund’s website, and the Pensions and Investments Publication.

7. ***Merit Bonus*** – Director Blas stated that on October 4, 2010, a Writ of Mandate was filed by Attorney Michael Phillips on behalf of the affected active employees. Director Blas stated that 4 GCA, Chapter 6, Section 6203 mandates that superior performance by a classified employee shall be rewarded by a lump sum bonus based on an amount equivalent to 3.5% of the employee’s base salary. Section 6203 has been in effect since October 1, 1991 (Fiscal Year 1992).

Treasurer Gerard Cruz, seconded by Trustee George Santos, moved to allow for an agreement for payment of the merit bonuses to all applicable employees back to 1992 for active employees subject to the condition that if the current lawsuit prevails and the judgment is less than the proposed settlement, the employees will not be obligated to reimburse any amount for the difference. Yes votes: Chairman Joe San Agustin, Secretary Antolina Leon Guerrero, Treasurer Gerard Cruz, and Trustee George Santos. Trustee Wilfred Aflague abstained. With four affirmative votes, the motion passed.

8. ***Salary Increment for Controller*** – Director Blas stated that at the Retirement Fund Board of Trustees meeting of July 2008, the Board approved a two-step salary increment for the Controller. This placed the Controller’s annual salary at pay grade R-20: \$93,613.00. Director Blas stated that pursuant to Section III.6 of the Employment Agreement with the Controller, any modification to the Agreement is subject to approval of the Director and the Board of Trustees. Director Blas stated that in order to provide for an annual increment for the Controller, an amendment to the current Employment Agreement is necessary.

Treasurer Gerard Cruz, seconded by Trustee George Santos, moved to approve to increase the Retirement Fund Controller's salary to \$96,889.46 effective April 17, 2010 and to further amend the Controller's Employment Agreement to allow up to 3.5% annual increase at the discretion of the Director of the Retirement Fund, subject to a satisfactory performance evaluation rating conducted annually; and to increase the Retirement Fund Director's salary to \$100,000.00 effective October 1, 2010 and to further extend the Director's Employment Agreement for an additional three years from May 2011 which will then expire on May 2014. Without objection, the motion unanimously passed.

9. **Legislative Bill: Bill 450-30** – Amendment to Section 8150 Relative to Investments in Bonds of U. S. and Federal Instrumentalities – Director Blas stated that Bill 450-30 is scheduled to be voted on at the next Legislative Session in November 2010.

Financial Report

1. **Contributions** – Director Blas stated that as of October 27, 2010, all agencies are current with their Fiscal Year 2010 employee and employer contributions with the exception of GMHA.

2. **Financial Statements** – Director Blas stated that the books for the month ending September 2010 will be closed on November 3, 2010. The books for Fiscal Year ending September 30, 2010 will be closed on November 4, 2010.

3. **Fiscal Year 2011 Annual COLA** – Director Blas stated that Public Law 30-196 mandated that the \$1,100.00 annual COLA for retirees and survivors be issued no later than November 1, 2010. Director Blas stated that the COLA checks are being mailed out today by Department of Administration (DOA).

4. **Fiscal Year 2011 Retirees' Supplemental Benefits** – Director Blas stated that the supplemental benefits for retirees and survivors for the month of October 2010 were paid.

5. **Fiscal Year 2011 Medicare Reimbursements** – Director Blas stated that the Retirement Fund received the October 2010 allotment from the General Fund and payments were processed accordingly.

VI. LEGAL COUNSEL'S REPORT

Director Blas stated that the Retirement Fund's Legal Counsel provided the following documents regarding Northern Trust Company's Proposed Securities Lending Program for the Board's review:

1. Securities Lending Authorization Agreement between Board of Trustees of the Government of Guam Retirement Fund and the Northern Trust Company (version 1.2 drafted October 22, 2010);
2. Securities Lending Authorization Agreement between Board of Trustees of the Government of Guam Retirement Fund and the Northern Trust Company (redline version 1.2 dated October 22, 2010 showing changes to the initial version proposed by Northern Trust);
3. Confidential Legal Report to the Board of Trustees of the Government of Guam Retirement Fund Regarding Northern Trust Company's Proposed Securities Lending Program (slide presentation date October 29, 2010);

4. Confidential Memorandum Regarding Lawsuits Relating to Northern Trust's Securities Lending Program (dated October 25, 2010);
5. James E. Reichert, *Securities Lending Program Outlook*, NEPC (October 21, 2008);
6. *Managing Value Generation and Risk*, JP Morgan Chare & Co. (April 2009); and
7. James E. Reichert, *Securities Lending Revisited*, NEPC (September 2010).

