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>> Matt Loesch: Good morning.

>> Russell Crosby: By way of brief announcement, Matt Loesch was sworn in by the City Clerk, so he is again a board member.

>> Matt Loesch: I'd like to call to order the December meeting of the Federated City Employees Retirement System. Under orders of the day, I have some service retirement changes to note, please. Under item 1.1F, Rocco Capassele, new effective retirement date March 31, 2012. Item 1.1H, James J. Ham withdrawing his retirement application. Item 1.1X, Dominic T. Zonic, new effective retirement date to March 31, 2012. Item 1.1N, Michael Say, new effective retirement date January 7, 2012. And I'd like to add a death notification to item 2.2, Loris Detmer's revised date of death to November 24th, 2011. Other than that, any other orders of the day I don't have any other changes or modification to the agenda, otherwise we'll take it in order.

>> Arn Andrews: Motion to approve the consent calendar.

>> Matt Loesch: The orders of the day first.

>> Arn Andrews: Motion to approve the orders of the day.

>> Matt Loesch: All in favor, all opposed, approved. Consent calendar anyone want to pull any for discussion? None, is there a motion?

>> Arn Andrews: Motion to approve consent calendar.

>> Second.

>> Matt Loesch: All those in favor, opposed, none, okay. So item 2, death notifications, I would like to request a moment of silence please for those who have served the city in the past. [Moment of silence]

>> Matt Loesch: Thank you. Number 3.one, discussion and action on Cheiron's June 30, 2011 pension actuarial valuations report for the Federated city employees retirement system. Get them situated. Confirm do we need a sunshine waiver on this table that's being presented? I believe it is numbers that are in table form or chart form in the valuation itself and this is just the numbers.

>> Mollie Dent: No, that's okay, it's a presentation.

>> Matt Loesch: Even though these may be discussion and action items?

>> Mollie Dent: You have properly agendized the valuation for discussion and action.

>> Matt Loesch: Very good, thank you.

>> Good morning. I'm Bill Hallmark and with me is Ann Harper. We thought last month we presented the valuation results, but didn't have the final report prepared for adoption by the board. So today, we're just going through the final report. And we can revisit any of the questions on the presentation last month, or any of the details in the report. I'll just quickly go through the executive summary of the report and point out how it's organized and then we can get to some questions. I've got the report on the screen. I don't know if you can read it there, so hopefully you can read it in your packet. But this will point you to the pages. The first page I just want to point out is at the very beginning we have the summary of key valuation results in the table. This table was actually in our presentation. Last month. And it shows the changes from the prior valuation to the current valuation, changes in the discount rate, changes in liabilities and assets and a summary of the contribution rates and amounts. Moving into the report on page 2, we have the table showing the big changes in the membership. So that there's the 14% decrease in the active population and increases in the retirees beneficiaries and disableds and the 24% decrease in the active member payroll and the average payroll decreasing of 11%. And we talked about these a lot at the last meeting because those changes drove a lot of our valuation results. Table 1-2 just gives more detail on the assets and liabilities. We didn't go through this in depth last time but I think it follows from all the other information

we presented. This just provides some additional detail. Table 1-3 on page 4, we did show this at the last meeting it shows the reconciliation of the rates and amounts from the prior valuation showing what changes in experience did and what the changes in assumptions did to those rates. The next part of our summary section shows the historical trends. We showed these in the PowerPoint presentation. I think you see the increase in -- this shows accrued liabilities and assets and you see the increase in the accrued liabilities and now that the market value of assets is caught up to the smoothed actuarial value of assets here. We also showed this trend on the contribution rates, obviously everyone is aware we've had a significant increase in contribution rates. And here's the gain-loss table which we've gone through several times with the experience study and the Val report. Then I want to finish the board summary section by showing the financial trends. We put two kinds of trend projections in here. One is based on all trends being met and the other is with varying investment returns. I just want to caution that the purpose of the varying investment returns is only to illustrate the volatility in the system. It is not a projection of what we expect returns to be. It's you know just taken from a period in history, so we get relatively realistic bounces in returns. But it is not intended to do anything other than illustrate the volatility inherent in your system. So the projections show what happens to the funded status, both the liabilities and the assets. And so the top chart here, on page 9, shows if all assumptions are met, you see a relatively smooth progression. If you use those volatile returns in the bottom chart you can see how the market value of assets bounces around, and the smooth value stays relatively steady, but not as steady as in the top projection. And so the funded rates bounce around a little bit. Then we show the same projections on the contribution rates. And here, we have shown both rates of contribution in the top chart, and the dollar amounts in the bottom chart. And so it's actually this bottom chart that's based on all assumptions being met, that your handout refers to. So the dollar amounts on the gold bars in the bottom chart are rounded to the millions, and should match the more detailed information in the handout. We also show the rates of pay which are in the top chart. So these are what summarized in that handout. And then these two charts just show how those numbers change using that hypothetical volatile set of returns. So with that, that's all I'm going to go through in detail. I do want to say, you know, there's a section that goes in more detail on the development of the assets. That's the next section, then the development of the liabilities. And the contribution rates. And then there's some accounting disclosures and then the appendices give you some exhibits on the member data. And a summary of the plan provisions, and the assumptions. So it's more -- the appendices are really the basis for our whole valuation. I do know that there are a couple errors in the --

