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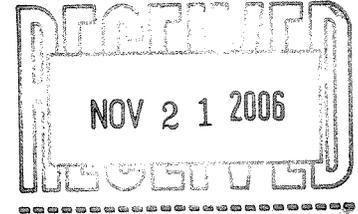
MEMORANDUM

TO: The Middlesex Retirement Board Advisory Council

**FROM: Thomas F. Gibson, Chairman
Middlesex Retirement Board**

**Brian P. Curtin, Chairman
Middlesex Retirement Board Advisory Council**

DATE: November 16, 2006



We are writing to inform you of recent events at the Middlesex Retirement Board, and to seek the Council's input on a critical issue relating to the management of the System's assets.

RESIGNATION OF LAWRENCE P. DRISCOLL

At its meeting of November 9, 2006, the Board accepted the resignation of Lawrence P. Driscoll, the elected fourth member of the Board. Mr. Driscoll's resignation followed the Board's receipt of a report from the Office of the Inspector General which asserted improprieties in expense reimbursement requests submitted to the Board by Mr. Driscoll from 2001 through 2004. Mr. Driscoll has stepped down from the Board in order to address these issues.

The Board's auditors and PERAC's auditors conduct regular audits of travel and expense reimbursements submitted by members of the Middlesex Board and its staff. As you are aware, on September 29, 2004, the Board's own auditors raised questions regarding Mr. Driscoll's travel and expense reimbursements. The Board, in keeping with its fiduciary duties, made full and immediate disclosure to the appropriate agencies, i.e., PERAC and the Attorney General. The Board also took action to investigate the travel and expense reimbursements that the Board's auditors had questioned. Following that investigation, the Board obtained repayment from Mr. Driscoll in the amount of \$1,240.54 for travel expenses and \$1,119.47 for meal expenses that were improperly reimbursed as lacking appropriate documentation, and an apology from Mr. Driscoll regarding his recordkeeping related to his travel and expense reimbursements. The Attorney General, after its own investigation, informed PERAC in April 2005 that it would not pursue the matter further.

Following the Attorney General's review, PERAC asked the Inspector General in April of 2005 to conduct his own investigation. In the course of his investigation, the Inspector General invoked his statutory powers to obtain documents and information that neither the Board's

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auditors nor PERAC's auditors had the statutory power to obtain. The Board learned the results of that investigation from PERAC after the Inspector General wrote a letter to PERAC on October 23, 2006. In that letter, the Inspector General asserted that he found numerous instances in which Mr. Driscoll had submitted false expenses, and that Mr. Driscoll had submitted the same expenses to his employer. The Inspector General also asserted that the Middlesex Retirement Board had "turned a blind eye" to Mr. Driscoll's questionable expenses. We certainly do not agree with that rhetoric nor, as noted above, is it supported by the record: the Board has consistently taken action to recoup improperly paid expenses when circumstances required, and did so in this instance.

The Board is, of course, seriously concerned about the results of the Inspector General's review of this matter and we have requested that the Inspector General provide access to these documents to the Board and its representatives in order that the Board can properly assess what further action is warranted. The Board is actively pursuing these issues and has voted to terminate all credit accounts for the Middlesex Retirement Board, and to suspend any pending expense reimbursements to Mr. Driscoll until further notice. The Board will be working with PERAC to review all recent expense reimbursements, and to ensure that the Board's reimbursement policy continues to be suitable.

The Board has also taken actions to address the issues raised by the Board's auditors. For instance, at its meeting of February 10, 2005, the Board adopted a new Policy on Payment of Expense Reimbursements, a policy based upon PERAC's Travel/Education Policy. This policy, which was filed with PERAC, provides now for a tri-level review and sign-off of all requests for expense reimbursements.

Lastly, under G.L. c. 34B, s. 19(h) the Council will be notified to conduct an election to fill the remainder of the fourth member's term, which expires on December 31, 2008.

RESIGNATION OF JOHN C. MACDONALD

At its meeting of November 9, 2006, the Board accepted the resignation of John C. MacDonald, Building Supervisor. Mr. MacDonald was the general contractor who managed the renovations of the Board's offices at 25 Linnell Circle in Billerica in 2002, and who was subsequently hired as Building Supervisor. The Board's auditors had also raised questions regarding issues related to the renovations, and the Board again made full and immediate disclosure to the appropriate agencies as noted above.

