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>> Matt Loesch: Good morning. I would like to call to order the May meeting of the Federated city employees retirement system. Under orders of the day, couple items. This meeting is only going to be audio-recorded so the use of the microphones, as close as possible to your mouth speaking clearly into the microphone is most important because they're not actively controlling the volumes. So if you could just be certain when you are speaking that you're speaking directly into the microphones so just not us but the folks who listen into this can access of the information you're providing or your input. Other items on orders of the day, I'd like to request from the board that we arrange the agenda a little bit, that we'll do first just pound through the consent calendar, get that one out in case there's anyone out there waiting on those. Then go to item 5.3 which is the Cheiron actuarial stuff and then do 5.1 and 5.2 in succession which is the Mikita stuff and then continue on with the remainder of the board meeting as agendized. Any comments or questions on that thing? That work? Yeah, okay can I get a motion for that please?

>> Motion.

>> Matt Loesch: Motion and second?

>> Second.

>> Matt Loesch: All in favor, aye, so on the consent calendar. Is there anything that needs to get pulled before we move for approval, I'll pull 2.9C please, I'll talk about that briefly before we move the consent calendar.

>> Second.

>> So moved I guess.

>> Matt Loesch: That will work, I apologize, if we could pull 2.3C as well, it's noted under 1.1, to be heard jointly with 2.3, that's the same person, I apologize for that, pulling 2.9C and 2.3C from the consent calendar. Does that work for the maker of the motion?

>> So moved.

>> Matt Loesch: All in favor. 2.9 C that is the memo from Mr. Richeda. I just wanted to make sure that that's the same as for the Police and Fire board, if there's any difference of opinion or thoughts.

>> Russell Richeda: Matt, I certainly apologize for the mistake in the heading of this memorandum. That shouldn't have happened. I apologize, and state that it won't happen again.

>> Matt Loesch: If there's no difference of opinion --

>> Russell Richeda: There's no difference of opinion.

>> Matt Loesch: That being said, I'd move approval of that or actually note and file. Always 5.3, discussion and action regarding the result of an actuarial May 2011 conducted by Cheiron. Cheiron is present. Kind of what, my thoughts are before setting them up to speak, this is obviously not contentious but there's certainly a lot of information here and a lot of things that we'd like to think about and discuss, a lot riding on some of the decisions of stuff that's being presented. So what I'd like to do is kind of foster this as a good discussion with the actuaries and the board and people who are interested to try to really get on each of the items that's being recommended and the concepts and the thoughts that they're presenting. So for Cheiron really to present their findings and recommendations and then have like a detailed discussion on each item. Because sometimes I think in the past we've kind of rushed through all the demographic changes, let's accept all the demographic changes as they are, in my minds kind of delving into them. I'll take responsibility last year as chair for not making this happen. But let's talk about the demographic changes. If it's page by page in the report, I have a lot of questions on them just so I understand. But sometimes it's easy to brush through, let's accept all the demographic changes or not, let's understand what's going on both with our experience but also with the recommendations and why so we can really understand. So my goal is, the outcome is that everyone really kind of understands our current position, what's being recommended by Cheiron, and why. And so that we really can be in a comfortable position. I don't

foresee having to make a decision on what these -- what position we need to make today. But certainly, I see a push and pull for more information, more detail. And then come back maybe in a month or so and actually firm up the decision as to what positions we're going to make on these things so we have a chance to dig a little bit and understand and mold some of these decisions, that is kind of my thought. Does that jibe with everyone else? It's deep and what I'd like to do is have Cheiron give their presentation and then kind of walk through it, and I have some other things, not try to control the conversation but try to focus it so we're getting through the items in detailed way, okay?

>> So Matt, just so if we have questions to go through, should we stop them or how do you want to --

>> Matt Loesch: That's entirely --

>> We would prefer if you ask questions whenever you have them so we can engage in dialogue. As Matt says we have come here today sort of in a vacuum. We've not received any input from the board on risk preference and the like. This is a sort of first shot at where we're at and we'd like to engage in the dialogue. There are things about the system that you know that we don't know.

>> Matt Loesch: Great point, Mr. Armstrong. That's why I'd ask them to be ready to put the report up, certain slides that are not in the presentation itself, would help tell the story, helped me understand better, with when I was going through fine-tooth and really understand the recommendations you're making and why. I don't want to rush this discussion, I really want to have a good cheer discussion so we're all on the same page. So with that whoever is going to begin. Can we first just introduce, so we have so many new folks.

>> My name is Gene Kalwarsky and with me is Bill Hallmark and we do predominantly most of the work on the system and we've already done the initial evaluation. We were in front of the board I think at the end of last year with our initial valuation. And now per the schedule that the system is under, periodically, actuaries will review the assumptions used in those valuations. And we have done such a study. And we have looked at the experience from July 1st, 2005, through June 30th, 2010, and we're here to report our findings. Our findings are in two

parts. I'll be doing the economic assumption analysis and Bill will be doing the demographic assumption analysis. The demographic are the people assumptions, when people retire, terminate employment, retire, mortality and the like and the economic are largely the -- mostly the discount rate and there's also the wage inflation. But I'm on slide 2. And just want to take a step back and say, this slide is depicting what the overall report card has been for the system compared to the assumptions used since I guess the 2004 valuation. You're looking at two sets of bars, gold bars which represent investment gains or losses relative to the assumption and gray bar are liability gains or losses. If it's below the zero line, you've lost relative to the assumption. If it's above it, you've gained. And you see largely there's losses in there. But this is looking at a seven year period. I believe you had biennium valuations previously, so the 2007 represent two years of experience as 2007 and 9 and 2010 represents just a single year of experience. But you're seeing largely investment losses and liability losses although we did pop up with a liability gain of 2010. But that just tells you in the aggregate all the assumptions without worrying about any individual one, how they all perform. And they've all performed pretty much to a loss side. So one of the messages we have here is that we -- as you probably already know we're recommending strengthening the assumptions and this is part of the evidence although we'll have more evidence. And we're not asking you to say today you've got to decide to strengthen it to certain number and if not, the system is going to be in trouble. The system is not facing bankruptcy at all. We want to get the system back on track and this continues discussion from our last presentation at the end of 2010 where we talked about the need to take some risk off the table.

>> So if we go come back to the liability loss, exactly what that represents --

>> It could represent -- and Bill will get into this later, it could represent people living longer, people retiring earlier, it could be representing pay and step increases, different than expected, disability retirement and mortality. Each year we compare it with the liabilities that we get from the data that you provide us and we compare it to what we would have expected the prior year if all our assumptions were realized.

>> So in other words, when we last did this, the net effect was, that we underestimated what the liability would be.

>> Over that entire period, yes.

>> Over that period of time.

>> Yes.

>> Carmen Racy-Choy: I'd like to add, the word about the investment losses. Because everybody thinks that let's say the fund earns minus 1%. That's an investment loss and that's what you're looking at. Not quite. The actuary assumes that the plan is going to earn currently the discount rate is 7.95. So for example, in a year where the plan earns 6.95, you're going to see a yellow bar, a loss really of whatever the minus 1% of the fund earns, in its equivalent dollar amount on here. The bottom line that I want to convey is that the way the actuarial methodology currently works, the benefit of earning each year 7.97% every year is front-ended. And as a result, if you don't make that assumption every year, you're going to see yellow bars and losses.

>> Matt Loesch: So just to follow on that, because I had some detailed questions on that later. For example, to clarify, in 2010, we beat our assumption handily. So why would this be a negative number then as an explanation?

>> We're showing the investment gain or loss compared to the actuarial value of assets which has a smoothing. So you see the losses there which are being recognized over five years.

>> Matt Loesch: So it's the 20% being kicked in from 2008?

>> Exactly.

>> Matt Loesch: Even though there was large gains, there was a negative 20% that was kicked in, is that what you're saying?

>> Russell Crosby: Also gains are smoothed. The same way losses and often there is a focus just on losses but the gains over the actuarial assumption also get smoothed.

>> Matt Loesch: So that's kind of getting to my point. This is tracking in the actuarial feeling every year of the one-fifth being put in. So the negative one-fifth from a few years ago is very large and still being tricked in and the positive experience is also small affected in there but obviously the negative is so large.

>> And the same with this year's. When we do the next valuation, if it looks like you're having a good year the same issue will come up.

>> Matt Loesch: That's what I'm getting at.

>> Carmen Racy-Choy: My preference is be the slide shows, just so it's clear to the board what this is. Really, 2010 was a if year, so why do we have a negative number but yes.

>> Matt Loesch: Why is why I wanted to -- this chart could be misconstrued and that's why I wanted to make sure the explanation got out there, thanks.

>> Okay. I'm going to not jump to the impact slides on 3 and 4. I'm going to go to slide 5 because I think the discount rate sets the tone for the entire presentation. We looked at the current, well your current assumption is 7.95. Although at the last valuation I believe we had recommended 7.75 but we recognized the boards wanted to move there in small steps so we dropped to 7.95. We did an analysis based on information provided to us by staff on expected earnings and risk on what the likelihood of what the fund could be earning. That's on the left-hand side of this chart. And what we found is that the likelihood of earnings, of gross return earnings would be 7.42, that's 50% of the time you should get a return, that's the expected return over the period. But what that means is that half the time you're going to be less than that and half the time you're going to be more than that. So at this point I want to just digress for a second and talk about more of a macro issue. Many of you have seen public

plans in the press, nationwide, in a number of articles, a number of studies, you know what's going on, people are saying there's no problem, other people are saying there's a major problem but there's no doubt there's a crisis out there. And there's a crisis out there because in our opinion, I'm going to flip to the very next slide -- returns are never going to be, if your expected returns are 7.42 like the prior slide said what that means is that at best 50% of the time you're going to be wrong. Because returns go up and down. And so what pension funds are realizing is that board risk preference means a lot. Do you want to be right 50% of the time or do you want to be right more often? So funds are starting to lower the discount rates which is akin to taking risk off the table because they want to be right more often than wrong. And I want to flip to a model we've created to explain this concept. Not that one. I'm going to be showing two pension funds in this model. There's a gray bar and red bars. The gray bars are going to be representing a fund that on the left here has 8% returns throughout the period. Each and every year. Whereas, the red fund is going to be having returns that are down and up, like the markets go. Well, they both happen to result in 8% returns up here. If you were to accumulate those funds over a ten-year period, no surprise, they end up with the same asset return at the end. And you could make this be like your fund, $1.5 billion in market value and it's up to $3.2 billion at the end of a ten-year period. But the moment you start introducing the notion of negative cash flow, that's more money going out of the fund than money coming in. Contribution and benefit payments. More benefit payments are going out of the fund versus contributions going in. So you have to rely on principle to pay for benefits. You start getting a distortion here. So Bill if you could put a negative cash flow minus 5%. Not there, not there.

>> Oh.

>> Over to the left there, yeah. Now, the two funds on an average return still earning 8%, this figure right here, as it did with level fund. But the way the actuaries measure it on dollar-weighted it didn't get its 8%, 6.4 because you earned fewer assets on a dollar weighted basis. This fund has lost 17% of its earnings, of its assets. This is a phenomenon that is going on with pension funds nationwide. You've heard about the baby boomer effect, baby boomer affect really is causing funds to divest their principle. And funds are negative cash flow is growing so Bill if we did that cell you had before, not that one, the one you -- right. It grows by roughly 10% a year. Now we have a fund that has lost a third of its money because it had a down market and up market over a ten year period. What

I'm going to do now is flip those returns in this column from a down market to an up market to the reverse to see if an up market if we gain it back when the markets come back. So now on the up market we gain 25%. We lost 36 in the down market, gain 25 in a positive market. What's happening to these pension funds is they're always going through cycles like that. You lose more on the down side and you gain more -- gain less in the upside. On top of that, what's happened nationwide is that pension funds have, during the up side, tend to spend surpluses. You have an SRBR. On the down side, there's also -- on the upside there's also contribution holidays have taken place nationwide and when we get to the down side there's not enough to make up that backfill. So there is a national movement to decrease the discount rates. And there are -- there's a group of actuaries called the financial economists that would go all the way down to risk-free rate of returns. And there's some solid theory behind that. We're not proposing that you go that route yet. But we want to be on record as saying that lower the discount rate helps funds navigate the long term. That having high expectations is risky, and it's one of the key reasons why pension funds nationwide are struggling as they are right now. In the private sector the government has already regulated private sector pension funds to be using low rates of return. The final comment I want to make on this is, the lower the discount rate, the plans that have used the lower discount rates are in better shape today than plans that had higher discount rates and that's no coincidence. I want to show you an analysis and it's on page 7 of your plan, of your document. And I'm going to first focus on the bottom part, the bottom chart. We did an analysis based on risk and return of your portfolio to see down the road in 2035, where would your contribution rate be based on the discount rate you ultimately select. And if you look at the row that's called median city contribution rate, that's projecting out to 2035, the lower the discount rate, the lower the ultimate contribution is going to be. The second row, the lower the discount rate, the lower the probability that the contribution rate will exceed 30%. Third row there, the lower the discount rate, the higher the funded status in 2035 is. And the lower the discount rate in the last row, the lower the probability of the fund falls below 80%. The basic theme of our discussion here today is that pension funds have absorbed too much risk and it's time to take risk off the table. How do you that and when do you that is more a board decision. But we're unequivocably behind the notion that discount rates need to decline. Not for this fund but for all funds. It encourages too much risk being taken by these pension funds and it largely contributed to the crisis that this country is facing today with its pension funds. So that was a sort of an opening theme and I think I'll probably get some questions.

>> Matt Loesch: Mr. Armstrong, hold on. Mr. Andrews has got a couple.

>> Arn Andrews: I want to start on slide 5. When I was reading your report it seems most of your analysis keys othe probabilities provided 50 retirement services department, and their probabilities come up to 7.42 out of a 50 percentile probability. About a year ago when we did the allocation asset mix our investment advisors also came to us with a probability and it was somewhat higher than 7.42 and I also think the term of their period was a little bit shorter, 24 you folks are using 30. I'd like a little more clarity. Since this is the basis of all the assumptions of what drove your assumptions, if there is any differential, from what our investment advisors did versus you did.

>> Carmen Racy-Choy: I believe Mikita was 7.42, probably it was up and down, clearly we've updated the capital market assumptions, the work that Mikita did was a year and a half ago. As you can see since we adopt a long term view it didn't really result in a significant change in what the median number is.

>> Arn Andrews: And --

>> Carmen Racy-Choy: From the Mikita numbers.

>> Arn Andrews: And so what you -- when you say the capital market numbers have changed, When you take our asset allocation, you put it through some kind of Monte Carlo scenario and generated returns and at the end of the day, 10,000 iterations and you come to this number?

>> Carmen Racy-Choy: Log normal model, that's fundamentally it's a similar process where you input assumptions about the various asset classes. You input assumptions related to volatility, return correlations to other asset classes and basically, the model will then tell you, given your current long term asset mix, this is kind of the probability distribution that you can expect.

>> And I want to emphasize that we did not just accept numbers that they gave us. We independently produced our own. And so we have produced these numbers in our own system, not their system. And --

>> Arn Andrews: That was going to be my next question because the way it read it was as if you accepted the data and then you used it but you also verified it independently?

>> Yes, absolutely.

>> We used their underlying capital market assumptions.

>> Because that was provided by Mikita.

>> Arn Andrews: Okay and then I had one or two other questions. In the presentation you just gave when you were talking about the concept of negative cash it seemed like there were two concepts going on there. One is I think the concept of volatility drag, where you're saying if there are investment losses you are earning less return on a lower amount of principle. But then you also started talking about negative cash flow. So I guess my question is, you plugged in a number of minus 5 so I guess my question is to retirement services, you know do we have a negative cash flow situation and is it consistent with the illustration we just had?

>> You're at negative 2, negative 2% so if you put that in, Bill -- and go to the down-up. And probable it's the same story although the numbers are going to be relative different.

>> Arn Andrews: The numbers are slightly better with the negative 2.

>> The concept is the same you lose more with the down than the up. Negative 2 in our stable of clients we have many public sector clients throughout the country. Your negative cash flow position is not as bad as many others are. And in fact, the funds that are in the worst shape that we have are funds that are minus 10 and up. In fact I know of one fund that was fully funded before the 2000 market downturn, fully funded, 105% in fact, and it went through the two litte, 2001 and 2008, and it's an irreversible death spiral because it's lost so much money. This

notion of once you're putting more money out the door than you're collecting, and you have lower principle to invest is a killer for these pension funds.

>> Arn Andrews: I appreciate your opening comment, the fund is not bankrupt. We have funds-

>> I want to reiterate, it is absolutely not bankrupt. We're here to work with the board to put it in proper form over time. This is just step 2. Step 1 we presented last year. We want to keep reinforcing that notion.

>> Arn Andrews: And your next slide when you were projecting out to 2035. I'm a little confused. It seems that you're saying as we lower the contribution rate, one of the benefits is lower contribution to the city. Are you holding the UAL constant or are you.

>> Lowering the discount rate you're pumping in more money.

>> Arn Andrews: That part I get. It seems there's a slight disconnect with our current reality and what you're projecting the reality to be. I guess what I'm saying with the current UAAL, is that included in this assumption?

>> Yes.

>> Arn Andrews: Lowering this could we eventually get to a place where contributions you have 14% for six, seven, 5, 17% for five-seven?

>> Yes.

>> Arn Andrews: I wasn't sure, whether the UAAL was being held constant?

>> No, it's being held constant.

>> Arn Andrews: That's the end of my questions.

>> Matt Loesch: Mr. Armstrong.

>> Michael Armstrong: So partly of that which is being driven by the demographic piece, we have this surge in people retiring early, for instance.

>> And also you have the fact that even though there's no surge in retirement you've got an active workforce that might be -- I've heard pay cuts and declines, I mean --

>> Michael Armstrong: Right. But it's more than that, it's kind of the natural progression of a pension plan. That as the pension plan matures you've accumulated assets to pay these benefits and then ultimately the benefit payments are going to be significantly more than the continued contributions. So it's just the -- it's really a natural process for a pension plan that it grows, and then as it matures, you will have negative cash flow.

>> Russell Crosby: And Mike, they can't see the surge in retirements that have occurred this year yet. They won't receive the actual population data until June 30th. That's when the snapshot will be made. So what they're looking at is the historic kind of performance rather than what's actually happening this moment.

>> Michael Armstrong: So potentially the problem could be greater?

>> Russell Crosby: It will be because we've had a huge surge in retirement.

>> And the asset losses as they get folded in, that's going to drive contributions up also.

>> And also offsetting that is the fact that with the payroll declines, you're going to have a lower projected liability. So there's a lot of different things that are operating here. And so some of the numbers that we'll be showing here like page 2 you can almost throw out the door because this new set of data we'll be getting is going

to totally reflect lots of things that have changed. But they do give you a feeling for relative change. But there's one other aspect of this negative cash flow or maturing thing that I wanted to mention, and Bill's comment reminded me of that. When you've got a -- when you've got moneys invested in equities or hedge funds and the like and you've got a population that's largely active they could absorb a loss for 2008 because they're covering for losses in the pensions but if you've got for example some of these funds two retirees for every active worker that same asset loss you've got to cover not only for your own benefit but for the two people that are retired. That's what's killing a lot of these pension funds, they continual to invest moneys for people that are gone. And invest that fully in equities, and the risk is just too much to absorb on the current payroll base. So I think I've prefaced our views at least on the discount rate. And --

>> Carmen Racy-Choy: Just one question on slide 5, a clarification. The table shows the percentiles and the gross investment return that may be earned. If you can clarify to the board the recommended range of 6.75 to 7.75, is that truly a gross assumption and if really the difference between gross and net is obviously the fund's admin Expenses, the investment expenses, and SRBR, if you can explain to the board how each of these components are treated. And whether this rate is gross or net. Thank you.