well, there's a typo on page 21 where the 7.95 and 7.5% returns were flipped. So it -- on page 21 it says we changed from 7.5 to 7.95 instead of vice versa, so I apologize for that. And in the appendices table A-6 on page 27, there appears to be something missing on the last line of the table for 2011. So we'll look at that and get that corrected for you. With that, I'll take any questions that you may have.

>> Matt Loesch: Questions from the board? Mr. Armstrong. Mr. Mayor, members of the Committee I was -- on page 23, on the GASB solvency test, I was wondering if you could kind of walk us through and kind of explain what this is. What this table is all about.

>> Yeah, this is a table that the GSOA's best practices requires be put in your CAFR. And what it does is, it looks at priority class, it allocates the assets to priority classes of the liabilities. And so if we go across, we'll do 2011. The liabilities can be split into these three classifications, in A, B and C. First is liabilities for active member contributions. Second is retirees and others, inactives. And third is the remaining active members. And then, the -- it shows the assets of the system. And so then the percentages indicate that the assets of the system would cover 100% of the active member contributions. Plus 84% of retirees and inactives and zero percent of the remain active member liabilities. So it's saying right now, we know we're 64, 65% funded. But that -- that's how that funded status breaks out, is it covers all of the active member contribution liability, and 84% of the retirees and inactives leaving nothing to cover the active member liabilities.

>> Michael Armstrong: So ask this a perspective on the overall solvency of the plan?

>> That's conceptual idea. If everything stopped right here, that's where you would be. Now, the measurement uses the actuarial liability which assumes some projection of future salary increases and so forth. So it's not precisely what would happen if everything stopped here.

>> Michael Armstrong: I guess what I'm trying to get from this is, what's the implication for the plan?

>> The implication is just that at this point, the assets don't cover all of the benefits and in particular right now they don't cover any of the active member benefits.

>> Michael Armstrong: Okay.

>> And only 84% of the retiree benefits.

>> Michael Armstrong: I guess my other question is, have you had an opportunity to read the Stanford report on the San José plan?

>> It -- no, I actually do have it printed out, but I have not read it.

>> Michael Armstrong: Okay. Be interested in getting your perspective, reaction to it. After you've had time to digest it.

>> Okay.

>> Matt Loesch: Any other comments or questions from the board? I have one. Additional things about -- one of the things I always have trouble with, if you flip to page 24, the very next page, it kind of gives a funded status as it goes along. And because this is my remembrance, and my remembrance is sometimes shady sometimes. Between 2003 and 2005 you see the decrease of funded status from 98 to 81. And my remembrance of the reason for that is an actuarial changes that occurred. And I don't remember what the actuarial changes that -- what was changed to make that happen. And again, if you look further on down the list, in 2009-10 area, or somewhere, it was the investment losses but then there was also big actuarial changes we made then that caused another large unfunded liability that was created based on actuarial changes we made. I'm wondering if this area here we could put a summary of just what those changes are, more for like a synopsis of what happened historically. So when we see these things we would know, I always think, why is that then? I have to look back at reports. If we have these things canned and in here, you don't have to change it, it's historical facts that

changed. Would it be possible to get from staff what changed in 2003, put that in there, and we have a synopsis of what we changed actuarially? We talked about what we changed here from the previous one, those details are in here but not what's happened in these other ones to kind of note historically what's going on whether it's just investment losses. Some of these large changes were due, to my remembrance, changes in assumptions or the way things were calculated. I just wanted -- for me, is that possible? To get that stuff and include it in the report?

>> We have old valuation reports that would show that, so yes, it's possible. I guess the question is, to what extent do you want it delineated? Perhaps we could -- do you want it as footnotes to this taxicab, for example, showing --

>> Matt Loesch: I think so simple narrative.

>> Benefit change or assumption change, that is something out of the ordinary?