Legal Counsel stated that Global Custody Services commenced in 2008. A lawsuit was filed against Northern Trust on Securities Lending. Legal Counsel stated that Northern Trust presented a revised structure in August 2010.

Legal Counsel stated that Vice-Chairman Wilfred Leon Guerrero received a letter from Blair Nicholas of BLBG. Legal Counsel stated that she spoke to Mr. Nicholas regarding his letter. The redline version shows the changes to the initial version proposed by Northern Trust. The structure changed.

Legal Counsel made a presentation regarding Northern Trust's Proposed Securities Lending Program and highlighted the following:

➤ **Key Considerations**

- Risk/Benefit Analysis to Utilizing Only Custody Services
- Risk/Benefit Analysis to Utilizing Custody Services and Participating in the Proposed Securities Lending Program

➤ **Custody Services Only**

- Possible procurement challenges from vendors who may have provided custody-only services at a lower cost
- Opportunity cost to foregoing revenues from a reasonably structured Securities Lending Program
- Fund pays: \$300,000 custody fee

➤ **Custody Services Plus Securities Lending Program Revenues**

- Fund Receives: roughly \$600,000 (Roughly 70% of \$860,000 estimated gross Securities Lending Program revenues)
- Fund pays: \$50,000 custody fees
- Net received by the Fund: \$550,000
- Minimize exposure to procurement challenges
- Incur reasonable risks associated with Securities Lending Program participation

➤ **Risk/Benefit Analysis**

- Do the Securities Lending Program revenues reasonably compensate the Fund given the risks of participation in Securities Lending Program?
- Does the revised structure of the Securities Lending Program (including non-cash collateral) sufficiently mitigate the risks of the previous Securities Lending Program?
- Is the \$300,000 custody fee commercially reasonable?

➤ **Managing Risk**

- Trade Settlement Risk (investment manager sells an on-loan security and Borrower is unable to return the security to the custodian to settle the trade)
- Mitigating Factors: 1) Reallocation, 2) Trade Settlement Protection
- Cash Collateral Reinvestment Risk and Interest Rate Risk Mitigated by use of ONLY non-cash collateral in the form on ONLY U.S. Treasury Obligations

➤ **Indemnification**

- Provisions in Section 16 of the proposed Securities Lending Authorization Agreement are similar to the provisions in the Securities Lending Authorization Agreement executed by the Board of Trustees on August 29, 2008
- §16.1 – Agent shall indemnify, defend and hold Lender harmless from and against any losses, damages, costs and expenses (other than special, incidental, indirect or consequential losses, damages, costs or expenses) Lender may incur if Agent is unable to recover Borrowed Securities and distributions made during the term of the Loan or Loans with respect to those Securities as a result of:
 - 16.1.1 Agent’s failure to make a reasoned determination of the creditworthiness of a Borrower through adequate analysis of all material, public information available to the Agent’s Credit Policy Committee before lending a security as provided in Section 2 and during the term of the Loan or Loans a Filing occurs
 - 16.1.2 Agent’s failure to demand adequate and appropriate Collateral on a prompt and timely basis as provided in Section 4, perfect a security interest or obtain rights equivalent thereto in the collateral, maintain control of the Collateral as provided in this Agreement; or
 - 16.1.3 Agent’s failure otherwise to perform its duties and responsibilities under this Agreement in accordance with the terms hereof or applicable law
- §16.2 – Irrespective of the applicability of Section 16.1, In the event of a Filing, Agent shall: (i) credit Lender’s Account with the amount of distributions made with respect to the Borrowed Securities of Lender that are due and payable by the Borrower on or before the date of Filing but not so paid; and (ii) transfer into Lender’s Account replacement Securities that are Equivalent Securities by purchasing such securities in the principal market in which such securities are traded; except that Agent may, at its option, in lieu of replacing some part or all of the Borrowed Securities, credit Lender’s Account with an amount equal to the Market Value on the date of Filing of Borrowed Securities not replaced, which amount shall be satisfiable at Agent’s option in cash, or by a transfer to lender’s Account of Collateral securities valued as of the date of Filing, or by a combination of both
- §16.3 In the event a Collateral Deficiency (other than any Collateral Deficiency caused pursuant to an event contemplated in Section 16.1.2) exists at the same time as a Borrower Filing, Agent shall have the right to set off the unpaid amount of any obligation of Lender to Agent arising under the terms of this Agreement from the Collateral Deficiency against any obligation of Agent to Lender arising under this Section 16. Any payment by Agent under Section 16.2 shall be applied toward the discharge of Agent’s obligation (if any) to Lender under Section 16.1. Agent shall be subrogated to, and Lender shall be deemed to have assigned to Agent, all of Lender’s corresponding rights against a Borrower (and against any guarantor thereof) and in the Collateral and its proceeds to the extent of any payment, transfer or credit made pursuant to this Section 16.