>> Okay, I'm going to -- we're both going to answer this one. I'm going to first talk on the range, and the investment expenses. One of the recommendations that's in our report in detail and it's alluded to on page 5 is that we want administrative expenses -- let me back up. The current 7.95% assumption is assumed to be net, or after you pay all your expenses, administrative and investment. It is our recommendation that you explicitly fund for administrative expenses and not say that your investment expenses will cover it. So that will be an add-on and we'll have a slide that gets you into the financial impact of that, that you explicitly look at your administrative expenses and that's an added cost to your normal cost. That is a very common approach used by pension funds. But on the investment side, and we had lengthy discussions with staff on this, and our position is, the investment side, we're quite comfortable that the investment expenses are part of the assumption, meaning that your -- our range of 6.75 to 7.75 which is on slide 5 is return after paying investment expenses. Because in our opinion, that any manager fees that you're incurring is with respect to earning alpha or additional returns. We've come up to answer Carmen's question, to 6.75 to 7.75, we don't want to go below what we earned last time, 7.75

is the cap or above it I mean. We could go below 6.75, in fact in time you probably -- most funds will, in fact the government may mandate that, GASB may mandate it but we're being practical at this time, that in the short term horizon that's the range you ought to be looking at. Is it scientific that we came up with 6.75 no, but it is our judgment call.

>> Carmen Racy-Choy: Just to clarify for the board, 6.75 to 7.75 is net for this year.

>> Net for investments. Not for administrative.

>> Carmen Racy-Choy: Going forward Cheiron is proposing to project what the admin expenses are going to be within their valuation. So when you calculate the normal cost there's going to be a component, you're going to be funding the admin expenses. Cheiron will do the same -- will do some type of probably stochastic modeling to value the SRBR which really is an option. So Cheiron is proposing. In the past, admin expenses investment expenses and SRBR were fundamentally ignored in the valuation. So you were only funding pension benefits, pure pension benefits. This year Cheiron is proposing, well, we know we're going to have admin expenses, the SRBR, the actual cost of SRBR can be anticipated, they're proposing to fund those. So the rate, the difference between the rate they are proposing, and the gross return on the fund, is purely investment expenses. And so that 6.75 to 7.75 is really net of approximately 30 basis points of investment expenses. So to be -- to be even, the plan would say the high end of the range. 7.75 plus 30 basis points is 8.05. So your investment program, the target for the investment program, would need to be 8.05 in order for the fund to break even.

>> As a gross rate?

>> Carmen Racy-Choy: Investment returns always.

>> In terms of looking at that, that table of percentile.

>> Carmen Racy-Choy: So that 8.05 then becomes a percentile, significant higher than the 50th percentile. The reason I went through the calculation is because the numbers you're looking at in the table are really gross.

>> Glad you asked.

>> Sorry.

>> Clear as mud.

>> Arn Andrews: So in the future, I mean not in the future, in the past, we said our return was 7.75, you've always advocated that in reality we have to earn 8.85 or something like that gross. Now we're saying that that net number is actually going to incorporate 30 basis points of the 90?

>> Carmen Racy-Choy: It's going to incorporate actually 60 basis points of the 90. So now to go from net to gross, you need to add only investment management expenses, which are approximately 30 basis points. And the reason it's included -- the actuarial valuation going forward will actually just like they tried to project what the pension benefits are going to be, they're going to take the admin expenses and they're going to inflate them and make projections on those, similarly they're going to try to anticipate the cost of the SRBR program, through appropriate modeling. And the normal cost of the actuary is going to calculate will fund pension benefits, it will fund the admin expenses, it will fund SRBR, but it will not fund investment expenses.

>> Arn Andrews: Right. And I remember a conversation from a few meetings ago where we thought the investment expense sides we might be changing because of the fact that we've implemented quite a few passive investments. So do we anticipate the 30 basis points associated with investments declining in the future or do we think this is a --

>> Carmen Racy-Choy: No because the moment you start implementing hedge funds, 2 in 20, really it's going to more than offset the impact of doing a few passive mandates.

>> Russell Crosby: You're probably at the low point for investment right now.

>> Arn Andrews: I sort of thought so.

>> Matt Loesch: Mr. Odell.

>> Stuart Odell: I'm sort of wondering, you set your discount rate based on your return on asset assumptions and that's what you're required to do, correct?

>> Not quite.

>> Stuart Odell: Okay. Maybe if we have flexibility around that that's one thing and we can set a discount rate that we think is appropriate separate from the return on assets. But if you are asking me to come in and tell you whether I think 6.75 or 7.75 is the right number you haven't shown me the right data to determine that. And the right data is how the investments are allocated and what assumptions you used or your consultant used behind that. And how much variability there is in those assumptions there.

>> That's exactly the table you're looking at right now on the left-hand side.

>> Stuart Odell: No you just gave me some numbers.

>> The left-hand side shows your current portfolio, your current allocation is expected to return, page 3, 7.42. I'm sorry, page 5.

>> Stuart Odell: What I would ask you is what sort of correlation are you using between asset classes on your standard deviation, your volatilities, what are your expected returns on the underlying asset classes, what kind of alpha targets do you assume? Those are -- that's what this board can deal with. Is I can look at your ROA

assumptions on the underlying asset classes and decide whether we think those are reasonable or not. But I -- willy-nilly adjusting -- I don't think return on equities I'm not going to take it from 8 to 6 simply because you have an underfunded liability exchange here.

>> We have been given a standard deviation for each of those asset classes and a correlation on each of those asset classes. These are based on these numbers.

>> Stuart Odell: I understand.

>> Russell Crosby: He just wants to see it.

>> Stuart Odell: Do we just ignore it? That's kind of what you're telling me.

>> No, go to slide 6 again. I'm trying to say once we get all those rate of returns you end up in that middle line there, right?

>> Stuart Odell: I understand that.

>> Now we're saying, we recommend that you go to the left-hand side of that line to increase your odds of meeting your rate of return and how far our recommendation is that you go as low as 6.75.

>> Russell Crosby: I think Stuart is saying he just wants to see the background, right?

>> Carmen Racy-Choy: We definitely will come back next meeting and come back with the volatility numbers behind the model. I just want to convey to the board that there is nothing in the actuarial methodology that says you need to assume the expected return on your investments. You need to assume a rate of return that's related to what your investments can earn. The norm, I would say that the best practice in the industry is to look at the gross return on the portfolio, and to kind of say, you need to be somewhere in the 50th to 75th percentile

range. This is something about the methodology that I want to clarify. Now we will gladly provide our capital market assumptions that are behind the percentile -- the 50th and the 75th that are shown here.

>> Matt Loesch: In a sense it comes in the chicken and egg scenario, if we night to crank out more assets to get more return, actuarially what the liabilities are doing as well. So that's why I sort of -- why a decision doesn't need to be made today. We want to push back and have this conversation, we need more data on this end to make this decision so the background information you're saying is what's needed for sure.

>> You brought up an excellent point that I just want to elaborate on. We have sat before boards where we have heard the investment consultant come and say, I'm recommending this asset allocation because your actuaries want to you earn 8 and the actuary says I'm going to set my 8% based on what your investment consultant says the assets can earn and that is a chicken and egg thing. That requires a lot of examination and discussion, and this is not a simple -- there's no simple answer to this.

>> Stuart Odell: And the range of outcomes that you've identified here is over a 30-year investment horizon. So your expectation is that over 30 years, we could lose 25%, or have a 25%, negative 25% rate of return. Has there ever been a 30-year period where the -- where there's-where we've ever gotten a negative 25% rate of return? Good I'm not following that. Our 95th percentile is over a 30 year period is 2.99.

>> Stuart Odell: Oh, sorry I was looking at a different -- I was looking at the distribution of returns here. Okay. Over 30 years has there ever been a return of 3%? Ever?

>> Maybe we'll find out in another 20. After what happened in 2000 --

>> Stuart Odell: I think just you've got a pretty long return stream of stocks and bonds. Just take 100 years of historical data, and worst case scenario we've never had a 30 year period where we've --

>> You can't just look at those returns. Remember? The negative cash flow model, the markets go down, those returns are -- you can't look at time weighted returns and all that analysis is time-weighted.

>> Stuart Odell: Okay, that's fair.

>> Matt Loesch: Anymore? Mr.--

>> Edward Overton: I have a clarification similar to Stuart. SRBR. Over the discount rate, if you have a 7.2% projected return there is no contribution to SRBR. And I don't understand how you can come up with a 30 basis points cost for an SRBR with a 7.4% investment return or a 7.4% discount rate. So I'd like to see some details on how you get to --

>> Matt Loesch: Why don't we -- they haven't even done their presentation part on SRBR changes, we'll mold on that and push for details. They haven't made their presentation in the talk about the SRBR.

>> I'm going to do SRBR. Then I'm going to turn over to Bill to get into demographic and wages.

>> Matt Loesch: Is there any further on that topic there?

>> Just discount rate.

>> Matt Loesch: We'll keep moving. I have a bunch more, why don't you continue on with your presentation.

>> Okay. One of the concerns we had when we knew that we were going to be coming in with the lowering of the discount rate would be that the lower the discount rate, the greater the odds are of the SRBR meeting the excess return. Meaning, if you lower your assumption from 7.95 to 7, pick an example, your odds of having the return increases. I think the problem we have with the SRBR if you look at returns being mountains and valleys, and every time you have a mountain you skim off the top, you are never going to be in the middle, you are lowering

your expected rate of return. General concept of SRBR is that we want to recognize that there is a liability, there is a real liability that you will be providing excess earnings to the SRBR and we should recognize that and prefund that. And to say that it just comes out of excess earnings and it's free is -- it's nonsensical. Because it isn't free. If you are going to be paying additional benefits you otherwise would have been paying out of excess earnings then you have lowered your discount rate. What we are recommending is that we, looking at a stochastic analysis of your expected return and risk if you have a provision in there for what your SRBR cost is. And so as we lower -- Mr. Overton, as we lower the discount rate, the odds are that if you don't change your asset allocation, you're going to have additional earnings than you otherwise would have had.

>> Carmen Racy-Choy: Let me just clarify. That if the SRBR excess payment was linked to a 30-year payment, meaning if SRBR actually said you know what if over a 30 year horizon we made more than 8% then in reality on an actuarial term you could claim that there is excess. Then in reality, this would be money from surplus, that's being distributed. The current SRBR says, this year, if only this year, I made more than 8%, then there's excess, and it needs to be distributed, and the reality is, last year you could have made minus 30. And in aggregate, over the long term horizon of the pension plan there isn't excess. So that's really the main explanation for your question.

>> Matt Loesch: Does that get towards answering? Yeah.

>> Edward Overton: My concern, and I understand Carmen's explanation. My concern is those years when we have negative returns, where do you pick up value from the SRBR?

>> You don't. In fact when you have negative returns what actually happens is, it's less than 0%, the SRBR cannot get credited with less than zero so you're actually making the transfer there. So if the entire fund earned minus 10%, the SRBR earned zero and therefore the rest of the fund had to subsidize it. So there's a transfer taking place there.

>> Edward Overton: But unless there is excess earnings there is no transfer to SRBR.

>> There is an implied transfer. You lost 10% to the assets. You can't take 10% from the SRBR reserve. That 10% has to come from the other reserves. It is an implied transfer. It is not a direct transfer when the moneys go the other direction.

>> The notion of excess earnings and sharing excess earnings is something that is a dinosaur in public pension funds. It's going away. It made a lot of sense in the '90s and the late '80s when we were all used to these wonderful returns. But you can't take the mountain tops and then not fill in on the bottom.

>> Edward Overton: So the issue then is going to be how do we balance it out?

>> Right. And we're saying as long as you maintain that we are going to anticipate that there will be excess earnings and we will advance-fund that. And on our -- our -- might as well go to slide 3 for a moment. Is that on --

>> It's on slide 5, or slide 8, 4th bullet.

>> All right, slide 8, 4th bullet. Basically, and it could be the last bullet, we're increasing the total contribution by 1.2% of payroll. If I cover all these bullets here we've already covered the first, second, third, and in the 4th bullet, we're recommending .35% of assets but that translates to in the last bullet, total contribution rate of 1.8% of pay.

>> Edward Overton: So this is telling me that on an annualized basis you need to add roughly 5 to $6 million to contributions to cover SRBR.

>> That's approximately correct. The actuarial standards --

>> Edward Overton: I just canned get my arms around that.

>> The actuarial standards allow two methods for SRBR. One is, you specifically account for it as Cheiron is stating, or there's where you simply disclose that, there is an SRBR but staff does not believe that is an acceptable method. You have to account for this if you are going to pay that, it should be a funded benefit.

>> Carmen Racy-Choy: Just looking at the past ten years the return on the fund has been fairly low. I don't know the exact number but around 4 to 5%. And yet we have made various SRBR payments. So the message there is, although the fund is -- really doesn't have excess earnings over a long term horizon, which is what the actuary and the valuations look at, money is being paid into the SRBR and an SRBR benefit is being distributed. That is fundamentally the message. And that has an annual cost.

>> I have a question maybe directed to Mr. Constant. So is SRBR, is that part of labor negotiations, or is this something that is embedded in the plan? Sort of in perpetuity?

>> Pete Constant: It is subject to meet and confer. And there's disagreeing opinions on whether it's a vested benefit or not.

>> Mollie Dent: I would say I think when -- when Mr. Kowalski, I appreciated him saying this is the analysis he is looking as far as this is the benefit, I think there are discussions about not having the benefit. So I think you -- and certainly, whether or not this is a vested benefit, I think that the city council, to a great extent, thinks that it is not a vested benefit. But that doesn't mean that it's going to go away tomorrow. But I did appreciate Mr. Kowalski saying that this is the benefit, as long as the city had the benefit.

>> Alex Gurza: Good morning, Alex Gurza, Director of Employee Relations. The topic of SRBR is on the table with many bargaining units, and we have a tentative agreement reached with one bargaining unit who would like to eliminate the SRBR and transfer the assets back into the fund. But that is still pending because we have 11 more bargaining units.

>> I think given some direction on the SRBR it seems to me it makes a lot more sense to know exactly what the cost of this is, and include it. Because one, you can get this out to, you know, your constituents and explain, the annual cost of this SRBR is, you know, 35 basis points or 2% of payroll each year. So I think separating it is absolutely the right way to go. Otherwise you're kind of burying the problem and not quantifying it for your constituents.

>> I can say last year the credits were about $8.5 million. None of that was distributed because of city council action but it was about $8.5 million last year.

>> So you know where our position is on the discount rate. And on the SRBR. I'm going to turn to Bill now to talk about the wage inflation assumption.

>> I have one quick question on SRBR. If we change the discount rate, as you suggested, that would increase the actual cost of SRBR, right?

>> Yes.

>> Do you know how much that would be?

>> Well our total cost if you take the middle of our range is 1.2% of pay. You're saying if we maybe it the 7.95?

>> Versus what you --

>> Maybe what --

>> It's on the chart here.

>> So if you look at the chart, running across the top, we have different discount rate assumptions from 6.75 to 7.75. And then the estimates of the cost of SRBR. So yes, as you reduce the discount rate, there's a greater likelihood of an SRBR -- greater likelihood of excess earnings being transferred to SRBR. But in the range we're talking about, it doesn't make a huge, huge difference. But part of the reason also to explicitly deal with it as a part of the normal cost rather than reducing the assumption is to eliminate that dynamic to a certain extent.

>> Thank you.

>> Arn Andrews: And one other question. This just shows the direct cost associated to the SRBR. This doesn't get to the volatility drag, every time we siphon off the assets, it doesn't take into the concept of volatility drag?

>> That's true and to us, the concept of volatility drag is a reason why you want to be to the left-hand side of that bar graph there. But we know we have to provide additional information on that.

>> Matt Loesch: Moving on from SRBR.

>> Let me go back to slide 4 on wage inflation. And before I go into wage inflation, let me just talk about in general, salary increase assumptions and how this fits in, and its role. Generally, we think of individual salary increases as having a couple of components. The first component that we're discussing here is a wage inflation component, which you can think of as like across the board increases, and but then there are individual increases that go on top of that, which we've called merit increases but they can be step increases, and other increases, that reply to an individual but not to a group as a whole. So in looking at wage inflation, we looked at national indices, so the increase in national average wages that's published by the Social Security administration, and we also looked at the increase in the average wage of the Federated employee population. So the first two bullets point to the differences we've seen historically, and the last ten years obviously, wage increases have been lower than over a longer period. We've had lower inflation and lower wage increases during that period. The experience nationally and the experience for Federated members is relatively close over those time periods.

>> I beg your pardon. But is there a difference between the national average and the average in our local economy in California?

>> There -- there may be. We use the increase for Federated members as a proxy for the locality economy.

>> But there's likely to be difference.

>> Lara Druyan: I'm asking. If you're asking us to opine on how good this assumption is, I'd actually like to know what it is state wide so we can have something to compare it to that is at least very specifically apples to apples personally.

>> I think you'll see variation from year to year, on the comparison of local to national. But based on what we're seeing here, I wouldn't expect a significant variation over the aggregate period. But we can see if we can get that -- get a comparable source for that. Then we also -- in addition to looking at historical numbers, we wanted to look at what projections are in the future. And the Social Security administration has a very detailed report with their projections. And they project, actually, private -- they project national average wages to rebound fairly quickly, and then, over a period of time, level off at an annual increase of 4%. What they're arguing is that coming out of the recession, wages will bounce back. And retain kind of an ultimate -- reach an ultimate sustainable path. We don't see that happening in the public sector. At least not in the short term. And so in the short term we're seeing lower -- we're expecting lower wage increases in the public sector, maybe even zero wage increase in the very short term. And ultimately, though, it will have to bounce back to some -- something akin to the national norm. So we've -- we developed a range for the wage inflation assumption from 3 and a quarter to 4%. We are recommending something a little below the median of 3.5, to recognize the short term, we expect lower wage inflation but over the longer term it may be higher. So it's an aggregate and a little tilt. The current assumption is 3.9%. So our recommendation going to 3.5 is a decrease. Now, the impact of that is, there are two places this gets used. One is in projecting wages that determine what benefits we expect to pay. And so obviously, we're projecting lower benefits by reducing this assumption. Which has the effect of lowering the members' cost and the employers' cost. However, it's also used in setting the amortization period for the unfunded liability. And with a lower

assumption, we get more dollars up front and fewer dollars later on, because our amortization assumes an increase in the dollar payments equal to this wage inflation assumption which we're recommending at 3.5. So it forces more dollar payments up-front. The net effect for the city is the decrease in cost of benefits versus the increase in the amortization, it's almost a wash. It's a slight decrease. But you end up with a slight decrease in the member contribution because they're just paying for the additional benefits.

>> Matt Loesch: Mr. Maley you had something?

>> He answered it.

>> Matt Loesch: As of 2010, current data, knowing you hadn't had anything for this fiscal year, I'm going to ask when this stuff does come back is what are the effects of, there have been commitments from some groups and most likely from all we'll be having a 0% wage increase for the next two years, with no step, so lock in zeros. But actually not only that the start point is down, wages have been reduced 10% and then going from there that's going to be the takeoff point when and if it does grow. And so understanding that analysis and how -- what that would do either to effect your recommendation or if that's baked into this already or what your thoughts are on this, knowing -- let's say there are -- let's say all the bargaining units in this group have contracts that lock those things in, what does that do to your assumptions and what does it do to the numbers?

>> So we are anticipating, we don't know specific numbers but we are anticipating lower wage increases in the short term. And that's part of -- this assumption has to be a long term assumption.

>> Matt Loesch: Right.

>> But that's part of why we're moving the assumption kind of below the middle of our range, to take into account that lower. The net effect that has in the short term is, we would expect to get some actuarial gains in this valuation, on the benefits that we are projecting. So the liabilities that we would have expected will be lower, because the wages are lower than we would have expected.

>> Matt Loesch: Right.

>> But the amortization payments will also be on a lower projected salary. And so those will increase as a percent of pay.

>> Matt Loesch: So I'm not looking for a magic wand. I'm just looking for the reaction of these if anything. There are going to be things that are changing so instead of starting here, let's say it's at $1 of wage and going up 3.5% we're almost at a negative number and that's the projection, does that change anything, if it does change anything, I would like to get that response so I can understand that.