>> Matt Loesch: I think so, yeah. Because I think it's clear because you note some of the investment losses and so forth as to what happened in this current valuation. But in some of these past valuations you basically have to have those valuations in order to explain things so you can understand trends. Because I tend to look at what's causing either a projection or change or direction or speed at which things are changing and the velocity of the change. If that's possible, if we could get that included. I assume since there are editorial things that need to be changed, there will be a revised version and sent off, is that correct? Since the other things you noted like the change in the numbers and looking at what happened in 2011.

>> Yeah, we can give you the editorial changes and give you a clean copy.

>> Matt Loesch: Is it possible to put this information on page 24? I don't know if 24 is if right location for it but seemed like it --

>> We might add it as footnotes to the table, we can do that.

>> Matt Loesch: Thank you. Any other comments or questions of the board? I assume we just note accepting the report, with the changes that have been mentioned. So I'll make that --

>> Mollie Dent: I would make a motion and second to accept the report with the changes so that it's on the record.

>> Matt Loesch: So I'll make a motion to accept the report with the revisions that somewhere been discussed here.

>> Second.

>> Second.

>> Second.

>> Matt Loesch: I don't know if we need to vote. If we have three seconds does that count as a vote? All in favor, opposed, thank you very much. Item 3.2, discussion action on counsel's memo, concerning trustees role in an environment of discussion and negotiations on vested benefits. This is the initial one, this is one from the city attorney's office and then an additional one in response to the response. So I guess we'll have Mr. Richeda start and then have Ms. Dent follow if she had any comment. Follow discussion.

>> Russell Richeda: The board probe knows this is a big issue but today I only want to speak on it for a very short period of time. But if there's any questions, you want to address me, please, interrupt me at any time. But-d and you might note out of all this, at least my perspective, I have one recommendation to the board, which is that you request the outside law firm retained by the city attorney's office to provide these issues, dealing with this supplemental memorandum. I think this is a very complicated issue and the more legal input that the board can receive might assist the board in grappling with these issues. Even as we all know that these issues are only

hypothetical at some period of time becoming real down the road. Throughout the nation there's increased public scrutiny on public defined benefit retirement plans. And obviously we know in San Diego -- in San José there is the possible ballot measure that has been vigorously discussed over the last several months. The board directed this office, and as did the Police and Fire board, to see to what degree the boards can adopt policies and protocols now to sort of get out in front of the issue before things become serious and before perhaps emotions becomes heightened. I prepared the memo that you have before you, I prepared it for Police and Fire. The upshot was that that board requested me to prepare a draft policy and submit it as part of the Cortex policy as part of the Cortex governance policy review and I've done that. But you can see just real briefly, I think there's two categories of issues that you're going to be concerned in this overall context. One, pending measures. For example, ballot measures that purport to significantly modify the plan of benefits, that you're obligated to administer. Obviously this could come from an ordinance of the city council, it could come to an amendment by San José charter, presented to the voters, and it could occur statewide through initiatives that are purported to be statute initiatives along the lines of the political reform act that the people adopted three or four decades ago or it could be a constitutional initiative or a statute passed by the California legislature that purports to apply to the retirement systems of charter cities such as our ours. And as you know Governor Brown is floating those kinds of issues, at the present time as part of his reform package. But it's unclear at what -- how those are going to be realized in what form, initiative, legislation or nothing. But obviously, lots of things are going on. But category 1 is, what should the board do when any of that category of events is occurring. And the bottom line for me, is that the board sole role is to provide neutral factual objective analysis of these -- of whatever the proposed measure is. And the law is relatively well developed on that issue. So with some confidence we can tell you what to do. And I think the Meyers Nave memo agrees with that, too. Things get more complicated in in the context of an enacted measure, whether enacted by the voters of San José, by the San José city council, or by the California legislature, or by the voters of California. And it seems to me there's two important categories of issues that would concern you. Number 1, significant ambiguities in whatever the measure, whatever the piece of legislation is. You really can't live with significant ambiguities. You have to know how to administer this plan. And I think this is a very complicated area so I am quite convinced and it's probably not surprising to you, to think that the probability of having significant ambiguities, in whatever comes down the road, I think is sizable. And you will have to decide what to do with -- in that context. There's another category I think of issues, that is probably no surprise to anyone, and there's an increasing conversation about them. Partly because of the fiscal dilemmas that many public employers are finding themselves in. And that is, if the purported or I'm sorry, now we're talking about once they're enacted. What do you do with issues or provisions of those enactments that raise serious, not trivial, serious legal issues and obviously the determination of whether it's a serious legal issue will require your judgment. Some issues are not serious. Some issues, particularly the easiest situation is one that seems to tread upon the vested rights doctrine as currently understood. Let's say there's a statewide initiative, it's statute, not constitutional, that changes the retirement formulas, for all retirement systems, including the retirement systems of charter cities. What to do? There is a well developed body of law under the vested rights doctrine, not every T's been crossed, not every I's been dotted under that doctrine, and there are certain sort of conceptual exceptions that really haven't been applied factually that perhaps, in the current situation, will be applied. But regardless of that you may well be confronted with situations where there's serious legal issues about the legal validity of the enactment that now you're obligated to administer. What do you do? One alternative of course is just to ignore the problem. I don't find that particularly reasonable or satisfying and I don't think that's consistent with your fiduciary duties and by analogy to what the trustee of a private law trust would do. So my recommendation has been that you obtain clarification of ambiguities, clarification of serious legal questions. And I don't think you can get adequate clarification from any entity outside of a court. Obviously, you can ask for that kind of -- those kind of opinions from general counsel, outside counsel, city attorney's office and mull over those responses, but they will not help you in clear and confident manner administer this system, only a court can do that. So my bottom line, and it's one that's very vague guidance because it's really going to depend on all the facts and circumstances of what you encounter, when you encounter it, and you may never encounter anything. But you're going to have to take reasonable steps in my opinion to clarify ambiguities, to clarify any legal questions that have been raised with respect to the enactment and then also thirdly, to get guidance and I think it has to be judicial guidance of how you're supposed to administer this plan during the pendency of any litigation, which, given the possible recourse to the California Supreme Court, and perhaps the U.S. Supreme Court, that there might be a gap of ten years between filing the suit and actually getting the guidance that you need. And during that ten-year period you need some sort of judicial clarification of how you are supposed to administer this plan. So that's why I've come to the recommendations I have, I've highlighted it, that at least to the latter questions, namely what you can reasonably do during the period after a proposition or a pending measure has been enacted. And then your obligation to administer kicks in. I've given you my reasoned opinion on what would be reasonable courses of action in accord to the action. You have the Meyers Nave response, which I think does not address these issues in a way that assists you in deciding how to confront them. And so my bottom line is that you request them to amplify if you find that appropriate.

