

THE HONORABLE DOMENIC J. F. RUSSO RE-ELECTED AS CHAIRMAN OF PERAC

On Wednesday, November 1, 2006, the Public Employee Retirement Administration Commission re-elected the Honorable Domenic J. F. Russo of Winthrop as Chairman of the seven-member Commission for a five-year term. Judge Russo was first elected on March 24, 2004 to complete the unexpired term



Auditor DeNucci and Commissioner Russo

of former Chairman Robert E. Tierney. Judge Russo was sworn in to office for his second term on November 21, 2006 by the Honorable A. Joseph DeNucci, Auditor of the Commonwealth of Massachusetts and Vice Chairman of the Commission.

During his tenure, Judge Russo has guided PERAC through a challenging phase in its history. In 2004, the Commission embarked upon a comprehensive evaluation of its then nearly eight year history of oversight and regulation of the State's 106 contributory retirement systems. This thorough analysis included the appointment of a five-member Reform

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LETTER FROM THE EXECUTIVE DIRECTOR

On behalf of the Commission and staff of PERAC, I want to wish everyone a very happy and healthy new year. As we begin 2007, we face a year full of promise and challenge to the Massachusetts retirement community.

With the Deval Patrick administration now in office and a new Legislature in place, it is expected that pension reform will be a topic of serious discussion. As you know, pension funding challenges and the very viability and sustainability of defined benefit plans are being discussed all across the nation. Maintaining well-funded pension systems that are moving inexorably toward full funding is a key goal. To this end, constantly updating our governance requirements to help ensure sound operation of our systems is a priority for the boards and PERAC.

Last year, legislation was approved by the Public Service Committee that incorporated many of the governance

reforms recommended as a result of the review of oversight and board governance initiated by the Commission. The moderate approach to the reform of retirement board governance and oversight reflected in those items was the culmination of a lengthy and inclusive process.

Since that time, PERAC has continued discussions with representatives of MACRS to further refine the proposal. These discussions have been fruitful and promising. On behalf of the Commission, I pledge to continue our efforts to try to craft a bill that not only meets the goals of the Commission in seeking governance reform but also is sensitive to the needs and concerns of the retirement community. We are hopeful that this goal can be achieved.

In addition, the issue of funding future health care liabilities for retirees and prospective retirees is now in focus due to the GASB Statement 45. The State has identified its potential liability as rang-

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Public Employee Retirement Administration Commission

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- The Honorable A. Joseph DeNucci
Auditor of the Commonwealth
Vice Chairman
- The Honorable Deval Patrick
Governor of the Commonwealth
- Paul V. Doane
Senior Vice President
Oppenheimer Capital
- Kenneth J. Donnelly
Lieutenant
Lexington Fire Department
- James M. Machado
Sergeant
Fall River Police Department
- Donald R. Marquis
Former Town Manager
Arlington
- Joseph E. Connarton
Executive Director
- Michael DeVito
Editor



JAMES M. MACHADO REAPPOINTED TO PERAC

Sergeant James M. Machado of the Fall River Police Department was recently reappointed by the Romney/Healy administration to a second term as Commissioner of the Public Employee Retirement Administration Commission. The Commission is responsible for regulation and oversight of 106 public pension systems in the Commonwealth. On November 15, 2006, Commissioner Machado was administered the oath of office by Secretary of the Commonwealth William Galvin at the State House.

Sergeant Machado will serve as the representative of a public safety union on the seven-member Commission. Commissioner Machado chairs the Audit/Fraud Sub-Committee, which evaluates violations and abuses of the

pension system. He is also a member of the Investment and Disability Sub-Committees.

Sergeant Machado previously served in government as a member of the Pension Reserves Investment Management Board,

responsible for the investment of the \$40 billion state pension system. He has also served on the Innovative Crime Fighting Task Force and the Commission on Racial Profiling.



Commissioner Machado and Secretary Galvin

Machado stated, "I am honored by the confidence the administration has demonstrated in my reappointment to this important position. Given the recent pension scandals involving both public and private systems, there has never been a greater need for governance and transparency. I look forward to working to ensure the integrity of the systems as well as the benefits to deserving members and their beneficiaries."

Joseph E. Connarton, PERAC's Executive Director commented, "Commissioner Machado's law enforcement background and keen knowledge of the complex problems which exist within the public pension community bring added value to the Commission."