>> If you go to slide 3 for a second. We've glossed over this because knowing there's going to be dramatic changes in the data for the next valuation, these are impacts of our valuations. For example, bottom chart left-hand side where it says city, you see MIN and max, 2.2, 7.4 and 13. If you take the two things we've discussed so far wage inflation and SRBR, the wage we're recommending, in the 2010 valuation, that would have increased the contribution rate by 7.4 per. But now we know with the potential decline in payroll, a very positive asset return, as Bill mentioned lower liability growth because of the payroll, can you can't rely on these numbers anymore. And so we're not going to be asking the board to look at this as a basis for our recommendation. But we can tell you as an estimate for example next time we come back instead of showing you percentages we're going to come up with best estimate dollar amounts.

>> Matt Loesch: That would be one of my follow-on points but --

>> Based on the 2010 payroll for example that 7.4% would have translate bead a $20.4 million increase in last year's contribution.

>> Matt Loesch: I get that based on these dollars, that's what it's going to be and based on new data, it is going to be a relative change, depending what those numbers of are. I'll ask direct questions, if these contracts are

signed and it does X and it specifies you know a negative 10% wage and you know zeros for two years, what is the response if any to the wage inflation? And so I don't need the answer today, I'm saying when we come back that's what I'm going to be asking. Mr. Constant.

>> Pete Constant: Well my question is, given the fact that our liabilities are based on highest annual year of earnings, does not the liability not decrease, even though pay decreases, and in fact, the normal cost contributions decrease, because of the lower pay, as a percentage of payroll, but the liability still stays at the prior year's salary levels. So if you take a 10% pay cut, your retirement is still calculated on that highest pay so in effect there is no reduction in liability.

>> The dynamic is fairly complex. The -- for someone who is just about to retire, what you said is absolutely true. Because their high average pay has not changed. But for a young person, where we're trying to project their pay out at retirement, now they've taken this pay decrease, and then we use this assumption and the merit increase assumption to project what their pay is in the future. That final projected pay is going to be lower. So you get a plan -- yeah. And so we have to actually run it on the actual demographics and that's partly of the issue Gene is raising, is with the changes this year, there may be significant changes in the demographic profile of the plan.

>> Matt Loesch: So the answer is it sort of depends, right?

>> Right.

>> Matt Loesch: Depends on what they actually appoint out. Ms. Choy.

>> Carmen Racy-Choy: Just to address your question directly, the 10% reduction in salaries is taking effect in June. When Cheiron do the valuation they will have that information so you should see a gain in the actuarial gains and losses. You should see a gain because of that salary reduction. So it will be factored into the valuation. It will be factored into the next set of regs. To the extent that there are MOAs to the extent some or all

of the unions agree to 0% raises, that is not something the valuation will typically look at, when it happens a year or so later, when the raise is 0% you're going to see a gain in the actuarial valuations. The reality is the recommendations, Cheiron is recommending that the valuation be lowered from 4to 3.5. One of the reasons they're doing that is wages are likely to be frozen in the near future.

>> Matt Loesch: And the reason I want to be explicit about that is, in the near future, we've gone over all these conversations, some of them have been pushed through fairly quickly and I'm going to try to vet everything make sure everything is out there. And I get that you know, that the valuation number and the wages is based on actual payroll, you know whatever that payroll wages ends up being. And it's different than what you would think well I didn't get a raise or I didn't -- it's whatever, if we have less people, less wages being paid out, different ranges of people, whether on the high end or the middle, that would have the effect. Once we get those things locked in I'd like to come back with that so you've talked about wages. Anybody else on the wage inflation?

>> Just not to be from left field but how does the setting up and funding of a health trust work into all of this?

>> Matt Loesch: We'll get to that when we get to 4.1.

>> Okay.

>> Matt Loesch: This is just on the pension, this stuff is just on the pension side. This is not on the health care side.

>> Except we use a lot of these assumptions for both.

>> Matt Loesch: Right.

>> So -- you know to a certain extent it does apply to the health side as well.

>> Russell Crosby: But further in the year we'll get into a discussion of the OPEB valuation and the assumptions that go into it because there are assumptions around health inflation and other kinds of things there, so that will come up later.

>> Edward Overton: What does the explicit inflation assumption include?

>> Because -- we did not pin down an explicit consumer price inflation assumption because it's not -- it doesn't affect your valuation. Your cost of living adjustments are fixed 3% regardless of what CPI does. So we didn't develop an explicit inflation assumption.

>> Edward Overton: So there's no inflation assumption included in the 3 -- what did you say, 3.5?

>> There's -- I mean the wage inflation is typically higher than consumer price inflation. And the range is probably 25 to 100 basis points higher. But we did not -- we did not explicitly identify a CPI assumption.

>> The spread that he's talking about refers to productivity gains and there's a lot of debate whether at least in the next decade or so there will be productively gains in the private sector. I'm expecting our explicit assumption is closer to 3.5. As Bill said, we didn't explicitly make it.

>> Edward Overton: Okay.

>> I'd like to turn to slide 9 and we're going to start through the demographic assumptions. And in the PowerPoint, we pulled out the two most significant changes we're recommending. But we can go through the report and look at the other changes, as well. And I want to start with the most significant changes, which have to do with termination rates and refund rates. So these are the rate at which employees terminate employment, other than for retirement or disability, or death. And they can either take a refund of their account, their employee contributions with interest, or leave it in the system, and get a benefit when they are eligible for retirement. But these are people who are not eligible for retirement currently. The prior assumption was simply based on

age. And so there were rates for different ages but did not take into account service at all. And so we're recommending a restructuring of the assumption into three different groups. One -- the first group is your first year of service because there's typically high turnover in the first year of service. The second is from one to four years of service, so that's before the employee would become vested. And then five plus years of service which is after they become vested. So the chart on the bottom of this page shows the actual number of terminations in each of those categories, and a total. So during our five-year experience study period there were 649 terminations of employment. Under the current assumption we would have expected 651. So that's pretty close. But if you look at the individual service ranges, it's very different. In the first year of service, the current assumption only expected 22 terminations and there were actually 101, the second, 138 and there were 250, and 538. So if you go all the way to the second column, which is labeled current A/E ratio. A/E is actual divided by expected. So there were 4.5 actual terminations for every termination expected in the first year of service, 1.8 and 3.6 for the other groups. So our recommendation, we don't actually significantly change the total number of terminations expected. But we are restructuring them to match the pattern based on service much more closely.

>> This is a pattern that's typical amongst public sector plans nationwide.

>> And bill how does that affect liabilities and normal cost?

>> Let me go to that after I go through the refund piece as well. Here's -- you will find in the report a whole series of charts like this. This is how we did the analysis on individual assumptions. We can go through a number of them but I wanted to have one here to talk through how to read the chart and what it means. So when this is examining termination rates for those with five or more years of service. And at the bottom of the graph you see age groupings. Five-year age groupings, 25 to 29, all the way up to 50 to 54. The black dots represent the actual rate of termination we saw in the experience study. So for 25 to 29, we're seeing a rate around just under 5%. The red line represents the current assumed rate. And the green line represents our recommended rate. The gray bars are a statistical calculation based on the number of terminations we saw, and the number of people who could have terminated in that age group. And it shows what's called the 90% confidence interval. And what that means is, there's a -- we can say with 90% confidence that the actual rate of termination for that group during that

period of time falls within that gray bar. And what that really means is, if you have very little data, we will have a very wide gray bar which means we may not want to move the assumption because we don't really have credible data. But if you have narrow bars, then that means you have credibility in your data, and may want to change your assumption in general there are a number of factors to consider. But in general, we try and keep the assumption within those gray bars. And if it's outside those gray bars, we recommend a change, moving to fall within those gray bars or near those gray bars. Any questions on how to read the chart? We have, on the right-hand side, there are sample rates of the current and recommended assumption. And the actual-to-expected ratios are shown at the bottom of the chart. So here's the chart for refund rate. So once a member terminates, as I said, they have a chance of either taking their account balance with interest or waiting and getting their retirement benefit. And what we saw is, among the group with five or more years of service, they obviously have more vested in the -- well, they have a vested interest in the system, and potentially more valuable benefits, if they wait and receive the benefit at retirement, compared to taking their account balance. So we saw much lower refund rates for this group than previously assumed. And particularly, for those close to retirement. People close to retirement, if they take their account balance, depending on their number of years of service, they may be giving up a substantial benefit. So they're not likely to do that. So we're recommending a significant reduction in those refund rates for those with five or more years of service. The combination of effects is a significant increase in cost.

>> Is this analysis just based on the last year of data or several years?

>> Last five years of data.

>> Okay, thank you.

>> So that the effect of these two changes would be to increase the City's cost by about 1.8% of payroll. And I think it's largely being leveraged by the refund rate for older, long-service people, and their expected termination rates. So the prior assumptions had many more of those people terminating employment and taking their account balance than the recommended assumption.

>> And 1.8 is roughly $5 million.

>> So this is by far the most significant demographic change we're recommending.

>> Now, the actuary's favorite topic, mortality.

>> Mollie Dent: Could I just ask a quick question? When you talk about city cost do you mean overall cost, I mean isn't this part of normal cost or -- if you could just clarify that when you are going forward if you are using the term city cost.

>> When I use city cost, I mean the combination of their normal cost rate and their UAL rate. So looking at mortality, there are a couple of things I want to point out. First, if you look at the active employees, and the disabled retirees, there are very few actual deaths. So our data is very marginally credible, to explicitly set an assumption for those groups. So what we typically do is, use a standard mortality table, and adjust it to the experience of your group. And in this case, for the active employees, what we've done is use the same mortality table for the healthy retirees and beneficiaries, but using obviously the ages that apply to active employees. So most of the analysis focuses on the healthy annuitant group. And their -- with the mortality assumption, one of the key things we look at is that actual-to-expected ratio. And normally we want an actual-to-expected ratio that's greater than 100% in order to anticipate future improvements in mortality. There have been -- there are there is a long history of improvements in mortality. And most of the actuarial literature indicates an expectation that that would -- that would continue at some level. We're looking at our actual experience today and over the past five years, but we're using this assumption to project mortality very far into the future. So it's typical to have an assumption with an actual-to-expected ratio that's greater than 100% to anticipate that. And the last study that was done by the prior actuary, the assumption they were using had an actual-to-expected ratio of 110 to 115%, which is kind of in a normal-target range. But notice in this example, it's dropped down to 101 or 103% and that's really with very -- you know they did that a year ago, so it's one additional year of experience, and chopping off a year or two on the other end. So we -- we were a little surprised to see that big of a shift in that little change in data. And so our recommendation is for some additional improvement in mortality, but we're not going all the way

to the 110 to 115% ratio until we see if this change was something that's going to be sustained, or an abnormality.

>> Edward Overton: In the past, Bill, we've used specific mortality tables.

>> Yes.

>> Edward Overton: Are you substituting the Cal PERS experience for those prior mortality tables?

>> Let me first address the healthy retirees and actives. The prior table was based on what's called the 94 group annuity mortality table with some adjustments. We've recommended a change to the RP 2000 table which is a little newer table but also with some adjustments, we've projected it forward 15 years, and set it back two years. So those adjustments reducing mortality from what was in the 2000 table. On the disabled annuitants, we have so little experience, the prior assumption was based on the 1981 mortality table. A national mortality table. And it had actual to expected ratios of 74 and 61%. And I believe the actual to expected ratios were also low, in the prior study. And so we're recommending moving to a more updated table, and we recommended using the Cal PERS ordinary disability table, as being probably a large study more representative of your population.

>> Edward Overton: Okay, could you enunciate that table in your report?

>> It is in the full report. It is not in the PowerPoint.

>> Matt Loesch: It is in the report.

>> Edward Overton: It is in there?

>> Matt Loesch: Yes.

>> Edward Overton: Okay.

>> Any questions on the mortality?

>> Yeah, I had a question. You had mentioned that the prior study, that the prior actuary, undertook actual expected rate of 110 to 115. Were you able to look at individual years and compare, or was information they provided just a total so you couldn't really tell?

>> Right. We just had the report they had. So it's just a total.

>> But you couldn't tell where there were differences?

>> Right.

>> Matt Loesch: Okay, it seems like you've kind of gotten through your slides, would you agree? In yes.

>> And I just want to make sure my notes are consistent with yours. I've identified three things you wanted us to provide enhanced data on. One is the capital market data that we're relying upon. That was asked for by asset class and the correlations and the like. And then the wage growth More data on wage growth locally vs. national and then to provide cost impacts, based on more relevant information what's happened to payroll and put them in dollar amounts.

>> Matt Loesch: Overall, my comments, just a couple of things. We've been switching and trying to present to the city a dollar rate as far as understanding what the contributions are going to be because of the declining payroll issues and what the implications of listing a payroll -- percent of pay versus a dollar amount. I would like, and depending on what the overall board would like, because they are essentially meaningless, because it's depending on another variable that we're not in control of and don't understand. Instead of this listing, let's list them all as dollar amounts. Because if all the charts are going to be updated and having them listed as dollar

amounts as opposed to percents of pay, understanding that some things may happen, more meaningful what the consequence is but also what the dollars really end up being, as a percent of payroll going up and down, I personally think if we are presenting dollar amounts at the end, we should be consistent as we go through.

>> Arn Andrews: I add, we still need both. For purposes of our discussion, yes.

>> Matt Loesch: They can turn it into anything they want, care baskets, doesn't matter to me. But for me, we need to have it in dollar amounts. Fit ends up being percent of pay, that would be one thing, that would be one major thing. Where does any of thee changes, one of the things that was presented us over last time as compared to other times, compared to the Rotor study that was put out that shows how the plans compare to each other in California, there's 40 of them and initially we're at number 40, and because of some changes we've made according to Mr. Rotor we've moved up to 34ish or 33ish. Most of these what could this --

>> We could use a whole other presentation on the basis --

>> Matt Loesch: Was that a useless perspective?

>> That was extremely extremely, we take great exception to it.

>> Matt Loesch: That's interesting to note because that was one of the things that was presented to us in the past, a way to think of how we're doing compared to other plans.

>> I can tell you if you move in the direction that we're proposing here today you're well ahead of the pace of some other funds. I don't know, you've recognized that Cal PERS recently was looking to lower its discount rate and at the tail end of that discussion the board declined to do so.

>> Matt Loesch: Okay.

>> Just question of curiosity. Has the same been done for Police and Fire?

>> Russell Crosby: Not yet. We're just in the contracting stages for them for Plaintiff. Police and Fire is transitioning. We tried to do a contract with a different firm, that didn't work and so we're to Cheiron and Cheiron is going to be doing Police and Fire as well but we're just in the contracting phase with them.

>> Carmen Racy-Choy: So to tie in though, you can expect the very similar analysis to be made for Police and Fire and very similar rationale and recommendation to be presented there, I mean if that's your question.

>> Russell Crosby: At least on economics, the demographics, there's a whole different set of issues in that plan. But on an economic analysis I got to believe they're going to come out pretty much the same.

>> Matt Loesch: In reading through the report there's -- this is -- it's very detailed. In the report itself, I mean, it's hard when you look at just the presentation to really get the grasp of all the details that you went through. What I really tried to go through and understand, essentially you're making 17 separate recommendations. And I think in the past we've made decisions, without necessarily knowing the effect of every decision. And I think for me, I would need to know the net effect of each one of those 17 recommendations. Now, some of them are you recommend no change. So obviously the net effect would be zero. But I think there are literally -- I'm sure you know there are 17 there because you wrote them all. We need to be specific as to what those are. Obviously some have more bearing than others, but all of them have some effect and if some of them have a cumulative effect, mortality tables, I'm not saying that's a big deal but assuming that one is but it might have a large effect if it's $5 million extra that needs to be contributed we need to understand that before we make decisions. So I'd like to explicitly, when we come back, have detail on each of the 17 representations you're making and the effect that it would have.

>> Could we categorize them so the that we have --

>> Matt Loesch: We can certainly categorize them but we need to know detail-wise what they are going to be.

>> Like the termination, we have the termination assumption, but like retirement, we have separate assumptions for under 30 years and over 30 years. You want to see that broken out or --

>> Matt Loesch: I would yes.

>> Or together?

>> Matt Loesch: I would yes. Because they're separate recommendations. Even though it's minuscule, I would like to know what the effect is of that decision.

>> Mollie Dent: I would just like to bring something up for you to think about in terms of the rate versus the dollar issue. And that is, the need to look also at impact on employees, too, and that will be a rate. So I understand the desire to look at the dollar amount on that. On the city side. But you may want to also be looking at impacts on all of your stakeholders. So --

>> Russell Crosby: I think Matt's asking for all of the analysis on each one of the elements. That would include both the employees and the city element.

>> Matt Loesch: Absolutely. Absolutely.

>> That's what I wanted to clarify.

>> That last comment, I'm not sure we heard it, for the employee --

>> Russell Crosby: It's to have the breakout between the city and the employee and the analysis that Matt has requested both on the employee cost and the city cost.

>> But would the employee cost be more relevant in terms of percent of their pay because that's how they contribute it city being dollars?

>> Matt Loesch: If the city contribution goes down 10% does it change? Because you're in the end looking for a dollar contribution yes?

>> Carmen Racy-Choy: Not the employees.

>> Do you want the aggregate impact of all employee?

>> Matt Loesch: $100 million is going to be split 8-3 at the current formulation, right?

>> Carmen Racy-Choy: The decision the board took was to change only the city's contribution to a dollar amount. So the employee contribution is still a percent of pay. And that was just I believe to ease the City's finance --

>> Mollie Dent: Well, that's the way the employee contribution rates are currently set.

>> Russell Crosby: Correct, yeah.

>> Mollie Dent: I think we do need to be clear about that. So that in order to look at the impact on employees, it would -- it would be at a percentage level. It would not --

>> Matt Loesch: And that's legitimate. But that comes from the dollar amount normal cost.

>> Russell Crosby: If you can do it both ways that is going to be helpful for our situation.

>> I had a question. I don't know your availability but when do you want this brought back to the board, at the time next meeting?

>> Russell Crosby: Well, they -- I can't do the next meeting. So next meeting is out. We'll have to either do it in July in a special meeting or in August at our normal. This doesn't -- these things don't need to be decided until sometime in the fall. We're trying to get a jump on it this year to get the discussion going, to give people plenty of time to understand and to think about it. But the real decision point is probably October or November. Somewhere along in there.

>> Another reason you don't want to do it in June is because we want to know by fiscal year end where your returns have been as well as payroll.

>> Russell Crosby: And we'll only be shipping that next data increment on what actually happened to the population with retirements and salaries and all of that stuff, won't occur, that snapshot won't occur until June 30th, and it takes us some time to clean up the data and get it all done and out the door. And I think we're talking about the third week in July.

>> July 3rd roughly to get the data.

>> Russell Crosby: To get the transmission from us to Cheiron on this year's data.

>> I know this won't be completed by then but some of these will have an impact on OPEB, the employee contribution to health care. There could be substantial changes there also.

>> This might be a question more for Carmen. But if we agree to lower the investment return assumption, does that then imply that we would want to revisit our asset allocation?

>> Carmen Racy-Choy: I think you should revisit the asset allocation independent of the discount rate decision. Meaning the purpose of the investment program is to make sure we're earning the most money, given the risk level that the board is comfortable for. And I think for that reason, we noticed to revisit the ALM. So I know there's relationship between the two. But the reality is, once you set your risk tolerance then you need to make sure the investment program is capturing the maximum return. And what number you're comfortable with with respect to the discount rate will follow. So --

>> We could not -- we emphatically agree with that comment. It's not something that -- Matt your comment about chicken and the egg. Elsewhere we see so many times where the investment folks will alter their allocation based on the investment rate. We don't think that makes sense.

>> Carmen Racy-Choy: To answer further we need to revisit the ALM because the market is constantly moving and we need to make sure we're maximizing the return on the plan at a level of risk that the board is comfortable with. That's why we revisit the ALM. Not because the actuary is recommending changes to the discount rate.

>> Matt Loesch: Okay. Any other questions? Are we clear about what we're requesting back? Seems like the first chance would be the third week in August.

>> And I'll summarize for you the capital market data. Wage growth locally vs. national hi. Provide cost in both dollars and percentages for both city and member. Summarize each of the 17 recommendations and each of their impacts. And look at the impact any of these assumptions have on OPEB.