>> Matt Loesch: Ms. Dent did you have anything you would like to add to the discussion?

>> Mollie Dent: Sure, I will be very brief. The memo that Meyers Nave provided to our office was not for this board, it was for the city council. It stands as our advice through outside counsel to the city council.

>> Matt Loesch: Mr. Andrews.

>> Arn Andrews: I think your memo and then the subsequent memos get to the heart of one of the reasons I thought it was important for the board to engage this conversation in the first place. Which is I don't want to be at a place where a day transpires, something has occurred and we've either done an action or, through inaction it can be interpreted that somehow we haven't upheld our fiduciary duty and we can find ourselves in a legal situation. And so I think your memo adequately starts the dialogue, so that we know what our role should be. And that we've had an opportunity to vet it before we get to the place in time when it might be too late to have these conversations. And I think, you know, just reading the three memos it's obvious that we need to have these conversations because there's already contradiction depending who you listen to. I read from these three memos you think it's appropriate that we get some prejudgment guidance. And then when I read the Nave memo it states, accordingly, we believe the board has a duty to administer the retirement system in accordance with the benefits and guidelines established by the city, unless and until a court of competent jurisdiction issues a final order. So in one sense we're being recommended we should get prejudgment guidance and the other one is saying, we don't have a role until everything is said and done. So I just want to make sure as a board we vet all these points which at some point will probably come to bear so we can speak with a single voice when the time comes or hopefully close to a single voice know what our role is appropriately. So I would tend to agree with the final memorandum

that we should get some additional guidance from Nave if they want to opine on this topic so we can continue this conversation.

>> Mollie Dent: Just so you understand, the Meyers Nave opinion was not provided for this board. So -- and the Meyers Nave opinion was not paid for out of plan assets. The Meyers Nave opinion was to the city council. So through our office. So in order for Meyers Nave to give any further opinion it would have to be under direction of -- either -- the city council basically. It wasn't -- it's being provided to you as a courtesy.

>> Matt Loesch: We could make a request and they could consider whether they want --

>> Arn Andrews: I guess my question to the board is, you know, Russ has opined on areas that he thinks are relative to us and potential sort of procedural ways we could look at things. Do we want to engage another voice? Using plan assets, which it appears you know this memo indicates would be an appropriate use so that we can get kind of additional thoughts on where our role would be or how would the board like to proceed with?