➤ **Collateral Margin §4 (Values Marked to Market Daily)**

- If Value of Borrowed Securities is less than Required Value, Agent demands Additional Collateral to equal Required Value
- If Value of Borrowed Securities is greater than Required Value, Agent redelivers Collateral to Borrower to equal Required Value

Legal Counsel stated that she recommends not removing the people off the list. Legal Counsel stated that she is not comfortable to write who you don't want. There is a \$50 Million cap for the borrower which may be lowered. Chairman San Agustin asked what \$50 Million. Legal Counsel stated that it is up to \$50,000 to borrow. Treasurer Cruz stated that we have collateral we can liquidate. Legal Counsel stated that any party could cancel the loan at any time. They could default by not returning that amount. Chairman San Agustin asked why not replace it instead of canceling the loan. Director Blas stated that they have to cancel the loan. Legal Counsel stated that it is to close the trade. Legal Counsel mentioned that the Organization for Economic Cooperation and Development (OECD) has 31 countries.

Legal Counsel stated that she asked to get less than 10 years for maturity and the response was no. Chairman San Agustin asked whether there is a monitoring report from Northern Trust. Controller Bernardo replied, "Yes." Mrs. Bordallo stated that she is not sure whether there is report on the Securities Lending Program. Trustee Wilfred Aflague asked whether there will be a retroactive in the increase in fees if we do not participate in Securities Lending. Legal Counsel stated that she is not sure. Chairman San Agustin stated that he told Northern Trust to re-bid if the fees increase.

Chairman San Agustin asked whether we will get back our collateral. Legal Counsel replied, "Yes." Chairman San Agustin asked what the timeline is. Legal Counsel stated that there is no timeline. Chairman San Agustin asked what happens if the collateral defaults. Treasurer Cruz stated that Northern Trust has an agreement with the borrower. Northern Trust will liquidate and then will pay the Retirement Fund. Treasurer Cruz further stated the agreement reads "If upon termination of a Loan a Borrower shall fail to deliver Equivalent Securities, Agent shall exercise the remedies available to it under the relevant Borrowing Agreement and applicable law, customs and practices for the benefit of the Participating Lending or Lenders thereby affected. Agent shall:

- 5.2.1. have the right to (and in the event of a Filing with respect to a Borrower in relation to a Loan entered into under a Borrowing Agreement governed by the laws of any state of the United States of America shall, subject always to Section 16) purchase Equivalent Securities;
- 5.2.2 apply the Collateral to the payment of: (i) the purchase price of the Equivalent Securities purchased pursuant to clause 5.2.1 above; (ii) any other obligations of the Borrower under the Borrowing Agreement; and (iii) all reasonable related expenses; and
- 5.2.3. Either pay to the Borrower any amounts then remaining, or demand from the Borrower any amounts then due and owing."