>> Matt Loesch: That work? Great. We're going to take a quick ten-minute break and I think we're done with the actuaries, right? [Recess]

>> Matt Loesch: Okay, we are moving forward now with 5.1A andB. And then 5.2. Just for clarification for me, we probably should have done this through orders of the day. If I could get clarification from the attorneys. Ms. Dent, hello, hello, 5.1 is listed as the performance report. We're obviously not looking at the performance report

before us specifically but it should right something other than that light the private markets performance review which is what the issue is titled. It's listed as the performance report.

>> Carmen Racy-Choy: I think there's two issues listed, one is the private equity component and the real estate component. Really it should say performance as opposed to performance report and the second piece is the going forward investment plan.

>> Matt Loesch: Right but the implication of performance report, it's our usual quarter report performance plan. We're aiming to get it for today but it's not here yet. I just want to be clear that's not an issue but we're going to proceed --

>> Mollie Dent: No, it's a performance report on this particular allocation, I think that's clear.

>> Matt Loesch: Just want to make sure. If you could just make introductions. This is the first time we're going to have Mikita here. We'll have introductions for the board, we'll pace it similar to what we did the performance stuff. If you could make introductions, tell us who Mikita is.

>> Sure, good morning. Thank you for having us. You know, as Matt said we didn't have the opportunity to meet all the trustees yet. I'm Laura Weirick, I'm a general consultant with Mikita investment group. Because of the bulk of the investment items we're going to be discussing deal with private investments markets, I have here Steve McCourt, one of the owners and, Jess downer, who is a specialist, specializing within private equity and real estate within our market group. I'll turn it over to Steve for a discussion on private markets.

>> Lara Druyan: Before you start, just a quick question, how long has this program been in place, so I mean because there's a huge J-curve at the beginning, you know just in terms of committed capital versus distribution. It would be helpful to know how long it's been in place.

>> We'll be looking at that data through this report. The first private equity commitment was made in 2004.

>> Lara Druyan: Okay, so seven years ago.

>> Yes. So as Carmen alluded to, there are reports we're going to be going through, general market review, a general review of your commitments and equity in real estate areas. And in going through this I'll provide you with an update on the current state of the private equity and real estate markets more broadly, and then comment on your current investments within those -- within those markets. The second document we have is a commitment pacing model which demonstrates based on several assumptions that I'll explain in going through the model how much the fund needs to commit to private equity or real estate strategies to achieve its target allocations to each over time. And those commitment amounts will vary somewhat depending on the specific strategies that the fund chooses to employ. First, let me just say a couple of remarks on the current role that private equity and real estate play within the overall fund. And this is obviously being presented today largely because, in the next 12 to 18 months, we'll be working with staff to further refine the roles of private equity and real estate within your portfolio. And as I'll explain as we go through this report we're at a stage now where the fund needs to begin thinking about committing assets to additional funds. Even just to maintain the current target allocations that you currently have. Presently, the fund has a target allocation to private equity of 6% of its investments. And a target allocation to real estate of 5%. So in total, an 11% target. As we sit here presently, roughly both programs are near the target allocations. Both are roughly 1% beneath the targets of actual fair market value of assets. Private equity is a broad asset class that incorporates a variety of investment strategies, and we'll go through in a moment your fund's allocation to each. But the three primary strategies that are incorporated within the definition of private equity are what are termed buy-out strategies, venture capital strategies, and distressed debt strategies or mezzanine debt strategies. Buy-out strategies involve purchasing profitable companies with using leverage in the transaction, making typically operational changes to the companies, to sell them back to the marketplace in a period of five to seven years at a profit. Venture capital, which I'm guessing most of you are quite familiar with, being this sort of the worldwide home of venture, entails providing capital to start-up businesses, that generally do not have meaningful earnings and in some cases revenue in anticipation of significant gains over the longer term, as those businesses become successful. And the third category, big category within private equity relates to debt oriented investments which can take the form of mezzanine debt strategies and also distressed debt

strategies. Your fund is actually invested in some of these in other asset categories in your asset allocation but it's also a meaningful component of how most people define private equity.

>> Well you just made a very good point. And that is, we have other private equity outside of what you're going to discuss today. And I think at some point we need to sort of consolidate the picture for us as opposed to maintaining these separate allocations outside.

>> In terms of a current market overview, I'll start with private equity and then we'll go into your private equity program specifically. The health of the private equity industry presently has roughly mirrored that of the public capital markets and the broader economy over the last three or four years. Private equity owned businesses have been at a state of meaningful rebound since the global financial crisis in 2008-2009. As a consequence, the valuations of private businesses have increased meaningfully over the last 18 to 24 months. As have the valuations of public companies, as well. Further, the activity in the private equity area has increased quite significantly. Mergers and acquisitions activity. And as a consequence, realizations in sales of private businesses have picked up meaningfully, which generally means that in private equity portfolios like yours, distributions of cash coming back to the funds increases. We've also seen more recently, a meaningful pickup in activity in the venture capital area, largely surrounding social media. You may be aware that today, linked in had an IPO that was initially priced at 45 -- well initially at $30 a share up last week to $45 a share and is presently trading on its first day on the NASDAQ at over $100 a share. So there's been a huge increase in valuation of social media companies with rumored transactions on Facebook nearing $100 billion and other social media businesses like Zanga or groupon close to $10 billion. So that has caused as a consequence values of venture capital owned businesses to increase as there's an instinct to mark up other businesses that compete with those businesses as well. And in the debt area, after most of 2008 and 2009, where debt investors were paid handsome sums of money to provide what in essence was rescue financing to businesses, the credit markets have come back quite meaningfully since last year and we are starting to see the private loans being refinanced through the public markets at much more cheap rates. So the opportunities going forward in the private markets are diminished vis-a-vis where they were a year to year and a half ago. That being said, we still see lots of opportunity in the both distressed and mezzanine debt areas broadly. Before I move on to your portfolio in particular, are there any

questions that people have on the industry more broadly or private equity as an asset class generally? Great. If you start on page 1, titled introduction, in the document we have a table on this page that just shows the aggregate private equity statistics for the program. As I mentioned, initially, the first commitments in this program started in the year 2004, and I'll go through each of those in more detail.

>> Matt Loesch: Steve, I'm just going to be -- let me interrupt a bit. There's a number in the middle of the book, you have section page numbers on the far right, and there's multiple page 1, but in this case we have 5 of 105, people are going to look for 1 and look for the wrong one. Sorry.

>> So either page 5 or page 1. We're nothing if not confusing. Since 2004, the fund has committed to five partnerships. And after translating the foreign currency part of that commitment, your commitment in dollar amounts in aggregate has been $135.6 million. Of that, $88 million has been called, $6.4 million has been distributed back to you. And the remaining value of the invested assets in the portfolio is $80.9 million. That results in roughly an internal rate of return that's flat since 2004. I'll note that this data is through September 30th, so it's a pretty large lag on this private equity data. The reason which you'll see in a moment is that so far, the vast majority of commitments that this fund has made into private equity has been made through a fund to funds which is a structure where you engage a manager to invest in underlying partnerships. Those commitments are made over a period of three to five years. The partnerships in turn make investments in three to five years in private companies. And to aggregate up to the fund to funds level, the valuations and to have those valuations audited by outside parties, typically takes four to five months, if not longer. So with fund to fund investments, there's a meaningful lag in the valuations that we can report to you. I will note that since 9/30 there has been a meaningful increase in the valuations of most private equity partnerships.

>> And are these marked to market only when there's a transaction, is that only how the revaluation is done?

>> The valuations are done a little different, depending on what sector of the private equity place we're referring to. Ultimately the valuation methodology is determined by the general partner or the asset manager of the partnership. And once a year that valuation methodology is audited by an outside auditing firm. And the valuations

ultimately need to abide by Fasma 57 regulations which requires that the manager support the valuation as a fair market value. Now, what that generally means in the buy-out sector, is that the valuation is based on comparables in the marketplace of recent transactions. So it's not required that the company have a recent financial event, where it was priced. But you could price the company based on how similar competitors were priced in recent transactions or multiples of EBITDA or some other financial metric. In the venture capital industry valuation is a little more difficult because you generally don't have a lot of financial data points to judge. So auditing firms I think are stretched more to determine what a fair and reasonable FASMA 57 valuation is. And as a consequence, you typically see in the case of businesses that don't have good either public or private market comparables, fairly conservative valuations at most times. In the mezzanine debt area, you generally see FASMA 57 valuations being based on the viability of debt payments being made over time. So generally if there's not a meaningful likelihood that debt payments are going to be missed or delayed you won't see that asset being marked down. So every sector has a subtly different way of getting at the fair market value. But overlaying all of it is a third party auditing firm that's required to provide a FASMA 157 valuation on the fund. And one note --

>> Lara Druyan: In venture capital it used to be exactly as you described, it was a financing event and that's the only time the valuations changed. Most of the big funds that audit funds no longer find that acceptable. They have put a big pressure on the GP in other ways of proofing value so it has gotten more conservative over time.

>> In terms of timing, FASMA 157 valuations are done once per year, in the vast majorities of times, are not independently audited. Okay, I'm going to skip to page 12 of 105. And I'm just going to review the overall structure and diversification of your current private equity portfolio which represents 5% of your entire fund. The pie chart open the upper left-hand corner shows the diversification by investment strategy and this breakout is based on the fair market value of your assets as of September 30th. And also, looks through your fund to fund investments to define the strategies of the underlying investments that those fund to fund investments make. The funds overall, private equity portfolio is distributed roughly 62% to buyout strategies, 21% to venture capital, 6% to private debt and 5.4% to special situations and other, which are typically categories set up to catch strategies that don't fall neatly into venture capital or buyout or private debt. These categories, these ratios roughly match what the marketplace for opportunities is. With one modest exception, to date your allocation to venture capital is

probably about double what the market weight is to venture capital. And that's just been a function of where the fund to funds have allocated capital on your behalf over the last several years. The pie chart on the right shows diversification by vintage year. Let me explain what vintage year means before we interpret the figures. The vintage year is when a closed end fund is raised and capital is started to be deployed. It's important because up like the public markets where funds are typically persistently vested and you're able to move your money in and out of market strategies at will, private equity visits are typically made through closed end structures that have contracted time frames of ten to 15 years. As a consequence when you commit capital to a private equity vehicle you're generally exposed to one market cycle. And if you want to be diversified across market cycles the only way to do so is to make investments over a series of vintage years, to make sure you're not fully exposed either one very strong or one very weak market cycle. So the pie chart on the far right-hand side shows vintage year, since 2004, the fund's commitments have been made in a very diversified way, with equal allocation to funds mate in 05, '06, '07 and '08. I'll note here that you have some very small allocation to funds that were formed in 2000 -- before 2004 before you made your first commitment. The reason for that is you have one investment in what's called a secondary fund, I'll explain that in a moment. But secondary funds is those that buy partnership interests off of others and many of those were raised prior to 2004. So in aggregate since this fund was raised it's been well diversified and deployed across vintage years. Page 13 shows the aggregate structure, manager structure of the program. As I mentioned the vast majority of capital has been deployed through fund to funds. And the bubbles on the right side of this chart show the names of the fund to funds and the commitment amounts. I'll describe each in a little bit of detail. Pathway was a custom fund to funds that your fund committed $40 million to in 2002. By custom what I mean is that your fund is the sole limited partner in the fund that pathway runs. So your money there isn't commingled directly with others. And that fund is now fully invested or fully committed to underlying partnerships. In 2006, this fund committed to two Pantheon fund to funds. A global fund that incorporated partnerships that were raised outside the U.S. And a U.S. fund to funds that incorporated funds inside the U.S. Those commitment amounts were $40 million and $10 million respectively. And then in 2008, the -- your fund committed $7.9 million euro to a secondary fund and a secondary fund in which one in which partners purchases, typically portfolios of partnerships from other private equity investors that are looking to shed their interest in private equity. Most commonly these investors you're buying private equity partnerships from are large banking institutions, for regulatory reasons, particularly after financial crises like we have had, are forced to liquidate their more illiquid positions to make capital requirements set by the governments. So in total, $100 million in fund to funds commitments have been made, and this fund made one small commitment to a buy-out fund in 2008, great hill 4, that was a $5 million commitment. Page 15 shows some additional diversification criteria that I didn't discuss yet. The pie chart on the top right of this page shows diversification by geography. Your program to date has roughly 72% of its investments in the U.S. 25% in Western Europe. And about 4% in southeast Asia and other areas. Again, reflecting my comments previously, these ratios roughly reflect the opportunity set of private equity globally. And relative to your broader retirement plan, probably is a little more focused on the U.S., largely because the U.S. private equity market is more developed than that of Western Europe or the emerging markets.

>> Do you have a look-through that provides more of a breakdown of mega-cap versus middle market versus growth equity? So we know how much of it -- I've looked at this so I know how much of it but you need to look through it for us and show everyone that we've largely got a domestic buyout.

>> Lara Druyan: Large cap buyout.

>> Portfolio and very little exposure to what I see, anyway, as small to middle market growth equity China, I mean, a lot of areas that I see missing. So I think if you could provide that look-through for us that would be helpful.

>> Yeah, we will certainly do so and we have access to that information. The fund certainly has a very high allocation to larger market buyout funds. That's -- a lot of that is driven by the pathway investment that was focused seemingly disproportionately on large and mega-cap commitments. The other thing I'd remarked though is while the allocation to emerging markets or China, specifically, is fairly low, that's also reflective of the opportunity set during those years that the plan was committing its capital. As we sit here today there's a lot more opportunity to allocate capital in the emerging markets that be there was just three or four years ago. And we have an I-chart on page 16 here.

>> Lara Druyan: Yeah, the other thing is at least in my package, I don't have -- I have the underlying funds for the first pathway fund but I don't have the other ones. I don't know the breakout of the other names in the global secondary or at least I couldn't find it.

>> Yes, unfortunately the first version of this report we produced were much more detailed, but there's some nondisclosure agreements between the plan and these fund managers. So because there was going to become public information at the meeting, some of the managers requested we review their underlying holdings and that sort of thing.

>> Carmen Racy-Choy: Because you are the decision makers, we asked the attorneys if we could have a closed session so we could discuss that kind of information. And the attorney's opinion was that we could not hold a closed session to discuss the investment performance. We could only do it if there was a sale of one of these private equities. So this is the --

>> Lara Druyan: We can't back out what we've invested is what I'm hearing?

>> Mollie Dent: That's not what -- staff was told they could not have a closed session. They weren't told that they can't provide information to you confidentially. There are exceptions in the public records act for disclosing information related to written information related to some of these. So we could --

>> Russell Crosby: So we just send them a report and we can't discuss it, is that what you're saying?

>> Carmen Racy-Choy: At the moment we zip it in an e-mail, and send it, it becomes public information.

>> Mollie Dent: There are actually exceptions in the public records act.related to investments and private equity. We can look at those. But there aren't exceptions in the Brown Act about this.

>> Lara Druyan: I'm flying blind. We have $50 million for which I now know nothing.

>> Mollie Dent: If we know exactly what staff wants the board to send on in written format --

>> Russell Crosby: Then it can't be discussed is that what you're telling us?

>> Lara Druyan: It can't be discussed at all?

>> Russell Crosby: We send out a document that then can't be discussed anywhere?

>> Russell Richeda: We appreciate taking these complaints up with the state legislature not the message engineers. The Brown Act is what we're stuck with. We didn't write it. The only exception is if you wanted to create an ad hoc committee of less than a majority so a certain number of you could find out and discuss it at that committee meeting but the rest of you could not. It's a very, very unsatisfactory situation.

>> Lara Druyan: Yeah I mean I take my fiduciary responsibility here very seriously and this is an area that I have a lot of expertise and now I find out a huge percentage of it I have no idea what we've invested in. So whatever the solution is, I'd like to have one.

>> Mollie Dent: So I understand the request. So we can separately address the ability to get the information to the board. So if we know what the information is, that you want to provide to the board, we can tell staff that that information can be provided, in a nonpublic format. Written information. There's a different question, though, in terms of whether or not you can have a closed meeting to discuss that information.

>> Carmen Racy-Choy: The fact though ultimately this is going to drive the investment program. So what I'm trying to convey is yes, we can provide the information but ultimately the information needs to get to all the board members so they can understand the rationale behind the investment strategy.

>> Matt Loesch: Even if they voted yes on all of it, those of us who weren't there --

>> Mollie Dent: I'm not suggesting that it can't be provided to all the board members. There is an ability to provide information for certain data to all of the board members and not have that information become a public record.

>> Russell Richeda: The issue is discussion. Obviously --

>> Matt Loesch: Let me ask this clearly. We couldn't have a closed session to discuss what's in the investments, just and then as we come out of the closed session, explain what we discussed, not the details of the -- what the investments are, even if we disclosed that we're discussing this proprietary information, not that we're making decisions but that particularly we can't have that discussion?

>> Mollie Dent: The only exception a closed session, the only closed session exception relates to realities investment in the Brown Act.

>> Russell Richeda: There's the other one, purchase and sale.

>> Mollie Dent: Purchase and sale of real estate.

>> Russell Richeda: Private -- there is the other one.

>> Russell Crosby: This is purchase and selling of private assets.

>> Russell Richeda: We're not purchase being or selling anything Russell. If we were purchasing or selling any of these assets, that would be different. This is different. You don't want to play fast and loose with this.

>> Matt Loesch: How does Cal PERS deal with this?

>> Lara Druyan: Cal PERS has a program -- you would probably know more about this than I would Stuart, they have a fund to fund -- I don't know how they deal with Foya, a lot of people won't take funds from Cal PERS because of the FOYA issues.

>> This is hard and fast on the manager, can we do to the manager and say we want to modify the contract.

>> Russell Crosby: They're the managers.

>> The under lying GPs usually venture guys that don't want to --

>> Russell Richeda: I mean certainly for future purchases and sales in this area, you could condition your purchase on their willingness to have these -- the underlying investments be disclosed. Not whether they're going to handle that --

>> Mollie Dent: That's actually I think been asked for, in most of our dealings, and it's not possible.

>> Lara Druyan: Not for the best funds, because the best funds can choose who they take money from, and they're not going to be subject to Foya.

>> Can we simply refer to them as manager A and manager B and we will also have the documents of who manager A and B are, will that allow us to discuss them?

>> Mollie Dent: Well I think we probably, for that question, we do need to go back and look at the underlying agreements because then you're talking about whether or not you're meeting your obligation to --

>> You're discussing results but you're not discussing who they're from.

>> Lara Druyan: That's a good solution.

>> Matt Loesch: You were saying?

>> Mollie Dent: It's going to depend probably on whether or not it's very easy to go back and figure that out. I mean we'll take a look at it.

>> Russell Richeda: It's also not clear whether that really complies with the Brown Act. There would be a risk involved. Maybe the risk is worth taking.

>> So on page 16 we have a summary table of financial statistics on the overall program. With the five partnerships that you've committed capital to. And at the very top is the aggregated statistics. As I mentioned before, the net of fee IRR as of September 30th was essentially flat over this time period. And as one of the board members mentioned, given when these allocations were made, there still is a pretty meaningful J curve impact from this overall program because in the fund to funds, going into private equity through fund to funds results in a protracted J curve because the fund to funds take often three to five years to commit capital to underlying funds, which in turn take another three to five years to commit capital to underlying companies and for that entire time period, you're paying fees on commitments to both the underlying funds and to the fund to funds. So while you started committing capital in 2004, the performance still reflects a return that's in the J curve for you. Though while I don't have the statistics handy, my guess is that return is roughly the same as the public markets equity return over that time period.

>> Edward Overton: On the 2002 vintage year, do we still have outstanding commitments for that, or is it fully realized?

>> The 2004 --

>> Edward Overton: I thought you said earlier there was a pathway for 2002.

>> Pathway was 2004.

>> Edward Overton: Okay thank you.

>> And there still is in the pathway fund, unfunded commitments to funds that they've committed to.

>> Edward Overton: Okay.