>> Matt Loesch: Well, let's do this. Let's kind of get everybody's feedback on what's going on. And if they want further input from Ms. Dent or Mr. Richeda or anybody else, then we can see where we go. Is there any additional comment?

>> Edward Overton: I agree with what Arn said and Molly and Russ as well. Meyers Nave have no standing with the board and their opinion is one that was provided to the City Attorney and I guess forwarded to the city council. It's good that we got it. I think we have our own legal representation, our own legal opinion. And I think we go with that. We can't have lawyers coming out of the woodwork saying this, that or the other who have no role with the retirement board. So my recommendation that we just drop any reference to Meyers Nave.

>> Matt Loesch: Mr. Armstrong.

>> Michael Armstrong: So just -- I'm trying to think through our responsibility and fiduciaries. So let me put you out some hypothetical situations for you to react to. If you read through carmen's report, no matter what we do on asset allocations, so on, ultimately we still have a major funding gap over time under a wide variety of scenarios. If you translate that into the impact on the city, and the cost to the city, let's suppose that there is a plausible scenario, in which the city would have to consider bankruptcy. If that happens or if we think that is a possibility do we have an obligation as fiduciaries to take a more aggressive advocacy position, on what should be done? In terms of sort of program design, funding, whether it is through an election, sort of what's our obligation there so that's one question. Second question that's sort of been gnawing at me, if over time we're basically running a plan that's 35% underfunded, are we exposed as fiduciaries because we're not running a funded plan over time? You know what's our obligation there?

>> Russell Richeda: My immediate response and those are complicated questions that deserve more than off the cuff responses but that's all I have at the moment, I think the easiest one, you take the plan as you find it and in the context of that you take reasonable steps to remedy the deficiency you find in it. You take those steps, no guarantee so much a fiduciary analysis is process analysis. Have you retained prudent experts? Have you obtained information from those experts? Have you taken prudent action based on those recommendations? Have you monitored the results of the decisions you made? Have you monitored your decisions based on your process? As far as I know you're engaged in that process. The results at the present time certainly aren't what everyone would desire. But I think from fiduciary perspective, you have -- the mere fact of the funding ratio is not a -- an indication that you've breached your fiduciary duties and on the contrary I think you're taking a multitude of steps that absolutely confirm that you're acting appropriately as fiduciaries. That was an easy one for me.

>> Mollie Dent: I would agree. I think the Meyers Nave's opinion is really clear that the board's role is not to determine the benefits. So to a certain extent it's really out of your control what the liabilities are going to be. But you do have an obligation obviously when you're setting the contribution rates, to act as a fiduciary. And you all have been doing that over the course of the last two or three years you know, with the rates of return and looking

at your liabilities. So I think that I'd agree that it's your responsibility as fiduciaries, is somewhat -- is somewhat limited by the plan design. Which is not within your realm.

>> Russell Richeda: Now you've raised more difficult questions with the first one which is one we don't particularly want to utter in public but the B-word. But you know from just a broad perspective we'd obviously be creditors and we'd be filing claims in the bankruptcy state in the contribution due us. I've never known that much about chapter 9, I was a little involved tangentially involved in the Vallejo bankruptcy. The city in a plan of reorganization, it is somewhat clear what they can do to contracts. It is less clear, I think, including under the bankruptcy code, what a bankruptcy judge can do with respect to obligations created by statute. And the law's undeveloped so we're not sure. So the bankruptcy judge might find that there's nothing that that judge can do with respect to the structure of benefits. Because that's set by statute. That that's going to be a difficult legal issue, that really, is probably neither here nor there as far as your question goes. Let's assume the bankruptcy court decides it has jurisdiction, to confront that kind of issue. Then it's going to be a very, I think, complex fiduciary decision making process for you. Now, you don't -- I'm not sure what role you even have as a creditor. I forget my bankruptcy law. Maybe the creditors -- there might be committees, I forget to what degree any subset of the creditors can themselves propose a plan of reorganization, which would be a vehicle under which you could explore some of the issues you're talking about. But otherwise, bankruptcy, given like so many legal vehicles, have certain ways of doing things and you cannot really move too far outside of those things. It may be difficult for us to take any kind of lead or you can only submit briefing and consult with the other creditors and the city.

>> Mollie Dent: So I'll just add that I think that bankruptcy is kind of a speculative idea at the present time. But I will just note that in the Vallejo bankruptcy, one of the things that didn't happen was that their retirement plan continued to function, and went on. So it's not necessarily the case that that would be something that would be disturbed in bankruptcy.