PAUL DOANE APPOINTED COMMISSIONER AT PERAC

The Public Employee Retirement Administration Commission is pleased to announce that Paul V. Doane of Harwich was appointed a Commissioner of PERAC by Governor Mitt Romney. Mr. Doane was sworn in and began serving on December 11, 2006. Commissioner Doane assumes the investment seat on the Commission. By statute, this seat must be filled by an individual who "shall be qualified by having training and experience in the investment of funds as a result of having been principally employed in such occupation for a period of at least ten years."

Mr. Doane has been employed as a Senior Vice President at Oppenheimer Capital, New York, NY. As of April 1, 2007, he will become the executive director of the Arkansas Teacher Retirement System. His professional background includes

service as the Chief Executive Officer of the Massachusetts Pension Reserves Investment Management Board (PRIM) and four terms as a Massachusetts State Senator. Commissioner Doane



Commissioner Doane

holds a B.A. from Northeastern University, a M.S. from the Georgia Institute of Technology, and a J.D. from Suffolk University.

PERAC's Executive Director Joseph E. Connarton welcomed Mr. Doane to the Commission and stated that, "I am pleased to be working with an individual who has such a depth of financial and public sector experience."

Chairman Domenic J. F. Russo also welcomed former Senator Doane and indicated that his background and knowledge would bring added value to the important work of the Commission.

Commissioner Doane's experience as CEO of the PRIM Board will be particularly helpful to the Commission. In addition, as a former Massachusetts State Senator he brings an awareness of the importance of PERAC maintaining a sound working relationship with the General Court – a top priority of the agency. Executive Director Connarton noted that, "I look forward, as does the entire staff, to working with Commissioner Doane as we meet the challenges facing the pension community in Massachusetts."

PUBLIC SERVICE COMMITTEE CHAIRS NAMED

The Senate and House Chairs of the Joint Committee on Public Service of the Massachusetts Legislature have been appointed for the 2007-2008 session. Senator Benjamin B. Downing (D), newly elected Senator from Pittsfield,

was appointed Senate Chair by Senate President Robert E. Travaglini. Representative Jay R. Kaufman (D), from Lexington, was reappointed House Chair by House Speaker Salvatore F. DiMasi. PERAC works closely with the two

Chairs during the legislative session and wishes them and all members of the Joint Committee on Public Service well as they embark on their challenging duties during the 2007-2008 session.

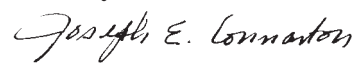
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ing from \$7B to \$13B depending on the Commonwealth's decisions on whether and how to fund this major liability. Cities and towns must also identify their liabilities. While we are not directly involved in insurance issues, since this liability impacts the future of retirees, PERAC is monitoring the situation and will keep you informed of important developments as they occur.

The year 2007 will be a challenging, yet hopefully rewarding, year for Massachusetts retirement systems. As is our charge, PERAC will continue to offer educational sessions to assist the boards in meeting their statutory and fiduciary responsibilities. This will include our Fourth Annual Emerging Issues Forum on June 26, 2007, as well as numerous other sessions on issues of importance to your systems. As always, I am open to

your suggestions on how we can better provide you with the information you need to be successful.

Sincerely,



Joseph E. Connarton

RUSSO RE-ELECTED (continued from page 1)

Initiatives Advisory Committee chaired by former Massachusetts Attorney General Scott Harshbarger. This Advisory Committee issued its report in 2005. The Commission later voted to approve all of the committee's recommendations; it also voted to file pension reform oversight and governance legislation in 2006. Judge Russo provides leadership to his colleagues and staff on a wide variety of statutory and regulatory matters.

Judge Russo is the retired First Justice of the East Boston Division of the District Court. Prior to that assignment, he also served as First Justice of the Milford Division of the District Court, and as Managing Justice of the Peabody, Lawrence, and Lynn District Courts.

Judge Russo attended Boston University and Boston University School of Law, and

is a retired Lieutenant Commander of the United States Naval Reserve.

Joseph E. Connarton, PERAC's Executive Director stated, "Judge Russo's extensive judicial experience has provided the Commission with invaluable guidance and leadership during the past few years, and I look forward to expanding upon our working relationship in the future."

COMPLIANCE CORNER

By Dana K. Mahoney
PERAC Compliance Officer

At PERAC, our goal is to assist Massachusetts' public pension boards in developing and implementing sound corporate governance practices. The public pension fund community manages significant assets. Money managers, brokers, traders, consultants, third-party marketers, transition managers, venture funds, hedge-funds, real estate investment funds, and others seek to assist in that management.