>> The internal rate of returns for each of the five partnerships is listed there as well. They are all between negative 10% and positive 10%. And in the subsequent pages we go into some detail on each which I won't go through formally here unless people have questions. The performance of each is so far in their lives within the range of expectations that we would have for funds raised when these funds were raised. The secondary funds raised by partners in 2008 is the one fund that has produced meaningful positive performance through September 30th and our expectation is that will increase meaningfully as valuations are updated through December 31, then March 31. And that's a consequence of secondary funds gaining exposure to existing assets, which are as I mentioned at the beginning are being valued upwards quite rapidly in this market. So the one concluding remark I'd make on the private equity portfolio is, so far as you can see, the strategy that this fund has taken to get exposure to private equity has been through fund to funds vehicles. In our next document, a report we're going to review which is a commitment pacing model, we're going to talk about the logistics of committing additional capital to private equity. And this board will have a choice of doing so, either again through a fund to funds mechanism or by investing in partnerships directly. And we'll talk a built about the pros and cons of --

>> Can you take a couple of minutes and tell us what your process is for reviewing these managers' performance, their organizations? How well do you know these fund to funds groups?

>> Very well. And we know their underlying partnerships very well, also. The process we use is twofold. Because the retirement systems that we represent invest in private equity, in both through fund to funds and then through direct partnerships, as well. So our due diligence process relates to both diligence of the fund to funds managers

and diligence of their underlying funds. With respect to the diligence of the fund to funds managers, these are groups that we meet with quite regularly, at our offices, with the key personnel that are involved in committing assets to underlying partnerships. They disclose to us their processes for selecting underlying funds to commit to. We have access to all of their historical performance that they've produced. And the due diligence process also involves reference checks and quantitative performance analysis to identify risks that may not be presented to us through interviews with the groups themselves. At the underlying partnership level we also meet with between 500 and a thousand private equity managers at our offices. We have a staff of about 25 individuals that focus on private equity due diligence globally. So our effort is not only in the U.S. but also in Europe, Asia and Latin America. And so I'm happy to talk about any specific aspects of the due diligence process but it's quite thorough at both fund to funds and direct level.

>> Want to clarify, this doesn't change the fact that we know the groups very well but Mikita was not the retirement fund's consultant when each of these funds were hired.

>> Well I'm going to ask your opinion on each of these next so --

>> Matt Loesch: I think we're at that "next" stage.

>> We can go through them.

>> Matt Loesch: We're at the next stage before we go on.

>> We understand the performance.

>> Yes, in terms of our opinion of each, there's you know, I think probably two comments or types of comments we can make would reflect with respect to each of the managers, one relating to their businesses, their organizations, and their strategies more broadly, and then secondly, comments related to the performance that they've produced for your fund specifically under the mandate that they've been investing in, since most of these

are broad organizations that do lots of different things, in addition to the types of funds that your fund is investing in. I'll start with pathway, and there's detailed data on the pathway fund on page 20 in your packet. And as I mentioned, the pathway commitment was made in 2004. Part of our process of evaluating these groups is somewhat reverse-engineering the process that this group came to in engaging these managers since we were not around at that time and I don't believe any staff members were around at that time, as well. So most of the information we have with respect to what their strategy was mandated to be really comes from them, as opposed to objective sources. And to the best of our understanding, the pathway portfolio was intended to be a well diversified portfolio of partnerships that span the private equity marketplace. The performance of the pathway fund has been positive 1.2% since 2004. Relative to the median fund, and the Thompson 1 database, it's slightly below the median. So in the context of that benchmark, the performance is slightly disappointing. The one element I'd remark on with respect to that, however, is the Thompson 1 databases, includes predominantly private equity funds. And as I mentioned fund to funds have an added layer of fee and also commitment delay. So comparing it to funds that were raised in 2004 isn't quite an apples to apples benchmark because many of the underlying funds that pathway committed to were past 2004 and as you move closer to the global financial crisis the funds generally had a lower return, so far have had a low-returning --

>> How does it compare to all the hundreds of other funds of funds that are in your database?

>> About average.

>> Again, going forward, I think first off, I don't want to invest in average private equity partnerships. I want to invest in top quartile or top decile. Showing me the median doesn't -- I want to see the range and where the top and the bottom of that range is on a regular basis going forward because I think that's pretty important.

>> We can --

>> And I really don't want to see Thompson's data, I want to see your data.

>> Lara Druyan: Actually I'd like to see both.

>> We use Cambridge associates. But I think Thompson has just a lot of crap in it.

>> Lara Druyan: Yeah, Cambridge is by far the best, it's a standard.

>> We can show multiple benchmarks. There's generally not a large difference in the return of the various benchmarks. And it sounds like you're familiar with this for lack of precision at this meeting, it's a reasonable assumption that the top quartile funds are ten to 12 percentage points higher than the median.

>> Lara Druyan: Well and to Stuart's point and to the point you made on fund to funds, you are paying fees and fees in order to get truly top performance. And to get median performance at least to me in a fund to funds manager is really unacceptable.

>> The list of the commitments that pathways made is on page 21. So this as we mentioned is the one fund we were able to disclose the underlying commitments based on NDA requirements. As I mentioned because this is a fund to funds you actually -- pathway committed capital through multiple vintage year 2004 through 2007. I would say if there's any kind of theme to these commitments, as Mr. Odell mentioned before, the allocations are certainly tilted towards larger organizations, as you look down the page. And less of an allocation to smaller venture capital or growth equity managers. The next of your existing managers we'll talk about is pantheon which is on page 23.

>> Stuart Odell: Can you comment on the partnership at all and any changes there issues with the organization, anything we need to be aware of?

>> Given that this fund is -- I say the primary thing to be aware of is this fund is through its investment period. So the role of a fund to funds manager changes with time during the investment period. It is an active role of committing capital to underlying partnerships. After the investment period the roam of a fund to funds manager is

largely administrative in terms of monitoring the investments, and dealing with capital calls and distributions that come in. The one issue that we will work or we plan to work more with staff on related to this investment is the fee schedule which is 80 basis points of commitments, most fund to funds have a scaled down fee after the investment period is offer acknowledging that the workload involved diminishes quite a bit. So we'll be working to both verify that fee and also discussing with pathway other possible fee arrangements going forward. But no major concerns on the organization, in terms of an organizational score if you will, pathway you know we believe is a -- is a strong organization, very experienced in private equity area, and despite at this stage in the fund's life anyway of fairly mediocre performance with other funds that pathway's done they've done fairly well. And so as with many organizations there's sort of areas of success and areas of -- that they've not been as successful in, this happens to be one of those.

>> Stuart Odell: Have you drilled down with pathway on the underlying GPs and discussed where you think these GPs are ultimately likely to come out at? So you know, I mean the portfolio is at a basically at book. But, you know, have you sat down with oak and Carlyle et cetera and gone through each one of those partnerships, to figure out where we might end up on this ultimately?

>> Yeah, we do that separately from pathway, since we meet with all the underlying groups.

>> Stuart Odell: So what's the answer?

>> The answer is that in a FASMA 157, there's not a lot of secret information that provides direction as to whether these funds are likely to end up significantly above or below where they are today. So I would interpret the valuations, for this and not all but virtually all private equity partnerships as fairly realistic estimates of the value as of today, in the partnerships. There are not nearly as many, under the current accounting regime, not nearly as many areas where managers can either hide problems or be conservative with respect to the valuations that they -- that they show. And certainly, with these larger buy-out funds, where many of their investments are larger and either publicly traded or were publicly traded and taken private, the financial information on these companies is readily available and known to many people, including the auditor. So the valuations generally do represent a

reasonable, current assessment of the value in that company, predicting where the company goes from there is probably as difficult as predicting where stock market is going to go. Each of these companies and each of these partnerships has unique business strategies to grow, and those strategies could be successful or unsuccessful based on a multitude of factors that are very difficulty to predict. So I think the only thing we can say with certainty, with respect to the direction these partnerships are going, is the closer in time you get to the '06 and '07 funds the less written in stone the valuations are. And even though and I'll reiterate what I said before that even though this is a 2004 vintage fund there's still a lot of time in this fund for value to be created or destroyed. We're still in the J curve in this fund. Okay, the next manager review is pantheon. Pantheon is also a very large global fund to funds manager. And I'll make the same organizational comments I made with respect to pathway. With respect to pantheon's ability to do due diligence underlying partnerships, they are a very strong organization with lots of experience, professionals and lots of experience managing portfolios for different types of investors, and in pantheon's case those portfolios have both been U.S.-focused and internationally focused. And you've committed to both types. Pantheon has offices both in London and San Francisco are their two main offices. This fund, I would make sort of kinds of similar remarks as I've made on pathway. It's a primary fund to funds. It's even earlier in its life -- its began committing capital in 2006. The net IRR of the fund is negative 2.5%, which is slightly below the median of funds raised in 2006. It's slightly below median for two reasons. One is that it made commitments not just in 2006 but 2006, 2007, 2008, and 2009. And so there's an apples to apples issue in comparing fund to funds to primary partnerships in a specific vintage year. And also as a fund to funds you have an extra fee drag so a more amplified J curve in the primary years of the fund to funds. So subjectively I would interpret this performance as not great but not awful and I would also objectively still say this fund still has a long way to go before we know, before we can deem it a success or a failure.

>> Lara Druyan: Is pantheon getting one -- you don't list these, I assume it's 1% as typical by most fund to fund managers?

>> It sounds like we're not able to disclose the fee in this report.

>> Lara Druyan: Okay. That would be another thing that would be useful to know. I'd like to know if the risk and reward makes sense. Thanks.

>> Yeah, I think perhaps what we'll do is after this meeting, work with staff to figure out precisely what information we can and cannot provide. Both at meetings and outside of the meeting context.

>> Did you comment that they made new investments in 2008 and 2009 or they only follow-ons to investments committed to earlier?

>> They -- 2008 --

>> The reason I'm asking is did you bought something in 2008 or 2009 you should be seeing pretty good results from -- to now.

>> Remember these fund to funds are two steps removed from the company investment. They committed to funds in 2008 but that doesn't mean the funds vested in individual companies in 2008. A lot of those commitments to funds in 2008 have not been invested yet. They're still waiting to be called. So the -- there are certainly some investment in 2008 and 2009 but it's very small in this fund. The pantheon U.S.A. fund which is the sister fund to the global fund is on page 25. Identical comments here. Diversified, fund to funds, focused on the U.S. Very similar return profile so far during its life. And you know --

>> Lara Druyan: This is not a secondary fund as I understand it and the previous one was. Correct?

>> Correct. Yep. And this fund is as you would expect, from a sector perspective you know roughly reflects the market opportunity, 60% buyout, 20% venture. And 20% to other opportunities. And again, no concerns with the pantheon organization.

>> Lara Druyan: Has pantheon traditionally delivered top quartile returns? Are these funds -- or are these funds sort of outliers in the fact that they are underperforming the median you present?

>> If you look at pantheon's older funds that were raised, ten to 15 years ago, those have produced top quartile returns.

>> Venture?

>> Excuse me?

>> Because of venture capital in them? That's what 95 --

>> No, to the I don't think the venture allocation would have had a meaningful impact, largely because most of these larger fund to funds during those years of strong venture capital returns didn't allocate as much to the venture capital market as the venture capital market represented in the databases.

>> Lara Druyan: So what would be your opinion for the degrading performance potentially relative to where they have been before or what I view as degrading performance since they were top quartile and aren't today?

>> I wouldn't jump to the conclusion that it's degrading performance. It's -- it's -- it's possible that at this stage in pantheon's older funds, they also had IRRs that were not top quartile. So in the -- in particular --

>> Lara Druyan: That's not comforting to say no.

>> You're looking at funds that really take, realistically you're looking at ten to 12 years as a reasonable time to assess performance. And if you look statistically at how revolt early-year performance is in providing good information on where the fund's going to end up there's not a big information component there. So I would argue a lot of what you're looking at here is noise. And I'm sure that's what the manager would argue as well. The -- this

fund may very well have a lower return profile than the prior pantheon funds but I don't think we'll no that for certainty in the next five to six years.

>> Lara Druyan: I ask that because pantheon has been around for a fairly long time for a fund to funds and I'm wondering to one of Stuart's questions earlier have there been any senior partners leaving retires, has there been a change that would affect that?

>> Yeah, there has been. Pantheon as many large organizations have, has had both positive and negative turnover at the personnel level over the years. I don't think that has been as impactful to their business, however, as the other factor which impacts all these businesses which is the amount of capital that they're deploying at any point in time. When pantheon was investing capital in the 1990s they were deploying far less capital than they were in the middle 2000s and the amount of capital you have to deploy certainly can distort how you allocate that capital inside your fund vehicles. So I think to the extent that there's a change in strategy, or a -- any difference in their strategy attributable to the organization is probably not attributable to personnel changes or organizational ownership issues as much as it's simply informed by the fact that they're a much larger, broader, bigger company today, a different company today than they were ten to 15 years ago.

>> Edward Overton: Who say that performance might be affected by the amount of capital that's flow into the private equity area and driving down real, true opportunistic investments?

>> Yes. In the long run. Money flowing into private equity today has a very positive impact on the valuation of your private equity investments today. So we've seen valuations increase more steeply than valuation increases in the public markets over the last 18 to 24 months. And certainly, part of that is a function of money flowing into private equity which needs to be put to work, and therefore, the demand for buying private companies increases which increases the cost of private companies. Longer term like with any asset class the higher the price you pay for any asset, all else being equal the lower the longer expected return. So money being committed in the vintage year today, 2011, will have a more difficult time producing returns as high as private equity has done historically than money that was commit during vintage years where private equity allocations were smaller. Whether you

want to look at 2008 as an example or 2002, 2001. So there's like with every asset classes, a cyclical component. The one thing I do want to mention however is, private equity is not the only asset class that's attracting a lot of capital today. We've seen high yield bonds, we've seen the public stock markets, we've seen emerging markets, we've seen commodities, every risky asset class has been the focus of huge capital inflows over the last 12 months. So in terms of allocating capital across asset classes what's also important is the relative valuation, the relative opportunities of private equity versus those other asset classes. Relative to a public stock market that, you know, based on trailing ten-year data kind of smoothed earnings might be trading in the low 20s on a price to earnings ratio, the valuations in the private equity market look quite reasonable today. But when you look at valuations of private equity today versus where they were in the early 2000s they're certainly priced more expensively.

>> But there's one other big, fundamental difference between back then and today, and the use of leverage is fundamentally changing in the private equity world. And maybe it's come back a little bit recently. But a lot of those returns that were generated in that period of time were extremely high use of leverage. And I don't think you're seeing the same use of leverage today in these vehicles that we've seen in the past.

>> Yeah, I -- I agree. The -- if you look ten to 15 years ago, the average amount of debt in a buyout transaction was about 60% to 65%. Today, you're looking at about 50 to 60%. So there's a diminished amount of leverage. It's not nearly the step-down that we saw from the '80s to the '90s however. When the buyouts started in the 1980s you saw leverage in many cases up in the 90% range.

>> Well, maybe when the real estate guy talks next we'll hear unleveraging in real estate.

>> Lower leverage levels, and we would concur that going forward we think that the movement towards lower leverage levels in private equity transactions is partially permanent. Will reduce the long term return potential of private equity but it will also reduce the risk involved as well. So it's -- it may not affect the risk adjusted return of the asset class long term.

>> So question for Carmen then coming back to you. So implicitly, what are sort of the expected returns we are assuming for private equity in our plan?

>> Carmen Racy-Choy: Too high. Something, I don't recall the exact number, but typically private equity would be somewhere in the 8, 9% range return. Every year. So -- but any private equity program is going to have a J curve. And typically you wouldn't start necessarily seeing positive numbers till a few years that the program is in. Clearly this program is already from 2004 to today, that's already seven years. So I mean, we should be outside of the J curve. We should start seeing positive numbers. We haven't quite seen that. To a certain -- to a certain extent that's kind of where we start.

>> Arn Andrews: I would add one comment just following up on Stuart's earlier thought. You know, earlier in the year we put some of the distressed debt in the opportunistic bucket. Stuart's saying that there's fundamental change in private equity because of the lack of leverage. So should private equity still be an isolated asset class or should it be considered an opportunistic asset class because of the cyclical differences when there's opportunities or not? I would just invite staff, when you do come back to us with asset allocations, we might want to fundamentally rethink if private equity should be a stand alone asset allocation or if it's part of an opportunistic you know classification.

>> Carmen Racy-Choy: I mean that's food for thought. I think staff's approach has been opportunistic. Meaning since we took on we added a few investments. But we haven't necessarily been making a fixed dollar amount every year. So the reality is, I think we have considered it as an opportunistic, where if we have a plan, we're going to go try and implement it. However, if we find that the market is not receptive and this may not be a good investment we're going to come back and advise the board. Just because you ask staff and the consultant to deploy $50 million in a specific area, if when we do the legwork we find this is not a good idea, we're definitely going to circle back to the board and say, we think we should do something different. So --

>> And I think it's hard to be opportunistic in fund to funds.

>> Lara Druyan: It is.

>> Yeah there may be a little bit of differentiation you can do, but for the most part you're just buying the basket and they're doing the allocation and hopefully they're being a little bit opportunistic when they're making their underlying allocations. But I think if staff wants to be opportunistic they have to continue to think about a more of a direct access to underlying GPs that are focused on the strategies that they think make the most sense at that time.

>> Arn Andrews: Because so far this conversation doesn't seem to be encouraging.

>> Carmen Racy-Choy: I think the -- strategically the reason we've asked Mikita to come forward with two approaches, one using direct and one using fund to funds, I think there's a lot of value in venture capital to fund to funds. Typically everyone knows that in order to get top returns in that sector, you kind of need to be in the top five maybe big names. Pension plans traditionally have not had access to these top five names. So if strategically the purpose of getting a fund to fund should be to try and get access in venture capital to the big names to the extent that that allocation makes sense. In the other spaces does it make a lot of sense to do fund to funds? I'm not -- I'm not sure that I can strategically say, yeah, absolutely. There is value to be had.

>> Arn Andrews: And part of my thought is because of the high fee structure associated with this, this is where we really need to get alpha and if you're saying that because of the nature of who we're we will never have access to the better alpha opportunities it just makes me think we should think about whether or not it's worth paying for average opportunities.

>> Carmen Racy-Choy: Well a lot of the funds you see don't have venture capital in them. So I guess my point is fund to funds can potentially considered in the venture cap space, only to the extent that we find that we can't do direct investments with the big names. Then using a fund to fund structure makes a lot of sense to achieve the exposure. But in other spaces, I mean, maybe if you land on a really good fund to fund, it might be worthwhile. But as you can see, this is --

>> But I -- just one point to that, though. I think as you look particularly China and Asia, I mean China the private equity market is just Blossoming so quickly that trying to figure out how to do direct you can pick a couple of the big groups that have been around for a while. But it may be the better opportunities are more emerging. I think in that case you may have -- it may be hard for staff to source those, again, sorts of top quartile maybe only need to be a median manager in China.

>> Arn Andrews: I think our initial pie chart showed 3% exposure to Asia.

>> Basically nothing. CDH or something.

>> Lara Druyan: In the other space it makes sense to the last group that's doing very well, is the partners group in secondary space. And in secondary you obviously have to do fund to funds, and if you get into the right groups you can make good money doing it.

>> There's two other funds to discuss. Great hill and partners. Great hill is your one direct investment. It's a buyout firm you committed $5 million to in 2008. This one is still very early on in its life. Its return, not dissimilar to the fund to funds is slightly below median. So far in its life but my comment is identical, it's still very early on and I'm not sure there's a big information content so far in that return in and of itself. The final one is partners group which is a secondary fund, because they're buying some of what they're buying is mature partnership interest that have investing -- have existing investments, those existing investments have been written up recently through 9-30. As you'll see here you'll see additional writeups as of 12-30 and March 31. Though I'll note that secondary funds can work in the opposite direction too, if the public markets go down, if valuations go down generally, this fund will be marked down accordingly. And so the benefit you see can work both ways depending on the market opportunity. I will note as well, fund to funds is not the only way to get exposure to the secondary market. You can also, as an organization, purchase one-off funds from other investors in the secondary market. As another way to gain access to mature partnerships, in a less diversified way than what partners and other fund managers do.