>> Russell Richeda: That issue wasn't addressed in the Vallejo bankruptcy. The city didn't attempt to -- they were Perez members.

>> Mollie Dent: That's why I'm saying it's kind of speculative to try to understand how the bankruptcy would proceed.

>> Arn Andrews: And I would just add as a glass-half-full person. Page 9 of the actuary report that we just accepted shows funding status increasing over time provided we make our 7.5 and granted the ALM study that we're going to discuss later talks about the disparity of 7.3 to 7.5 but that disparity is of significant improvement over discusses we've had in previous years. And so just to echo the sentiments of the two attorneys, I do think as fiduciaries we've been moving in a prudent manner and moving in a way where hopefully, page 9 of the actuarial reports will come to fruition one day, and instead of being a 35% deficient, it will be something less than that. So that's my brief moment of optimism and I'll just stop there.

>> Matt Loesch: You're allowed one. Mr. Armstrong.

>> Michael Armstrong: It does seem likely that something has come down the pike and we'll have some uncertainty, so I think it's -- you develop a plan to deal with that and this is a good first step.

>> Matt Loesch: Any further comments or questions?

>> Would I just say I'm not in favor of going back and spending more legal resources to rebut the prior memorandums any further. I think it's very clear to me anyway what my responsibilities are on this board. I'm also not in favor of spending a lot of legal time on what ifs of what might get enacted in the future. We have -- we're not allowed -- we're not going to opine on those things publicly, that's not our role. Our role is to interpret those things, and follow through with them. So if we don't understand whether the -- what we're being asked to do is legal or not, then we obviously have an obligation to determine that. But I don't think we should be spending a lot more money until we actually have something tangible that we have to interpret.

>> Matt Loesch: Anyone else?

>> Arn Andrews: I would agree with that with one exception. Just at the recent council meeting and the liaison can speak to that, if he would like. They did approve putting it on the ballot in June and I've heard people say they hope it would provide budgetary relief come July 1st, we're not going to have a lot of time to react as a board. The expectation is, and I agree with assessment that the board does not have anything to do with the benefit structure. But I think where I'm concerned is if the benefit structure changes and if there are lawsuits, that one day down the road reverse what had happened, have we collected the appropriate amount of contributions at that point, and we will not. And so that's why I totally agree with you. That we should not be moving into speculative areas and wasting resources on speculative areas. But I'm concerned the way the calendar's lining up we'll have a very short window to think about these things. And that's why I just wanted to have the conversation happening to a certain extent now.

>> And you know we may have to do something in response and we may have to change that later, after we've had the opportunity to fully vet it and under the implication. So I don't think there's anything that says we have to react within a month to something, and we can't change our mind later. So as the process goes through, we may take, and it sounds like if this does get litigated, it is literal a years and years process. So we will certainly have plenty of time to do our legal work, as well.

>> Matt Loesch: Councilmember Constant.

>> Pete Constant: So if coy just clarify the action that council took. The council approved the ballot measure language. But agreed to not transmit that language to the registrar of voters until March 8th or 9th, I forget the exact date, with the intent of continuing in mediation with the bargaining units. So that language can, in fact, change between now and March 8th or 9th. So nothing will really be set in stone until that transmission has been made to the registrar of voters.

>> Matt Loesch: Any further comments or questions?

>> Mollie Dent: That is correct. It's the ballot language was approved, but it has not gone to the registrar of voters.

>> Matt Loesch: Okay. First of all I'm kind ever in favor of just sitting pat right now and not seek more advice legally at this point, I don't think we have -- I think we have kind of a framework of -- these are the kind of ranges of possible thoughts that we might or potential activities that we might engage. And in the next month or two, we'll have additional maybe different counsel and we may want to review some of the thoughts then and see if we're on the same track and see how these things go. So I mine to spend more resources at this time, I agree with Mr. Odell that if we stay pat that would be a good idea. Any comments or questions? Our action is no action.

>> Edward Overton: Move to note and file.

>> Second.

>> Matt Loesch: All in favor, opposed. 3.3, update on legal request for proposals.

>> Mollie Dent: So the legal panel has finished their scoring and we've had one conference call to go through the scoring and we're going to try to set up another one now that we have our -- Mr. Loesch was one of our interviewers was back on board. So we're still moving forward, and hoping to have something to this board in January. I don't think we will have something for the Police and Fire board in January because of how early their meeting is.

>> Matt Loesch: That's a stretch. Yeah. Would you expect the negotiations on the actual agreements to be fairly efficient? Because they've already essentially agreed to the block format, right?