The renovations of the Board's offices also became the subject of a report by the Office of the Inspector General this past April. While the Board has vigorously contested the legal and factual basis for the Inspector General's conclusions in this matter, the Board was nevertheless sufficiently concerned regarding the perceptions created by Mr. MacDonald's role in the renovations, and by his subsequent role in the building operations. The Board is reviewing all existing vendor service contracts and will determine whether to re-bid in these areas, or to outsource the building management in its entirety.

SETTLEMENT WITH GOLDMAN SACHS

By letter of October 11, 2006, the Board reported to PERAC that it had settled a demand made upon J. Aron & Company and their affiliates, including Goldman Sachs & Co., for the amount of One Million (\$1,000,000.00) Dollars. The settlement arose from the Board's claim relating to commission payments made to undisclosed third parties which were generated by trades made with Cambridge Financial Management ("CFM.") CFM's losses are the subject of litigation now pending in the matter of *Middlesex Retirement System v. Boston Safe Deposit and Trust Co., et al.*, commonly referred to as the "Mellon litigation."

The Board learned of these commission payments as a result of investigative findings made by the Inspector General and the Board's claim was substantially based upon those findings. Prior to hiring CFM, the Board required CFM to disclose in writing, under the pains and penalties of perjury, whether it had any third party relationships. The principal of CFM swore that it did not. While the Inspector General, again using his statutory powers, was able to uncover these third party payments, the Board knew nothing about them. Moreover, the Board's lack of knowledge is buttressed by the payment of \$1,000,000 to the Middlesex Retirement System by Goldman Sachs. It should be clear that this payment would not have been made if there was any credible evidence that the Board was aware of the role of the third parties who profited by CFM's trading.

The Board is also currently seeking to recoup the losses sustained in the CFM account as a result of CFM's fraud, which we have previously reported to you. The Board agrees with PERAC's ultimate determination, expressed in its Interim Report of October, 2005, that, "the fact that [CFM] perpetrated the fraud in account management and in reporting of prices is the real source of the loss that the MRB incurred."

As do all self-investing retirement systems, the Board hires experts, like Mellon, to provide expertise in the investment process. CFM's losses went undetected because one of the Board's experts failed to perform as they had promised. PERAC's Interim Report determined that, "The MRB did not act in an unreasonable manner in relying on the Mellon custodian reports and the Russell Mellon performance reports in assessing whether the account was on a net basis, achieving gains or losses." PERAC's findings, arrived at after a thorough and unbiased review, convincingly dispute Mr. Sullivan's assertion of alleged "breaches" by the Board.

REVIEW OF THE SYSTEM'S INVESTMENT PROGRAM

On February 14, 2006, the Board met with officials of the Pension Reserve Investment Management Board (PRIM), overseers of the \$43 billion Pension Reserve Investment Trust Fund (PRIT). The PRIT Fund consists of the retirement assets of the State and State Teachers' Retirement System. Under the law, municipal, county and regional retirement boards can choose to invest all or part of their system's assets through the PRIT Fund. Over the past year, the Board has voted to allocate \$10 million to the PRIT Real Estate Fund, \$32 million to the PRIT Absolute Return Fund, and most recently, \$20 million to the PRIT Emerging Markets Fund.

The Board is mindful of the System's statutory funding requirements, and keenly aware of the financial pressures brought to bear on the member units through substantial increases in retirement assessments, which are necessary to fulfill the retirement promises made to our public employees. The Board has been fully engaged with several entities and member units regarding these critical funding issues.

On November 10, 2006, we met with representatives of PERAC to discuss these and other matters relating to the issues presented above. After careful consideration, the Board now believes that a temporary transfer of the management of substantially all of the System's assets to PRIM may be in the best interests of the Middlesex Retirement System, and would allow us to focus on the important issues before the Board, and would save the System substantial costs associated with further litigation.

We would welcome Council member's input on this issue as early as possible, as a transfer by January 1, 2007 would be optimum for performance reporting and record keeping purposes. Please e-mail, call, or write directly to us with comments regarding the transfer of the management of the System's assets to PRIM.

As always, the Council's support is greatly appreciated, especially during these difficult times.

Thank you.