>> And can you just talk a little bit about great hill partners? That is not a fund to funds, that's right, so a lot of capital is not called. So what's the organization like?

>> Great hill partners is a group that was new to us when we were asked to evaluate them. They're not a group that we've committed capital to historical. The fund's strategy primarily is to purchase companies that they perceive to be target acquisitions by large organizations. So from a strategic perspective, a macro perspective, you would -- you might say that today's market environment should be a pretty strong one for that strategy broadly given that corporate balance sheets are fairly flush with cash presently. The types of companies they buy are typically small or middle market companies with growth characteristics, positive cash flows, growing cash flows and the exit opportunities as I mentioned are typically strategic -- sales to strategic buyers in the marketplace.

>> Are we your only client who's invested in this?

>> Yes.

>> And presumably you guys have been around a long time. You must have known these guys existed, were they just not one you preferred, and you liked other groups better or -- and if so, why?

>> If -- if we were familiar with this group it was not one that was ever elevated to a point of strong interest within our organization.

>> Small buyout group based in Boston.

>> Yeah.

>> Isn't that where you guys are based?

>> We're based in Boston too.

>> Okay, I assume you're meeting with this manager now on a regular basis on our behalf?

>> We are. And again we're not familiar with the process that this fund went through to identify and select the manager. I spoke a bit about the performance of the partners fund and the structure of the fund as a secondary vehicle. I'll echo comments related to the organization. Partners is a Swiss company, very large, global, fairly stable organization. And so from an organizational standpoint there's nothing that we see that's a specific risk in terms of their stability, structure, ownership or senior talent at the organization. They, like all organizations, do have a decent amount of personnel turnover both positive and negative. But on the whole, their culture of allocating capital to funds is largely unchanged over the years. And a group that is well-known for doing strong due diligence on underlying partnerships. They like the other two also do both primary funds and fund to fund investing.

>> And back to Steve's earlier comment about not reading too much into earl early performance, if you had looked at this particular fund's performance just say six to nine months ago, you would have seen negative performance with funds. So these early vintage year funds can have pretty wild swings of performance in the first few years.

>> So I guess concluding on the private state of your equity portfolio, I -- it's still a portfolio that's relatively early in development. It is one that is very well diversified. If you judge diversification by the opportunity set that's presented to the private equity investor universe. And it is one that's largely directed through fund to funds vehicles. And going forward, will be --

>> Arn Andrews: Can I just interrupt one second? Do any of the other board members actually have the pacing studies?

>> No, huh-uh.

>> Arn Andrews: Okay, I was just curious, thank you.

>> Yeah, and I'm remembering now we're only halfway through the other reports. I need to switch back because we have real estate to discuss too. So any other questions on -- it's -- so I -- I'm sure we'll be back to this board fairly shortly, with some more concrete information related to both the current portfolio that you have in private equity, but also related to recommendations on how to approach the private equity market and its opportunities over the next -- over the next decade. Okay, I'm going to shift to the real estate program. And on page 41, we have the aggregate characteristics of the real estate program. You've committed to six partnerships. The net IRR, that's calculated -- that we calculate on the program is negative 6% so you're a little bit under -- underpar. As I'll talk about in a second. That's largely attributed to the timing on when you've made most of your investments in real estate as opposed to be execution of the managers per se. More -- much more so than private equity real estate as a private asset class was more heavily impacted by the global financial crisis and was more delayed in rebounding as well. If you turn to page 48, I'll review for you your investments in real estate so far. Unlike private equity, two of your major investments in real estate are in open-ended vehicles. So these are vehicles that don't have a specific contract term. You are able to put more money into them and take money out of them under certain conditions, at any point in time. Those are Prissa 1 which is a core U.S. real estate fund and American core realty which is a core U.S. real estate fund. Core properties by definition are those that are expected to receive most of their return through current income. You're typically looking at class A office properties and multifamily housing where vacancy rates are very low. And other sectors where not a lot of capital is required to improve or maintain the properties so income is generally your largest part of the return. And historically at least the income levels have been sort of 5 to 7% on core properties today on the low side of that range. Core represents between a half and two-thirds of your real estate allocation presently. The other part is in strategies that we and the market define as value-added. These are values that are more private equity like. They are strategies that require the manager to deploy capital into the properties to improve them to get them into a state to lease to the marketplace. And the managers that you've employed there are DRA, in two funds, GES at management in one fund and fidelity growth fund. On page 50 we show the diversification of the portfolio. The statistics, the aggregate statistics are a little more difficult to aggregate because we're combining both open ended and closed ended vehicles. I will describe how we did this a little bit. Because you don't commit to an open

ended vehicle, you invest capital directly in an open ended vehicle, the commitment pie in the top left side just includes your closed end vehicles which are 100% value-added by strategy. And the geography of this portfolio is 100% in the U.S. By strategy, and by the fair market value of the assets. About 55% is core properties and 45% value-added properties. That distinction is important because the risk factors that impact core and value-added properties are meaningfully different. A value-added investments are much more sensitive to economic down turns. Core properties tend to be more sensitive to interest rate changes because their cash flows are typically more certain. So not unlike the way you could think about a fixed income portfolio, core properties are sort of investment-grade and value-added are kind of below investment grade in the sense that the types of economic factors that impact them. By asset type, you're fairly well diversified across the major sectors of the real estate marketplace. Office, multifamily, retail and industrial. On page 51 you have a summary of the performance of the real estate portfolio. This is also a little bit mixing apples and oranges, since in a closed end fund framework the appropriate way to view performance is the internal rate of return or dollar rate of return. In an open ended framework because the manager does not have control over when they deploy capital for you the appropriate metric is a time weighted return. You can't incorporate both on the same table easily so here we use the IRR as a metric. And the notable negative returns on this page are from the GES as management value-add realty partners which has a net IRR of negative 33% and the fidelity real growth real estate fund which has an IRR of negative 31.7%. Both of those funds have the returns they do because they were raised at the time they were. Those returns are not unusual in relation to other value-added funds raised at the time. Both of these funds and many funds raised at that point in time are struggling with properties whose values are beneath the values of the loans on those properties and so you typically look at situations where the manager has to make decisions to write off the property or put more capital into it to support the loan. The core fund that was funded in 2007, the American core realty fund, has survived the global financial crisis better than the value-addeds strategies have as you would expect but it's still down 9% on an IRR basis so even core properties were damaged by the real estate downturn in 2008 and 9. With respect to the specific managers, on page 55 we have a summary page on American realty, American is a U.S. based real estate manager specializing in core properties and they're based in Los Angeles with offices in other major cities around the U.S. I'll make similar comments as I made to some of the private equity managers here. American is a very solid organization in terms of their strength of senior investment professionals as well as their stability. They've had funds in the past that have been very strong performing funds. On an absolute basis this fund is down 9% on an IRR basis. No the time weighted return mix is a more relevant indicator here. And that return is stronger than the pre-QUIN universe of real estate funds median IRR by about 8 percentage points. But there are some meaningful apples and oranges issues going on between comparing a core real estate fund to a universe of real estate funds that include value-added and opportunistic strategies as well. Relative to other core funds this particular fund is tracking slightly behind other core funds and it's doing so largely because it has a much lower level of leverage than most core funds. So the rebound in valuations that other core funds saw in 2009 and 2010 has been lower for American realty than other core real estate funds that we see. We do have here a list of the properties that American invested in, in subsequent pages if you're interested. It's a very diversified portfolio.

>> Arn Andrews: Sorry, just one general administrative comment. I don't know if the other board members care, or agree. But going forward, instead of sorting alpha by the name of the property can you sort alpha by state?

>> Yes.

>> Yes.

>> Arn Andrews: Thank you.

>> DRA, which is the ongoing effort of Dreyfuss realty associates is a value-added real estate manager that you've committed to two funds with. They're a very well regarded and historically strong manager in the value-added space. The first fund here, fund 5 that we show information for on page 61, is through its investment period. It is doing better than the median value-added fund in the preQUIN universe although its returns are still negative and it's distributed a meaningful amount of capital back to you as many of its investments were made prior to the global financial crisis and some liquidations prior to then as well. We don't have any concerns with the DRA organization. They are a manager who has a fund coming out to the marketplace with a fund that will have very limited capacity. As an existing limited partner you will have an opportunity to invest in their vehicle and we can work with staff to determine whether it's appropriate given the current parameters and strategy of your

program. But we think very highly of this organization. Pressa is a Prudential's real estate platform. The Pressa open ended real estate fund is one of the longest running institutional real estate funds in America. You made your investment in PRESSA in 2004. Since then the return has been 2.1%. Relative to the prequinn universe that's slightly below -- below the average over that time period. And relative to core funds that we see, this fund is about average compared to the other core real estate vehicles. I will note quite distinct from the private equity conversation or even value-added real estate conversation that we had related to the performance differential between top quartile and median performers, in core real estate there's not a huge distinction historically between the returns of top quartile managers and median managers. The return differential may be two to three percentage points as opposed to ten to 12 percentage points.

>> So would that mean that fees are similar for everyone or --

>> Fees are similar. The core real estate space is one where most of the managers are very large, employ similar strategies, similar levels of leverage. They mostly bid on the same properties when they come to market. There's not a lot of distinction between how the big five or six core managers allocate capital. I would -- I would summarize that the distinctions are at the margin as opposed to the core of their fundamental strategies.

>> One distinction that we did see over the last few years with core real estate strategies was really a fork in the marketplace between core managers that stuck exactly to the strategy that Steve described and others, that somewhat deviated from that, in taking on additional leverage in the portfolios, increasing allocations to value-added or opportunistic type investments on the margin within the portfolios. And the latter funds we saw in the last few years underperformed other core managers, whereas over the last 12 to 18 months they've outperformed due to the higher leverage. With respect to American and Pressa, they both fall into the category of managers that largely stuck to their strategies through the bubble in the real estate market.

>> So you said that pressa was sort of average for a core fund. Are the top -- the top core fund managers from that '04 vintage were they pursuing a little more value-add in that early period and is that how they got their returns up or is it they were buying core properties and they were just buying them at better prices or buying

better properties? Good yeah, there's only a couple levers you can pull to kind of make the returns meaningfully different than competitors, and you hit on one of them. Some core funds do allocate a portion of their capital to more value-added strategies, and if they did so at the appropriate time in the market cycle that added meaningful value to their returns. And the other is leverage. There are some core funds that employ more leverage at the right time. Pressa has been a very strongly performing core vehicle for 30 years. And so your experience with them is limited in the context of their program that goes back much farther. G.E. asset management's real estate partners is on page -- page 80. This is one of the closed end value added funds that was raised at the least propitious time you could have raised a value-added real estate fund. In 2006, further they deployed most of their capital before the global financial crisis hit and heavily leveraged highly priced opportunities. As a consequence their return is quite negative. Negative 33%. And that does include some properties that have been wholly written off. So unlike my comment on the private equity portfolio, where it would be very difficult to estimate the potential of returns going forward for a lot of the investments, with some of these real estate investments you can say with a fairly high degree of certainty, money that's been lost has been lost permanently. And this is one of those partnerships where there has been a permanent impairment of assets. And as a consequence in all likelihood this fund will have a negative return when it concludes, in addition to having a negative return today. G.E. fund was focused primarily or entirely in the U.S. but diversified by region. And the bulk of their investments were made in multifamily properties. 58% of the funds is invested there.

>> So in a fund like this I'm trying to think of alignment of interest of us and the manager. I mean kind of what, I mean how does this play out? I mean if they're incredibly far underwater, I mean, what's your perspective on this? And what might we do in a case like this?

>> Yeah. There are potential conflict of issues issues, with managers that have portfolios that are deep out of the money. And real estate projects that are like this one. This particular fund, when the global financial crisis hilt and it was clear there were permanent impairments on properties, staff was very proactive in working with the manager to reduce fees, and I'm not sure if Carmen wants to kind of discuss that issue. But one of the conflicts is obviously, the manager has an incentive, if they're paid on commitments, and paid on a commitment period, to make that commitment period last as long as possible. And from an investor's standpoint, if you know that assets

are permanently impaired, it doesn't make a whole lot of sense to pay fees on assets that have no value and never will have value. Some work was done there. I'll let Carmen kind of discuss that. The manager has the discretion as the manager to determine when they want to support a property that's struggling versus not. And when properties are valued at or below the amount of the loan the manager has the right typically in the case of a nonrecourse loan is simply give the property to the bank. And every manager makes a choice depending on a case-by-case situation and whether they believe that additional capital being put in the property will accrete to added value to the fund. And so that's always an ongoing issue, one that limited partners typically don't have a lot of control of because by contract you give that discretion to the asset managers but one that can also lead to a misalignment of interest at times.

>> Carmen Racy-Choy: I think the only additional comment that we can say really is, we've had manager meetings and obviously, the issue of fundamentally stated, the fees needed to be renegotiated and they acknowledged that their performance had been so sub-par that they were willing to renegotiate. And that's what we did. Having said that, the first time that I believe G.E. sent the representative was slightly inebriated in our first meeting. So --

>> Inebriated. You said --

>> Edward Overton: That's what I thought you said.

>> Carmen Racy-Choy: I'm not sure there was much more. Obviously the fees was our labor and hit on that front, and tried to have them reduce the fees and they agreed to a fee reduction.

>> For all LPs or just --

>> Carmen Racy-Choy: No for G.E, specifically this investment.

>> No but --

>> Carmen Racy-Choy: I think we've had efforts with other LPs but I mean --

>> No I mean did G.E. honor that to all their LPs or just to you?

>> I believe it was just the retirement system.

>> Not anymore. [Laughter]

>> If they were drunk enough maybe we could have gotten our capital back, too. [Laughter]

>> Matt Loesch: Do any of your other funds have this investment in their portfolio?

>> No, no, this was the --

>> Matt Loesch: I know this was pre-you. But --

>> This is the only fund that Mikita has that has this fund.

>> The investments are they G.E. in general pension fund and subsequent to this fund they will no longer be offering funds to institutional investors.

>> The DRA growth and income fund 6 is a 2007 vintage value-added fund. Identical comments on DRA obviously, they're a group that we think highly of. The performance, while it's early-on is much better than average for this fund. And I don't think there's, you know, much more relevant to say that I didn't say in my discussions on DRA 5. The final fund is the fidelity real estate's growth fund. This is another value-added fund raised in 2007 where a lot of capital was deployed before the global financial crisis, and some impairment has occurred, so the net IRR as of September 30th is negative 32% on this. There is a modest organizational change with this

group. They are spinning off from fidelity calling themselves long wharf realty going forward. And we'll be continuing to evaluate any impact that that has on them as an organization. At this point it does not appear to be meaningful. And the performance here is negative. I would echo comments that some of the properties here are probably impaired to the point where the likelihood of getting the cost value back is quite slim in them. So similar comments here as with G.E. asset management.

>> Is this a group that you know and have followed in the past or --

>> It's a group that we know, have followed but I've not allocated capital to in the past.

>> And one quick difference to point out here between the performance of fidelity and G.E. is that fidelity's deployed less than half of their commitment so far. So there's a much higher probability that they could turn this fund around versus G.E.'s fund.

>> Just a question. When you have a client that only has -- we're the only client in this particular fund with this manager, do you do the same level of due diligence on an ongoing basis when you only have one client in there and it's not a manager you typically recommend?

>> Yes. It's as soon as we have a client that has the manager, that manager gets put into our due diligence process just like all others that have been in there historically. Okay, so that's the current state of the private equity and real estate portfolios. The next presentation sounds like board members may not have in front of them.

>> Matt Loesch: I've not seen that, no, I don't believe it was in our packets.

>> Carmen Racy-Choy: We apologize. Staff I think is now printing copies of the facing studies. There is clearly no presentation that needs to be made but we'll provide hard copies today if you would like to see the facing studies.

>> Matt Loesch: What's the pleasure of the board, would you like to proceed with the presence, have the discussion now and still receive the hard copies, or would you like to hold off until June?

>> Personally, I'd like to hold off. I think first off we need to revisit asset allocation anyway as a board. So I mean this is probably based on some 5% target rate that you're trying to hit on the portfolio over time. So I'm not sure it's all that relevant to us right now. I would rather go back and kind of take it at the asset allocation level and then let's see where we come out. Maybe it's zero private equity, maybe it's half the portfolio. Obviously not.

>> Lara Druyan: I concur. I think it would be great to try to digest it before discussing it as opposed to having the discussion on the fly.

>> Matt Loesch: We'll postpone it then.

>> If I could make one or two comments related to it because it sounds like you will get the document. To maintain the current allocation, you should start thinking about committing additional capital in 2011. And the amount that you commit will be dependent on a lot of factors. But one of which is whether you choose to, in the future, exploit the opportunities in these two areas through fund to funds or through direct investment. In addition to the decision and conversation about the right allocation, the fund should have to private equity and real estate, important subsequent conversations need to be had with respect to whether or not the appropriate approach is fund to funds versus directs, and with either of those, what -- what sectors and characteristics out of the asset class does this board want to try to achieve? There's a lot of subtlety around building a portfolio that can lead to quite distinct characteristics from an investment standpoint.

>> Matt Loesch: All righty. Well we had a topic here on 5.2 as well. We're going to bypass 5.1 B or table it I should say. Do you want to talk about 5.2, that's a discussion action on Mikita group's recommendation regarding the short term investment in alternative investment allocation?

>> Carmen Racy-Choy: I'll make some comments. The purpose of this document was really just to allow discussion. As you may remember from past discussions, we're still unallocated to absolute return strategies. And we've allocated the private debt allocation of 5% to three managers. However, so far they have called only .5% of that entire allocation. So we have approximately just under 10% sitting in fixed income. During the ALM, I just wanted to provide background, why -- what were the options and why that decision was made. And I wanted to make sure that the board was comfortable in either continuing in that direction or seeing if they wanted to reconsider. There was really two approaches to allocate that 10%. One is to fundamentally maintain your asset allocation which means we have a target allocation of 49% to equities, 20% to fixed income, 10% to commodities and infrastructure. These are the liquid components of the asset allocation. So one thing that could be done is to take the 10% and allocate a little bit more than 5% to equities, a little bit more than 2% to fixed income, another 1% or so to commodities and infrastructure, in a way that maintains the target asset allocation. This would allow the plan to remain at the same risk level as in the ALM. The other approach is to do what the plan did, which is to park the amount in fixed income. The goal of that allocation would be to reduce slightly the risk level of the entire allocation. The issue there is obviously lack of diversification. However, you are parking the money in a lower goal asset class. So from a perspective of forward-looking where is the best place to put the money? Really nobody has a crystal ball. There's issues I think with what the equity performance could be. There's issues with the fixed income segment. So the question is really comes back to does it make sense if this is money that we're going to move into absolute return, and the private debt? Within probably a year, maybe a year and a half, does it make sense to put that money on the equity I'd? And I think this board took the decision that it did because they were uncomfortable with that component.

>> And that was in -- sorry in 2008? When did they make --

>> Carmen Racy-Choy: That was in 2010.

>> 2010?

>> Carmen Racy-Choy: Yes. The implementation of the U.S. asset allocation I believe happened in April 2010.

>> April or June.

>> Carmen Racy-Choy: So I guess the question to the board is we really want to open it is, do we maintain the approach? Is there any thoughts?

>> Arn Andrews: I appreciate you bringing there up because this is one of the conversations we had a while back, admitting the fact that we have an overweighting and if we continue to have the overweighting and we're not necessarily making the allocation we have to acknowledge the fact that we are choosing an asset class over another asset class. I mean, personally I think I like the concept that you mentioned of spreading to our current asset allocation but then we have to acknowledge the fact that we are going to be accepting different volatility through those different asset classes as opposed to theoretically a low volatility asset class in fixed income. However, I think you asked a question when we did this in 2010 and so far we've benefited greatly from our lack of implementation. But I don't know if that's going to go on indefinitely. So I think my personal thought process would, to try and figure out a spread method that would dampen volatility as much as possible but would still get something similar to the asset allocation that the plan is trying to implement.

>> What does Mikita think?

>> You said we were overallocated to fixed income right? So we underperformed?

>> Carmen Racy-Choy: Yes.