>> Mollie Dent: I would expect the negotiations to be pretty efficient. We will still negotiate even though we got price proposals we'll still negotiate but the form of the agreement is pretty well set. And there were some -- there are a few things that will have to be negotiated. But I don't -- I think the interview process will be -- is going to be

difficult to set up with the holidays. That's really the main question, whether or not we can get through interviews before January 1st.

>> Matt Loesch: And just to note to the board, before my term expires, I did get my scores into the attorney's office before the term expires and they did hold the conference call while I was technically still a member of the board and I did participate in that. So soon. Okay. Item 3.4, discussion action regarding the review of retirement services department staffing. Understanding there's no update at this time but we hope very soon in the next month or so we'll have a response back from the city? Is that correct?

>> Russell Crosby: Correct.

>> Matt Loesch: Okay so is there any other comments or questions to that?

>> With respect with respect to the response to our letter I assume?

>> Matt Loesch: Correct.

>> Any other question, does that mean City Manager is going to come to our meeting in person or will we get a response in writing? Do you have any idea what that looks like?

>> Russell Crosby: I have no ideas but there will be a response I was told probably before the holidays.

>> Lara Druyan: Thank you.

>> Matt Loesch: Okay.

>> Will that be an agenda item for the next meeting then?

>> Matt Loesch: We'll continue it until it's resolved, hopefully the response could come before then. Update on the electronic board packets. Ms. Busse.

>> Donna Busse: We've received nine responses to our RFP and we've narrowed it down to four. And we had demos from the four on Monday, and the staff is now working to formulate a recommendation to the board which will come in January.

>> Matt Loesch: Comments or questions? January it will be. It will be an exciting month. 4.1. Update from the chair of the investment committee. Ms. Druyan.

>> Lara Druyan: Some of this is already in your PAC but we had a long meeting. We discussed the current performance of the plan. Both for the quarter ending September 30th, as well as an update through October 31st. As of the Q3, for year-to-date we were down 5.2. But we were hitting our benchmark policy benchmark of negative 5.1 and custom benchmark of negative 6.2 which we're ahead of. Year-to-date we made a lot of gain, lot of ground we recovered, year-to-date we're up .6% and again we're hugging our benchmarks in terms of performance. Mikita present they'd to us. And they also did an educational presentation to us about CIO in a box. This is obviously in part concurrent with the discussions around lack of staff. And our inability to hire staff. So we were presented with Mikita who had discussed their experience in managing money for one plan. They don't have a particular CIO at Mikita. They make their decisions as a team. And in terms of one of the questions I wanted to understand was allow the '08 performance was. The '08 performance they said was comparable for the plan where Mikita manages where they act effectively as our staff would, was down about 22% comparable to San José. That's probably better in the sense that I think San José was more conservatively managed, relative to people who took more risk that was a better return. But we can have a more spirited debate of what we would want that to be if we were to outsource. And Mikita does doth this for a couple of plans. Over the next number of meetings we're going to have different presentations from other groups that would, could, would, be interested in doing this for San José. Again, it's educational, it's not a decision. We're just trying to educate the committee to understand what options are available to us in the event that either you know we have more staff leave, or that the plans decide that's a route they want to go down.

>> Matt Loesch: Okay.

>> Lara Druyan: So that was -- that took -- we also had a very lengthy discussion about priorities, both with -- on the P and F side as well as our side. And we also approved, which is going to be up for discussion, moving forward with Alborne on the hedge fund side on the absolute return side as an advisor, they're a group that Stewart knows well and they will help us set up our absolute return program.

>> Matt Loesch: Questions or comments from the board?

>> Edward Overton: Do we not have Carmen acting as CIO?

>> Lara Druyan: No, of course we do.

>> Edward Overton: What's -- where does the CIO in a box concept, how does that mesh?

>> Lara Druyan: CIO in a box would, if, heaven forbid, Carmen resigned we would find ourself in a position without a CIO. Given some of the constraints we've discussed at this board about what we are able to pay a CIO, that may not be an easy position to fill. And we would like to understand what alternatives we have, should we have difficulty in finding a CIO, since I certainly don't want to be responsible for running the assets of this plan. And I don't think anybody on the board does. So to have -- understand what other alternatives we have, I think is important for us as fiduciaries.

>> Edward Overton: Okay.

>> Lara Druyan: That is not a -- this is not a decision, this is really an educational process.

>> Edward Overton: Right. I guess my concern was, what was driving the educational piece of it?

>> Lara Druyan: Yeah, I think we are so understaffed we have difficulty selling our staff position and we need to understand if people resigned, what alternatives do we have?

>> Matt Loesch: Covering the proverbial bases.