Management of public pension systems is governed by Chapter 32 and PERAC Regulations. The regulations set out how public pension boards are to address the protection of the individual member funds, beginning with 840 CMR 1.00: Protection of Interests of Retirement

System Members and Their Beneficiaries and concluding with 840 CMR 27.00: Standard Rules for Orders to Protect the System.

PERAC is focused on assisting the public pension boards with the tools necessary to protect their funds. Some of this effort involves the development of a compliance curriculum that we look forward to implementing as an integral part of the Commission's overall training initiative.

A year ago, I became PERAC's first compliance officer, working with our investment unit to aid each retirement system in reaching its full compliance potential. Significant progress has been made toward achieving that goal.

I am pleased to introduce this new Compliance Corner column in which I

will address various compliance issues and keep the public pension boards up-to-date on emerging compliance concerns.

Corporate governance continues to be a hot topic in the investment arena. The importance of this issue was noted in the Report of the PERAC Reform Initiatives Advisory Committee:

Scandals in corporate governance have affected almost every major institution in our society, leading to an increased focus on accountability, transparency, disclosure, expertise, independence, and responsibility to constituents and shareholders to ensure integrity as well as performance. As the agency responsible for oversight and monitoring of local retirement boards, particularly with respect to the investment of funds and the administration of the systems,

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COMPLIANCE CORNER (continued from page 3)

PERAC must periodically conduct a governance review and audit the strengths and weaknesses of the current legal and statutory framework.

PERAC continues to monitor all issues relating to corporate governance and to follow-up with the public retirement systems via memoranda, e-mail, and telephone.

PERAC defines governance within the public pension fund system as follows:

The laws, regulations and rules of sound business practice by which any corporation, board, individual or entity shall abide to ethically, morally, prudently, and with good conscience fulfill the promise of meeting their fiduciary duty to the members of the Massachusetts public pension systems.

As PERAC's compliance officer, I will be working closely with Massachusetts' retirement boards as they manage their public pension systems. If you have any compliance-related questions, please contact me at 617.666.4446, ext.933.

SOME BURNING QUESTIONS FOR 2007

Robert A. Dennis
Investment Director

2006 was a very good year for the markets but, as we begin 2007, here are some burning questions on the minds of investors.

Has the US stock market entered 2007 with an unwarranted sense of complacency? The market has gone up for four straight years, which is usually the limit for such extended rallies. But even more worrisome, there has not been a 10% correction in the market for the past four years, the Dow has not had a 2% daily decline in almost 3 years, and the standard deviation of daily price movements is only about half the historical rate.

This low volatility, combined with high liquidity as a byproduct of generally low interest rates and ample availability of funds, has caused investors' risk appetites to increase, as seen in the unusually strong and persistent outperformance of small cap stocks, emerging market stocks, and high yield bonds as well as continued flows into commercial real estate.

As a result of ample liquidity, very high margin debt has helped the stock market to advance while rising personal debt has fueled an unabated US consumption

binge. Will what some have called a "debt bubble" end unhappily?

How long will the US consumer continue to spend if the residential housing market continues to weaken?

As oil prices decline, will reduced purchasing power from the oil-producing countries (who are major purchasers of US bonds) combine with lower home values to finally dampen liquidity?

This decade has seen a synchronized worldwide economic expansion, as strong US consumption growth spurred overseas manufacturing demand in rising low-cost countries like China, which has in turn helped to bolster commodity prices which are essential to the economies of Russia, Australia, Latin America, and other areas. Will this chain break? With commodity prices leveling off, has this already begun?

With its huge current account and trade deficits with the rest of the world, will the US tacitly encourage the continued weakening of the US dollar, a trend that would discourage further heavy purchases of US securities from abroad?

Will concern over a softening economy and the high level of debt lead the Fed to begin lowering rates? Or will the Fed have

to consider raising rates further in order to support the dollar?

US stocks are seen as fairly valued on a price-to-earnings basis, but so are most market sectors, making it difficult for investment managers to isolate undervalued stocks in the market. Where will managers try to find value? Will the increasingly efficient market lead to more use of indexing?

Will tech stocks, which have underperformed the market throughout this decade, ever regain their sizzle?

Will the flood of money into private equity, abetted by the liquidity surge of recent years, lead to unforeseen disappointments? On the other hand, will the market for initial public offerings improve, opening up the venture capital market for better returns?

The markets have so far been basically unaffected by the continuing carnage in Iraq. Will unforeseen developments, such as a wider war, cause this to change? If foreign hostilities cause oil prices to spike upwards again, what affect will that have on the markets?

Last but not least, who will the Red Sox closer be this year?