>> Because the equity markets just went, right? So we lagged as a result of it being overallocated.

>> Arn Andrews: I think in the first half we overperformed and then we underperformed in the last half.

>> Russell Crosby: What does Mikita think on the subject?

>> I could argue both sides really well. I think ultimately what it comes down to is what the board's definition of risk is. This is capital you know is going to be called in the next 18 months let's say. If your perspective on risk is the risk of losing money and you knew in advance that there was a certain amount of capital you'd have to come up with in 18 months, you probably wouldn't invest that in equity. You would invest it in stable securities. And so your current methodology is one that minimizes the risk from an absolute perspective. The risk that you're going to fund these portfolios with dollars that maintain the -- their current value. If your view of risk is more relative, how do you perform relative to your policy index compared to peers the current methodology is more risky because it forces an overall allocation that is more conservative than your policy allocation. As a consequence that may cause you to look good or bad depending on what the markets are. But that adds an element of uncertainty relative to that policy index. If the board's concern is relative risk you should choose to spread it. If the board's concern is absolute risk you should choose to maintain the current protocol.

>> So I mean I give an opinion, you know, I would prefer we spread it out generally, and kind of got to our overall risk portfolio, as best we can. Rather than maintaining an overly conservative allocation to fixed income as a place holder, where -- and also in terms of sourcing liquidity, once these capital calls come you've got a pretty liquid portfolio, it's really not -- shouldn't be an issue even though there are draw downs in order to force sufficient liquidity to force an 8 or 9% asset of the capital. So I mean that's generally how we would do it. Unless you could really tell me that whatever you're using, what you're invested in the fixed income is a good proxy for where you're ultimately going which I think is what we've indicated it's not a great proxy for it, that I would spread it.

>> Carmen Racy-Choy: Yeah, we don't believe necessarily that the current investments are a good proxy for hedge funds or even for private debt. So I can't argue that.

>> Matt Loesch: Mr. Overton?

>> Edward Overton: What is the current cash level for managers in the other asset classes? Are they likely to be able to take additional capital from fixed income and invest it in a normal process? Are we putting more stress on them, what?

>> Carmen Racy-Choy: So your question is what's the current cash level of the fund?

>> Edward Overton: Yeah, what's the likelihood if we go down the road that Stuart has just talked about, what is the likelihood that those funds will actually be deployed?

>> Carmen Racy-Choy: Well, we can deploy them very quickly, I mean two to three days --

>> Edward Overton: So the managers would be able to add securities --

>> Carmen Racy-Choy: Yes, absolutely.

>> It wouldn't include any of the illiquid --

>> Carmen Racy-Choy: Exactly. We would redeploy them only on the liquid markets. So that's equity, fixed income, and commodities -- infrastructure arguably isn't very liquid so it would be commodities.

>> Matt Loesch: Mr. Armstrong.

>> Michael Armstrong: If memory serve me, we're still not comfortable, we're still looking for a core fixed income manager, or will be, correct? So if we want fixed income it's some sort of quasi-passive, right?

>> Carmen Racy-Choy: Sorry, what's your question?

>> Michael Armstrong: Well the question is if we put it completely into fixed income instruments, what manager are we talking about?

>> Carmen Racy-Choy: Currently we have the allocations spread out as per our fixed income allocation. So a portion of it is in TIFs. A portion of it is overweighing some of the credit investments in high-yield and convertible bonds. So it's basically the same investment structure as the current fixed income assets.

>> Michael Armstrong: So we're implicitly making a fixed income bet also of some nature?

>> Carmen Racy-Choy: I think the goal of the board was not to make a fixed income bet, but give a short horizon for redeployment, select a lower volatility asset segment. I don't want to portray it as a bet. I don't think that was the intent of the board.

>> Michael Armstrong: Probably the intent was, you were going to invest this capital sooner than we have or is this time line that you were expecting how long it would take to deploy the capital?

>> Carmen Racy-Choy: Well I think this is the time line because at this stage we don't even have a database for hedge funds.

>> Stuart Odell: I know you are not there now, but initially when you came up with this strategy was your goal that we are going to get this within six years or a year, or what was your expectation at the time?

>> Carmen Racy-Choy: I think we knew that we weren't going to get there in less than a year so I think we're on plan.

>> Stuart Odell: So this is within their time period that you expected to be in the -- overallocated to fixed income for that period of time?

>> Carmen Racy-Choy: Yes.

>> Matt Loesch: Mr. Odell can I take your comment as a motion?

>> Stuart Odell: Yeah I'm happy to make the motion. Make the motion first?

>> Matt Loesch: Motion then further discussion.

>> Stuart Odell: I'm happy to make the motion to spread the allocation to the different liquid assets in the portfolio.

>> Matt Loesch: Any further discussion on that?

>> Edward Overton: What's the time frame?

>> Carmen Racy-Choy: Typically we try to execute the board's decision within three to five business days. So we will have, once the board makes the decision, we will have the letters to the managers within that time frame.

>> Edward Overton: And so this money is going to come out of the Northern Trust passive allocation?

>> Carmen Racy-Choy: Well, Northern Trust is currently the custodian and they will remain the custodian. So the money will remain there but the money --

>> Edward Overton: No, no, aren't they running a couple of strategies for us?

>> Carmen Racy-Choy: They are running one strategy but they're not running for example they hold the TIFs. They're not necessarily running all of the fixed income pieces. So the money will come out from wherever

there are over-allocations to fixed income and will be deployed in the various liquid portions of the asset allocation.

>> Edward Overton: Okay.

>> Matt Loesch: Any further comments or questions? All in favor? Aye. Opposed? None. Thank you. Okay.

>> One quick question on that. When you redeploy those assets, no, actually, sorry.

>> Carmen Racy-Choy: So very rough --

>> I figured out myself.

>> Carmen Racy-Choy: Very roughly speaking if we're looking at 10% which is going to be reallocated you're going to see a little bit over 5, maybe 5.5 go into equities. Roughly two and a half will remain in fixed income. So I'm left with two, two is probably, we're not going to put two in commodities but maybe one and a bit will do the exact math and the rest will be increase the prior numbers that I mentioned. That would approximately be how it would be reallocated.

>> Matt Loesch: We're on to 1.1A. This is a service connected disability of John A. Martinez Sr, I assume we're moving on. And is Mr. Martinez present?

>> He is.

>> Matt Loesch: And then is this Mikita's laptop? I just want to make sure before we get moving.

>> Arn Andrews: And Mr. Chair --

>> Matt Loesch: One second, Mr. Martinez, yes, just -- and before we get going here, Mr. Andrews wanted to make the comment. We will probably have some feedback from the attorneys and then we'll move on with the case.

>> Arn Andrews: Yes, Mr. Chair, I asked to recuse myself from this particular hearing. I've been in a reporting relationship with the individual, and the individual has been represented by our department, in the documentation and so I feel it's now appropriate for me to recuse myself from this hearing.

>> Matt Loesch: My understanding he should probably exit or should he stay here?

>> Mollie Dent: He shouldn't participate in the hearing. He can sit at the table as well as sit in the audience but not participate.

>> Matt Loesch: Thanks for clarifying that. Ms. Busse.

>> Donna Busse: So John A. Martinez is a warehouse worker requesting a service connected disability based on his left and right knee. 54 years old with 9.69 years of service. Medical reports are listed in your packet. The work restrictions are that he should avoid sustained crouching he should avoid sustained walking. He is currently separated from the city effective 11-27-09. At the time of separation and at the time of application he was working full duty as an office specialist 2. There is no permanent modified duty or alternate employment available. Dr. Das, do you have anything further you'd like to add to the --

>> Dr. Das: No, I don't.

>> Matt Loesch: Okay. Mr. Martinez at this time if you had any statement you'd like to make or presentation or comments you'd like to make to the board?

>> Well I'd just like to --

>> Matt Loesch: Why don't you use the long mic it's better for pickup. Talk into the mic please.

>> I would just like the board to consider my disability retirement. When I was hired into the department my body was 100% operable. Like I said due to the injuries I sustained working you know for the city, throughout the years, my knees is permanent knee, you know not fully disabled but a percentage disabled which I'm going to have to have. Total knee replacement in both fees. Knees, the injuries have you know stain a part of my life away from me that I'm not going to be doing really physical things with my grandchildren anymore. The doctors state within a year or so the right knee is definitely going to have to be replaced. Like I said when I was hired into the city I took a physical before I was hired pardon me and I was 100%. I'm no longer going to be 100% the rest of my life, that's why I would hope that you would consider giving me my disability retirement.

>> Matt Loesch: Okay. Any comments or questions from the board members? Mr. Overton.

>> Edward Overton: There was a reference in one of the medical report to a 1999 incident with your knees. And you didn't start work with the city until 2003. Can you explain how it was?

>> The 1999, it wasn't a knee injury. It was just a routine doctor visit in 1999. I was hired with the city in 2003. The original first injury on the right knee was sustained in 2003. Which I tore the meniscus, I had the surgery done and I was put back to work within two months I believe on modified duty. And then four years later in 2007 is when I reinjured the right knee and injured the left knee. From that point on just everything went down because then I had to have a second surgery done to the left knee which I was out of work for a year and a half I believe. And then returning back to work, in 2009, February of 2009, I was -- I was -- the doctor said that I could no longer go back as a warehouse worker because if I did I would injure the knees I would make them worse. So the only way he was going to release me back to work is if I could get modified work, pardon me, which the finance department was able to accommodate me as an office specialist. We kind of figured out, wasn't going to go back to the warehouse anymore. So they were going to accommodate me in a permanent status situation, which means he had to study for a test. I took the test I passed the test. But the human resource department kind of dragged its

foot and took five weeks to -- to make it a permanent thing. So you know I was shy 19 days from being permanent status which would have gave me my ten years carried into that position, you know, as an office specialist. But being let go it had to turn me -- put my classification back into the warehouse position which they couldn't accommodate me, the restrictions I had. You know, so like I said the injuries sustained while working for the city you know have taken an effect on my life.

>> Edward Overton: I'd like to ask Dr. Das to comment on the impact of repairing a torn meniscus on being able to use that knee in its almost -- well, not original form bit substantially, to its preexisting condition, pretear of the meniscus? Is that repair likely to put that knee back to preexisting conditions?

>> Dr. Das: Well, we're talking about two different issues. One is the condition of the knee and two are the symptoms associated with the knee. With respect to the meniscectomy his arthritis associated with that because you've removed some of the protective covering for the bone, there's going to be more bone on bone irritation, so you would expect there to be earlier signs of osteoarthritis. The key is that you could have these on -- and it's a very individual basis. Some people can report significant symptoms without significant findings, and other people can report no symptoms, with very significant findings. And the -- and that's where the -- and that's where we're at at this point. It's primarily the -- limitation is not from a -- is symptomatic. Are there other alternatives that can be done to make the person less symptomatic, so they can perform these activities? And that's -- we're talking about medications, we're talking about synovial injections, there are other kinds of modalities, even total knee replacement can be done that would ameliorate the symptoms. So that's kind of really the key. If your question is, can he get back to where he was pre-injury, no. His knee has changed, symptomatically maybe he can get back to where he was.

>> Edward Overton: Okay. My issue is Dr. Jeter describes his as having a preexisting arthritic condition of his knee. And what impact does that have on the torn meniscus and its repair and if it was repaired, is this problem, the problem that Ien understand that the doctor should conclude that cannot go back to working a warehouse worker, is that basically because of the tear or is it because of the arthritis?

>> Dr. Das: Both, they're contributing factors. What he describe as a specific injury in which his meniscus was torn in order to relieve the symptoms and allowing him to walk without pain, or so that his knee doesn't lock, they clipped off and cut off part of the meniscus so it wouldn't interfere. Obviously, it -- I don't recall showing that he had well he does have -- and then there is the other component is the preexisting, what they were calling about was a circumferential meniscal perforation. So perhaps something else was perhaps had gone on in the past. We weren't able to find any medical records that suggested anything. But what we're talking about are two contributing factors. Where there's specific risk factors for knee arthritis, and typically you think of obesity or being overweight as the primary risk factor and then we have the contributing factor of the meniscal tear and the meniscectomy. Resulting in early arthritis. And then what we have presented before us is a combination of those two, and Mr. Martinez reporting symptoms when he does these activities. And the key is, the severity of his symptoms corresponding to the pathology. And moreover, and more importantly are there things that can be done to help improve his work tolerance. So I think we need to look at the definition of incapacity and whether this injury is incapacitating. And I don't know that it is.

>> If I may, you had stated about the preexisting arthritis, Dr. Geter states that.

>> Right.

>> But I had talked to him also and it's a possibility that it had started in -- I didn't see Dr. Geter until 2007. The original tear was in 2003, which the medical records show Dr. Trib was the original doctor that did the first surgery. Now you had a four year span before I saw Dr. Geter, because Dr. Trib retired due to medical reasons. That four year span, Dr. Geter said could have contributed to the arthritis in the left knee and the meniscus being torn four years prior.

>> Dr. Das: I think part of the issue though is if you look in the interpretation of the MRI from August 4th of 2003, preoperative, that that was the issue that came up with the subligamentous subluxation, and the knee capsule tear, when you have the knee capsule and the men is cuts, that indicate thread was something going on. Whether

it was an acute trauma or some sort of degenerative issue, Mr. Martinez denies any trauma, that wasn't something that would have been just specifically present due to the injury that was described.

>> Edward Overton: To me, Mr. Martinez has suffered a disability. From the job of warehouse worker, not from the office worker position or office specialist I guess it is, office specialist 2. However I'm struggling with the causation. And whether or not his repaired meniscus is sufficient, absent the degenerative arthritis to allow him to return to work.

>> Dr. Das: I -- if that's your struggle, from a contribution standpoint, I definitely feel that the meniscal tear and the meniscectomy contributes to the presence of arthritis in the knee. There is a contribution from work. As to trying to figure out whether most of the contribution is coming from early degenerative changes due to his obesity, versus that -- I mean I would -- my -- I don't have good scientific data or anything to tell you what the specific contributions are. But personally, if you're talking about acute trauma and something being torn that would be a more important contributor than the chronic degenerative process. Unless it was something that was going to happen anyway. But I don't know that in this case, it was something that was going to happen anyway. My struggle is more with the type of disability that it is, whether it's something where his doctor feels that he's going to get worse, from doing these kinds of things and experience more pain and that's why he's provided him restrictions as a treater versus a physician that's looking at this from an incapacitating injury, where there's just things that you can't do because of the pathology involved, and from my perspective, I don't see that kind of incapacitating injury.

>> Matt Loesch: Any other comments or questions from the board? The challenge I see with this one obviously is you look at this from the outside and we have this person who's willing to work at an office specialist position and that office specialist position goes away and so we're left with this void of how to deal with him. Dr. Das, is it clear in your mind that Mr. Martinez was -- so your statement, your previous statement is, it is not clear in your mind that the incident that happened in 2003 to his knee, to his meniscus makes him disabled from the warehouse worker job?

>> Dr. Das: That is correct.

>> Edward Overton: Then what does?

>> Dr. Das: What does make him incapacitated?

>> Edward Overton: Yes.

>> Dr. Das: Nothing.

>> Edward Overton: Well Dr. Trib definitely said he could not return to warehouse work.

>> Dr. Das: Are you referring to Dr. Geter?

>> Edward Overton: Geter.

>> Dr. Das: No, and I think this is where we have to define my role versus Dr. Geter's role. Dr. Geter is the doctor who doesn't want him to have any symptoms, wants him to work and do what he can without discomfort and doesn't want him to get worse and says if you keep on walking on that and you don't lose weight you're going to get worse. My role is a little bit different. My role is to determine whether this is an incapacitating injury and it's not as Mr. Martinez's treating doctor and if he was my patient I may have a different opinion about what recommendations I have for him so that he can comfortably work. My role is determining is this something that is a -- an incapacitating type of injury. And it isn't an incapacitating type of injury. There are -- the restrictions are based on pain. There are things that can be done to address the pain. There's Synovisc injections with Hiolonic acid. Medications can be used to help reduce the discomfort associated with the work. There's no structural defect that is that severe that precludes him from doing the job.

>> If I may, but you're saying, the question was put that you, what would it take, you know, what would eliminate me as an office worker. I mean do you feel that and you say no. But if you look at the requirements, the job description of what the city says a warehouse worker in order to be a warehouse worker these are the duties that you have to perform and I can't perform those duties and there wasn't -- there's nothing there that they can accommodate me to do those duties, you know which goes back to the disability. Had I not got injured and had four surgeries on both -- two on each knees working for the city I'd be able to return back as an office worker I mean as a warehouse worker and do the job which the city requirement. Dr. Geter's report doesn't state I don't believe it states unless I missed it that I'm overweight. That's in your report. The doctor, yes he's my private doctor, he's the one who's actually gotten into my knees and see what's in there you know, what's not in there anymore. You're basing your medical evaluation just on a report, the physical taken at that time health services office. Dr. Geter, yes he is my physician but you know like I said he's done the actual surgery, arthroscopic surgeries have gotten in there and seen what's in there and what's he taken out. So I don't -- like I said, in my opinion, you know, I'm not able to do the warehouse worker to the standard and the requirement of what the city requires for me to do that. Because of the fact that I've had four surgeries. And part of that percentage of me is gone, that --

>> Dr. Das: And what I have to rely on is, as much objective information as I have. And what I'm relying on is the objective information that Dr. Geter describes in his operative report and the interpretation of the MRI. And I agree that you do have degenerative findings in the knee and as I stated earlier I do believe that a large contribution came from work due to the meniscectomy. But in terms of the working capacity versus work tolerance issue that's another issue. And that's -- that's a little different, in terms of trying to determine what's incapacitating. And you know, there's -- in terms of when you say you can't do it, it -- what other options have been tried? Have there been any recent Hylgen injections in the knee to see if that improves your work tolerance? Are you taking inmedications on a regular basis to help with the pain so that you can improve your work tolerance? That's what I look like in terms of trying to determine whether something's incapacitating or not?

>> Matt Loesch: I'll entertain a motion from the board unless there's further discussion.

>> Edward Overton: It's not in accordance with Mr. Martinez's request but I'd move for nonservice connected disability. Is that okay Mollie?

>> Mollie Dent: Yes, you're allowed, you'd have to deny the service-connected disability and then the board on its own motion can make a motion for nonservice connected disability. But he's also on for a service retirement, too. Today, as well. So I don't know. There needs to be an action on the service-connected disability, though, either an approval or a denial before you move on to the other.

>> Edward Overton: Okay. In keeping with my motion I would move that we deny service connected disability.

>> Matt Loesch: Is there a second on that?

>> Second.

>> Matt Loesch: Okay, motion and second. Any other further discussion or comments on that? Okay, all in favor of denial of the service-connected disability, aye. Opposed?

>> Nay.

>> Matt Loesch: We have one nay and one abstention or recusal. Okay. Is there another motion you'd like to make?

>> I mean I -- I mean I've had knee surgery. And torn meniscus. I have a second one. I you know -- you know I can -- I can certainly find a very credible, and I can't imagine working in a warehouse with less cartilage than I was born with.

>> Matt Loesch: Okay. Did you want to make an additional motion?

>> Edward Overton: I would make a motion that he be granted a nonservice connected disability retirement.

>> Matt Loesch: Is there a second? I'll second it. Any further discussion on that?

>> Mollie Dent: Can I ask staff is that going to make any difference for the applicant in terms of service -- in terms of the regular service retirement versus nonservice connected?

>> Donna Busse: The member has 9.69 years of service so he would normally on a service retirement get 2.5% per year of service. Let's see, when did you start? You started -- we have a change in the way we calculate nonservice connected disability.

>> Started with the city in May of 2000 -- 2000.

>> Mollie Dent: My only question really is if it's been official to the applicant. If it's not been official -- if it's been official to the applicant I think it's fine for the board to move forward with it. But since he has the service retirement request already on he could ask for that to go first.

>> Donna Busse: Back for change in service?

>> Mollie Dent: That's true you could do the higher of the service or the nonservice connected.

>> Edward Overton: Well I would rather base my recommendation on the preponderance of the medical evidence and the indication as to causation rather than how much the benefit is.