Mrs. Bordallo stated that what Chairman San Agustin is saying is to be made whole in at least three days. Treasurer Cruz recommended having Northern Trust include in the agreement that they will make the Retirement Fund whole within 36-48 hours. Legal Counsel stated that it should be immediately or daily. Treasurer Cruz asked what happens if Northern Trust is unable to perform. Legal Counsel stated that the Retirement Fund should file suit against Northern Trust. Treasurer Cruz stated that the Retirement Fund should accept U.S. Treasuries Collateral only.

Treasurer Gerard Cruz, seconded by Trustee George Santos, moved to approve the Securities Lending Authorization Agreement between the Board of Trustees of the Government of Guam Retirement Fund and The Northern Trust Company. Without objection, the motion unanimously passed.

VII. TREASURER'S REPORT OF FINANCIAL STATUS

Treasurer Cruz reported on the Retirement Fund's cash flow. \$2 Million for October 2010 and the \$3 Million each month for the second quarter of Fiscal Year 2011. The estimated drawdown request is \$17 Million.

Chairman San Agustin stated that the investment income is decreasing. Treasurer Cruz stated that it is the impact of Public Law 28-38. It decreased \$320,000 a month. If GMHA does not become current, the drawdown will be \$2.3 Million through March 2011.

Treasurer Gerard Cruz, seconded by Trustee George Santos, moved to approve the drawdown schedule. Without objection, the motion unanimously passed.

VIII. STANDING COMMITTEE REPORTS

A. Members and Benefits Committee

Trustee Santos presented his Committee's October 2010 report to the Board of Trustees.

Trustee George Santos, seconded by Secretary Antolina Leon Guerrero, moved to approve the recommendation of the Members and Benefits Committee contained on Pages 4 through 11, including the attached Annuity Worksheets, based on the Committee's review and findings during their meeting of October 13, 2010 and subsequent meetings thereafter. Without objection, the motion passed.

B. Investment Committee

Treasurer Cruz reported that the Investment Committee meeting was held on October 8, 2010. The Committee reviewed and approved the Investment Committee Minutes of September 10, and 17, 2010.

Informational Items:

1. *Securities Lending* – Treasurer Cruz stated that as a follow-up to prior discussions on Securities Lending, Vice-Chairman Wilfred Leon Guerrero spoke with Blair Nicholas of BLBG regarding Northern Trust's Securities Lending Program. Treasurer Cruz stated that a follow-up letter subsequent to their discussion was provided to the Investment Committee for information.

- Since issues discussed in the letter are different from the situation with the Retirement Fund, a copy of the letter was forwarded to Legal Counsel for clarification.
- Director Blas also indicated that Legal Counsel, Joanne Grimes, will be available to meet at today's Board meeting to discuss the issues with the Securities Lending program.
- Treasurer Cruz requested that an explanation of the differences be put in writing.

2. *Quarterly Performance Meeting/Annual Manager Reviews of Domestic Equity and REITs Managers* – Treasurer Cruz stated that the next Quarterly Performance Meeting (for quarter ended September 30, 2010) and the Annual Manager Reviews of Domestic Equity and REITs Managers (7) are scheduled for December 15, 16, and 17, 2010.

IX. TRAVEL REPORT

A. Vice-Chairman Wilfred Leon Guerrero: alternative Asset Investment Summit – October 17-19, 2010, Las Vegas, Nevada

Chairman San Agustin stated that Vice-Chairman Leon Guerrero's travel report on the Alternative Asset Investment Summit he attended on October 17-19, 2010 in Las Vegas, Nevada, is submitted for the Board's information.

X. OLD BUSINESS

None

XI. NEW BUSINESS

None

XII. OPEN DISCUSSION / GENERAL PUBLIC INPUT

None

XIII. ANNOUNCEMENTS

None

XIV. ADJOURNMENT

There being no further business before the Board for the Defined Benefits Plan, on motion of Trustee George Santos, seconded by Treasurer Gerard Cruz, and without objection, the meeting was adjourned at 3:50 p.m. Motion passed.

I hereby certify that the foregoing is a full, true and correct copy of the Minutes of October 29, 2010 Regular Meeting duly adopted and approved by the Government of Guam Retirement Fund Board of Trustees on November 26, 2010.



ANTOLINA S. LEON GUERRERO, Board Secretary

RECORDING SECRETARY:



Jackie Blas