>> Mollie Dent: I understand that. But I think the applicant also --

>> Edward Overton: Oh, okay, his choice.

>> Mollie Dent: His choice.

>> Edward Overton: I'm okay with that.

>> Mollie Dent: Because he has his service retirement on the agenda.

>> Edward Overton: Okay.

>> Mollie Dent: And I'm assuming that he would want --

>> Edward Overton: Should we address that prior to the vote?

>> Matt Loesch: She's scribbling away over there.

>> Russell Crosby: She's going to give him the information for the decision.

>> Edward Overton: Okay.

>> Donna Busse: It was slightly better than (inaudible).

>> I don't know what's happening.

>> Matt Loesch: Ms. Busse, would you explain to Mr. Martinez?

>> Mr. Chair, might I suggest you have them step out and handle the discussion and hear some of the other items because of the timeliness of the meeting?

>> Matt Loesch: That's right, you have your meeting after there don't you. Why don't you go ahead and hold off on this one and, and good suggestion. If we can ask a moment of silence for those who have passed, item number 3, death notifications. [Moment of silence]

>> Matt Loesch: Thank you. Moving on to item 4.1, this is a discussion and recommendation on the San José city council on the ordinance of San José, to add a new chapter 3.52 and to amend section 3.28.380, 3.28.1980, 3.28.1995, 3.28.2030 and 3.28.2045, and add a new section, 3.28.385 of chapter 3.28 for the purposes of establishing a new trust pursuant to section 115 of the internal revenue code related to health care benefit funding and payment of retiree health care benefits.

>> Mollie Dent: So you have a memo and an ordinance and I do have to ask you to waive sunshine on it because I posted it late and got it to you late. But I would like you -- I would ask you to do that. The council, the city council has passed the ordinance for publication of title so it's die to be adopted by council this coming Tuesday. And the reason that we're trying to move forward with it, quickly, is to get this trust in place by July 1st so the city can and employees can continue their ramp-up to full funding for retiree health care.

>> Russell Crosby: And if I could, even though the legal documents will be created, we are under extreme staff constraints and potentially losing one of the key staff members in the middle of all this, to set up the money managers the custodians all the other things that go look with this particular trust so --

>> Mollie Dent: Right, there will be decisions that will have to come -- there -- it's because the board won't be constituted as a board until after the 1st of July, and the -- this ordinance appoints you, this board as the board for the new trust, and there are no July board meetings, unless there is a decision to have a special board meeting for this trust, there's a lot of work for staff to do to get -- to handle the money as it comes in.

>> Arn Andrews: I would suggest that the board should do whatever it needs to do in terms of meeting schedule to facilitate this request. So I don't think that should be an impediment. We should figure out schedules if and when you're ready for the board to hear it.

>> Russell Crosby: That's not totally up to us, Arn. The custodian has a say in this and the money managers and exactly what you're going to do for an allocation and where you're going to park the money and there's a whole bunch of stuff that goes beyond simply the creation of the legal receptacle to put this stuff in.

>> Mollie Dent: So to move it along the two things that we're asking for today is a waiver of sunshine and that you make a recommendation to the city council to move forward with this as soon as possible and to go ahead and adopt this ordinance.

>> Matt Loesch: First things first, we have any motion to waive sunshine?

>> Edward Overton: So moved.

>> Lara Druyan: Second.

>> Matt Loesch: Motion and second, all in favor? Second? Fine. I have a series of bullet point questions myself, do we need an affirmation from each trustee that they will accept this duty of the appointment?

>> Mollie Dent: It will be fine if you wanted to do it that way. The way we structured it is that each of the trustees by remaining on the board will automatically be assumed to have affirmed that.

>> Matt Loesch: Okay so you're aware, that's one of the things we want to make sure.

>> So just to be clear, so is this covered by ERISA or not covered by ERISA?

>> Mollie Dent: No, it's not an ERISA trust.

>> So what's the liability exposure for a trustee?

>> Russell Crosby: As soon as there is a legal entity I will get you fiduciary insurance.

>> Matt Loesch: That is on the list.

>> Mollie Dent: You will see there is a lengthy section in this trust document about limitations of liability which there is not in the main pension trust. So this document does have more layers of protection actually in the document than the existing pension document does.

>> Matt Loesch: So if in fact that these trustees accept that responsibility do we need to hold separate meetings and post separate agendas?

>> Mollie Dent: Yes, they will, they don't have to be separate. You can do just like the city council does the Redevelopment Agency. It can be that one after the other.

>> Matt Loesch: Splendid. Do we have to have separate fiduciary liability insurance for it? Additional?

>> Mollie Dent: You should.

>> Russell Crosby: You will.

>> Russell Richeda: Russell you can at least contact the insured and see --

>> Russell Crosby: We can add.

>> Russell Richeda: You can at least contact the insured and see if they could add.

>> Russell Crosby: We can see if we can add you can't add rigor to the --

>> Russell Crosby: We're going to have to have --

>> Mollie Dent: You're going to have to have separate administrative and separate CAFRs, I think it will be part of the --

>> Carmen Racy-Choy: I think you need separate CAFRs.

>> Russell Crosby: I do too, absolutely.

>> Mollie Dent: I was thinking --

>> Russell Crosby: Eventually these things are going to have different asset allocations, they're going to be managed in different ways.

>> Mollie Dent: I was thinking more of the distinction between this -- we're going to be running the existing 401 (h) account parallel to this for a while.

>> Russell Crosby: Correct but this is a distinct legal entity to be tracked separately.

>> Mollie Dent: But eventually it will be the only health vehicle.

>> Matt Loesch: That goes to my last question. After we get private letter ruling from the IRS, can we move all the money from the 401 (h) account into this?

>> Mollie Dent: No you'll still have your 401 (h) account so that account will continue to exist in the pension fund.

>> Matt Loesch: And we're burning off of that first then correct?

>> Russell Crosby: Correct.

>> Mollie Dent: Well, that's the default is to burn that off first but we actually wrote this so if the trustees don't want to do that, they can make the decision. Because our outside tax counsel pointed out to us that as you get to the end of the 401 (h) account you may still have some illiquid investments that you don't want to have to liquidate, because if your 401 (h) continues to be invested with all your pension stuff, you may have little stuff that you don't want to liquidate through 401 (h) right away. You may want to convert to convert over to starting to pay out of the new trust. Until you make that decision it will all come out of the 401 (h).

>> Matt Loesch: Wonderfully complicated. Any other questions?

>> Edward Overton: Yeah, I read this, unfortunately I read it on the computer screen and I didn't have specific notes that I should have taken. But my issue was, in a number of spots on here, it refers to the city whereas I think it should probably be the health trust or the retirement plan. And an example of that and if you tell me I'm wrong Mollie that's fine. Example of that is on page 16, under A, where it says, in part, GASB 45 or shall be used. It's about six lines down from the top. Used for or diverted to any other purpose, other than meeting the City's obligation to provide health and welfare benefits. Does --

>> Mollie Dent: So I'll ask your question for our outside tax counsel. I know the provisions of this that came directly from our outside tax council, and the provisions of this that I drafted. So that's not a provision that I drafted, and it's my understanding that it is the City's obligation to provide the benefit. But this is the vehicle to meet that obligation. But I will check that and I appreciate your question on that.

>> Edward Overton: Okay, that -- and any instance where it refers to -- where it could be the trust obligation or the plan's obligation, if you could just --

>> Mollie Dent: I will and Mr. Richeda has given me a couple of comments on the ordinance too that I would consider in the nature of clerical corrections, that I -- that we can make between now and next Tuesday if we need to.

>> Edward Overton: Okay.

>> Matt Loesch: Any other comments or questions on it?

>> None.

>> Matt Loesch: I'll entertain a motion.

>> Arn Andrews: Motion to approve sending the ordinance before city council.

>> Matt Loesch: Motion to move the recommendation to city council. Motion and second. Any further discussion or comments? All in favor? Aye, opposed, none. Okay. Do we have -- I think they're still discussing so we'll move on. We're on 5.4, this is a discussion and action regarding the delegation of authority of the secretary to act on behalf of the board, you have a report from Mr. Kumar discussing what has presently been delegated to the secretary to act on behalf of the board. Any further detail on it?

>> Edward Overton: What is the purpose of the memo?

>> Matt Loesch: At the last board meeting we were discussing what has been delegated to the secretary and we had asked for a report-out of what presently has been delegated to the secretary as of this -- and we couldn't have the discussion because it wasn't agendized last time and so it was agendized properly and it was a memo listed as to what was actually delegated and if we wanted to have further comment on it or possibly change or modify it that's the purpose. It could be just a note and file.

>> Edward Overton: Move to note and file.

>> Matt Loesch: May I have a motion and second? Motion and second, I don't believe we need to move to note and file. Got one anyways. So do we have an applicant request on 1.1A?

>> Donna Busse: Correct, the applicant does want a nonservice if that's available to him.

>> Matt Loesch: We have a present motion for nonservice disability and a second, still have our quorum without the -- with the recusal. Any further comments or questions on that? Okay, all in favor of approving a nonservice disability to Mr. Martinez, aye, four ayes. Any nos? Okay that's approved, good luck, thank you.

>> Donna Busse: Five.

>> Russell Crosby: Lara absent and Arn recused.

>> Matt Loesch: Item 5.5, that's a discussion and action regarding the fiscal year schedule and committee and chair appointments. I don't think there is any memo, but we had talked about it last time, I had brought it up that in practice we'd been doing it in December that they're effective in January for the calendar year even though our government structure or whatever it was said that we do it in November for December to December. Any comments or questions? Do we want to keep going with our practice and make that the official policy or would you like to actually utilize our existing policy?

>> What are the advantages and disadvantages?

>> Matt Loesch: Well one thing is if -- you can take this, I'm not trying to -- my term is up in November and I wouldn't be appointed until December if I chose to run. It would be true of any other employee, if you choose to have the employee be the chair or vice chair, November or December, it could be a ploy to eliminate the employee from that position if you so chose or if you wanted to have the full employee vote of the new folks it

would be there working for you you would wait until December to vote and it would be effective the calendar year. In my mind that's the advantage, it isn't to covet the spot or whatever.

>> What is your recommendation?

>> Matt Loesch: My recommendation is to use the calendar year appointment for the chairs and they're voted for in December. That is not our current vote. Our current policy is November vote for December to December and it gets into a problematic if you have employee votes which elections are traditionally in November for December appointments. And so that's why you would end up not having a person available if you wanted to choose an employee for one of those two positions. So I'd put a motion forward that we actually put in place the policy that our practice has been that it's a December vote for a calendar year appointment.

>> Second.

>> Edward Overton: I'd support that.

>> Matt Loesch: Okay, any other comments or questions? This is my eager feeling to get to an appointment. Very clear.

>> Edward Overton: I thought you were going to try to quit.

>> Matt Loesch: All in favor, opposed, Mr. Constant's comments before, not that anybody, I had motion and second was whatever. Nobody else wanted the position that's why I'm here. But not to support me but -- probably accurate.

>> Opposed.

>> Matt Loesch: Exactly. Everybody step back. Discussion and action regarding the board governance regarding formation of an audit committee.

>> Russell Crosby: No it's actually board governance. What I'd like to do is get a consultant in here. There are a couple of firms that are specialized in this business, one of them was Cortex which was used by the city to do the reconstruction of the boards. And it's really about how do you govern yourselves internally, what committees are you going to have, what authorities does the chairman have, all of those kinds of things. These people are specialized in helping the boards do that. What we need is an RFP. Quite frankly the staff can do the RFP, we don't need to have the authority to do that, I wanted to make sure there would be some receptivity to having a consultant like that on board. And the idea, would be we would split the cost with Police and Fire and piggyback as much as we could to minimize the cost of doing this. So --

>> Matt Loesch: And so your point is to run the arc, come back with who you approve --

>> Russell Crosby: But if the board is add manipulately opposed to it I don't want to go down that road and we don't have staff resources to waste on RFPs if that's not going to go anywhere.

>> I think you should move ahead.

>> Matt Loesch: Is that a motion?

>> I'd like to make a motion, yeah.

>> Matt Loesch: Second?

>> Second.

>> Matt Loesch: Motion and second.

>> Edward Overton: I have just one comment. We had Cortex do a board governance report what, two years ago.

>> Russell Crosby: No, the city had hired Cortex to do the study. It was not done by the board.

>> We used IFS.

>> Edward Overton: Pardon?

>> Didn't the board use IFS a couple of years ago?

>> Edward Overton: My issue is, out of that Cortex study we implemented about 1% of their recommendation.

>> Russell Crosby: It wasn't a Cortex study. It was somebody else's study. If it was done by the board it was --

>> Edward Overton: No no no no. This was the board governance that was done by Cortex. They called me.

>> Russell Crosby: It was the City's correct.

>> Edward Overton: And I don't know what the city paid for that but, you know, I'm not sure they got good value because as I said, very little of the recommendations were implemented.

>> Russell Crosby: How can you say that Ed? These boards are sitting here with all of these new members as a result of that. The boards have completely been reconstructed. How can you possibly say anything like that?

>> Edward Overton: Well, there was also some other things that --

>> Russell Crosby: There were other things in the report besides the reconstruction but that was the essence of what that board was about was to get outside people involved.

>> Edward Overton: I don't think that was what it was about. I think it was in part --

>> Russell Crosby: It was indeed. Did you read the report?

>> Edward Overton: Yes I did.

>> Russell Crosby: And you came to that conclusion?

>> Edward Overton: Yes.

>> Russell Crosby: Oh my goodness gracious. I don't know what to say by that.

>> Edward Overton: Well, this isn't said for you to have to say anything, okay? The content of the report, there were reporting relationships, there were compensation issues, there were a whole bunch of stuff in there that was not done and that's my point. The restructure of the board was the only piece of that, that I can say was implemented. And what I want to do, and make sure that if, in fact we go forward with the -- you know another study, and you, Russ mentioned IFS. We went through IFS and the same thing happened, about 2% of what was in there was implemented. And if we are going to do this, I say we have a commitment to implement the recommendations.

>> Well I have just one comment on that, though. We may not agree with their recommendations. I mean I think it's just great to do the study. But I don't want to up-front say yeah we're going to implement all this because we don't know what they're going to recommend and whether we agree with it. But I hear your point. Beyond that, I mean, it may have bent the first time arounds --

>> Edward Overton: That's my only issue.

>> That they only implemented 2% because maybe the other 98% were not recommendations that you thought were prudent. I don't know. But let's at least spend a little bit of money and see what they can come up with. And then we can decide as a board whether we think those recommendations are worth following through with.

>> Matt Loesch: I'm of the personal belief that the full knowledge of governance of how boards should be structured is not housed in this facility and that someone who does that on a regular basis and studies board construction can make recommendations of what we're doing with committees, how we're interacting what our staff is like and how we're interacting with them I think would be crucial. We have new folks on here, it's the time to do it, I think it's prudent so I'll support the motion.

>> Mollie Dent: I was just going to offer that I think when it comes back for the board to look at hiring a consultant, what will be important for the board to look at is what the scope of work is for that consultant. And you'll need to be comfortable with the scope of work so that you at least feel like if the consultant made a recommendation within that framework, it would be something you'd want to hear about. So I think that's -- I do think that you know there is a -- at that point, when it comes forward there will be a way for the board to keep the work for the consultant, so you feel like they're being appropriately tasked.

>> Matt Loesch: Okay so I have a motion and second. Any other further comments or questions? All in favor? Aye, opposed, none thank you. Okay we're on item 5.7 discussion and action concerning government code section 7513.95 and its impact upon board members. I'm going to to make a humble recommendation we defer this to next month.

>> Mollie Dent: That's fine.

>> Matt Loesch: Mostly because we want to make sure that Ms. Druyan is here, it affects the outside folks.

>> Russell Richeda: May I?

>> Matt Loesch: Yes.

>> Russell Richeda: Police and Fire directed that a memo be done on this. Does the Federated board want a similar memo?

>> Mollie Dent: What I would suggest is if any board members after looking at this code section, which is very short and this is all there is, have specific situations that they are interested in knowing whether that situation presents a problem, would they please give that situation to the director, so that when we're looking at the -- that's what Police and Fire did, they gave us some scenarios that they were concerned about. So if any of you have scenarios that you're concerned about give them to the director. And our approach is going to be to analyze them ourselves first and then perhaps even go to the attorney general's office but it would help us move it along if you would let us know.

>> Maybe this isn't appropriate. What is considered an investment product?

>> Mollie Dent: That's one of the things we know to look at. We're looking, we will --

>> Russell Richeda: As Mollie's mentioned before it is an investment product that would be considered an asset of the fund which again is not self-defining but it's maybe a more refinds qualifier on what investment product means.

>> Matt Loesch: I'll make a motion to direct the staff to present a memo to us at the next meeting and if there are scenarios that are outside, particular head, want to make sure they are addressed in that memo to get to the secretary posthaste so they're in our June meeting, can I get a second?

>> Second.

>> Matt Loesch: Any further comments or questions? All in favor, opposed, okay. 5.8 is discussion and action regarding a board retreat. No memo, no comment?

>> Russell Crosby: Police and Fire had an interest. You guys have an interest.

>> Would we retreat with them?

>> Russell Crosby: I don't know that you'd want to. I really don't know that you would want to.

>> Matt Loesch: Good luck with that. I think the general thing is we brought a lot of folks in here. There's lots of changes going on. It would provide an atmosphere that is not necessarily less formal, but it's to get the perspectives of folks. Do you want us to pursue something like that?

>> I think it's a terrific idea.

>> Matt Loesch: Without any dined of idea of scope presently right now?

>> Arn Andrews: Just one question, if all of us congregate are we posting agendas and things of that nature?

>> Russell Richeda: We've done it before.

>> Mollie Dent: We've done it before.

>> Arn Andrews: It's not a retreat, it's work.

>> Mollie Dent: It's like a study session.

>> So everything we talk about is recorded and public is what you're telling us?

>> Mollie Dent: Yes.

>> Russell Richeda: It has to be in the jurisdiction.

>> Mollie Dent: It has to be in the jurisdiction. So --

>> Russell Crosby: It has to be in San José.

>> Mollie Dent: In San José.

>> Matt Loesch: I'll make a recommendation that we pursue the idea for the staff to come back to the board with more formal structure to finalize. Any further comments send them to the secretary. All in favor, opposed. Item 5.9 discussion and action regarding electronic agendas.

>> Russell Crosby: This is another item actually Donna and some other of the staff have been meeting with vendors. A question is coming up we're killing half the trees in California for these agendas.

>> Donna Busse: Correct, we're looking at ways to have electronic packets and agendas. Barbara went to another jurisdiction yesterday to see how they pretty and we'll come back with a proposal.

>> Russell Crosby: There are applications like the iPhone board notes that you could have on your iPad, it would be a lot cheaper than the amount of paper that goes into these agendas killing.

>> Could you just fill these out is that acceptable?

>> Russell Crosby: And we do except that the board members have always wanted paper.

>> Donna Busse: And we have to work around confidentiality.

>> Russell Crosby: We can't e-mail the confidential items. Mr. Mayor.

>> Matt Loesch: Where you can't get it anymore.

>> Russell Crosby: The way these systems would work, you would get it the night before on a portal type thing.

>> Matt Loesch: It would be like a cloud. Mr. Constant?

>> Pete Constant: I would just note if you haven't already to talk to Dennis Hawkins in the Clerk's office because they are looking at the exact same thing for perhaps a pilot project in the city. And it would probably make sense to have the same system if they should work for the same because they're the same type of agenda packets and I know he's identified a couple of different vendors.

>> Russell Crosby: Thank you.

>> Matt Loesch: So we're going to keep moving on it sounds like, I'll make a motion to keep things moving. I'll make a motion that it comes back to us for approval.

>> Second.

>> Matt Loesch: If you have any improvement on Mr. scat's ideas. Item 2 is to accept the minutes from the March 16th, 2008 meeting.

>> Motion.

>> Second.

>> Matt Loesch: Any comments or questions, all in favor, opposed, none, note and file, education and trainings that's all the 7s. Future agenda items? Seeing none, any public or retiree comments? Don't have any public or retirees looks like. Move adjournment.