>> Stuart Odell: But even the CIO in a box, the job responsibilities are beyond a single individual. It's really talking about the fact that you have got, what, four investment staff vacancies right now that they don't have filled. So where is that -- where are you going to get that expertise and the questions is do we look at other ways to get that, if we're not able to fill the positions within it. So I'm -- I just want to make sure that the titling of CIO in the box doesn't just mean a single individual.

>> Lara Druyan: Yes, absolutely.

>> Stuart Odell: Who is kind of standing at the top and deciding where the asset allocation goes. But this is really the investment structure that stands behind it. So where are you doing your research? How are you selecting managers? You know how are you doing due diligence? Ongoing performance monitoring. So all of the staff functions how are they going to get handled going forward. Hopefully, we are going to perform our jobs and get higher salaries and all of those things in but --

>> Lara Druyan: There was another thing that could be done with these depending. So some of the people who run these are nationally known investors. And there are groups, so let's say Abu Dhabi investment authority I don't know how many billions of dollars they run, they have massive staff. They do outsource part of their portfolio, I don't know, N-hundred-million to groups around the country to borrow the best thinking in finance. That is something they do effectively renting it right? And so that's also something that's worth learning, do people have something that's worth renting and is that something from which we would benefit? Because as good as our staff are, there are also, real experts out there who also have access to things that we might not have access to. In terms of either private equity or absolute return or what have you. Sorry Marty.

>> Martin Dirks: Just seeing all the best practices and being put in place will be helpful to us.

>> Lara Druyan: I'm sorry, Arn, did you have something to say?

>> Arn Andrews: I was just going to say, in essence, to the point that it's not a single individual. It's a contingency plan for the left side of our organizational chart right now, the whole investment side.

>> Russell Crosby: Correct.

>> Lara Druyan: Absolutely. And also potentially, as I just described, additive to what we do.

>> Carmen Racy-Choy: Meaning even if I'm still around, we would benefit from having, for example, McKenna as one of our managers, because they are very transparent and they would, looking at their manager rosters, gives you an excellent list of managers that you could potentially when you're doing searches, focus on whether any of their managers that might be a good fit, and ultimately, that might lead you to a better answer. So I would say that even if you have staff in-house, outsourcing a portion of the assets to an excellent manager, and seeing how he's structuring and how, basically which managers are on his list, can be quite helpful.

>> Lara Druyan: Well, and also that some of these groups like McKenna or Hivest or whatnot are in funds that are closed. And they have allocations because of their relationships with these funds. And in a world where -- you know a lot of those funds are afraid of public plan money for a variety of reasons. And it's a way for us to potentially get access to things we just wouldn't get access to otherwise, because the funds have been closed for so long, and don't accept any limited partners.

>> Matt Loesch: How is the joint meeting structure working?

>> Lara Druyan: Well, P and F has obviously because they have different managers, they have had -- they didn't implement a global equity strategy when we did, they have different issues with respect to, you know, who those managers are and so on. So at some -- so that's hard. Because that is stuff that we -- doesn't necessarily affect Federated but we are involved in some of those discussions. But it's great in that you know, when we have the discussion about Alborne we're not having two sets of -- you know two committees, one choosing Alborne, one choosing cliff water, having staff have to do due diligence on both, we benefit from fee negotiation once we set up an LLC frequent where we can do it as a joint pool, truly. So I think although, as you probably listened to the tapes and heard, some of the differences with respect to what their issues are, I think in the medium and long term it's going to be great for all of us because staff won't be having two sets of directions on the same items. And so I think it will be very effective for us. But right now, there's some start-up costs.

>> Matt Loesch: Sure, some of my concerns, I've expressed them before, as we work jointly, it is sometimes very good and very handy, but also we sometimes handicap each other by the issues that need to be resolved on either end. And as long as we just keep focused and try to make the efficiencies, if there's times where we just need to have just Federated things and they need to have just Police and Fire things, to the extent the knowledge base is beneficial to both, I think it's great. But I also want people to be cognizant that just because this is the way it is, doesn't mean we can't make adjustments. And I want you to feel empowered to make those adjustments.

>> Lara Druyan: Thank you, and we will, so far I hope it's been better for staff in doing it this way. Certainly with respect to getting the hedge fund strategy off the ground.

>> Russell Crosby: And I don't think it's just an issue of staff and staff resources. I think there's also real advantage and over time that's going to emerge more and more, where there's differing expertise between the two boards. Right now, I would say that there is a flow from Federated to Police and Fire. But over time it may flow back the other way. So I see great advantage over time, because the trustees particularly the ones on the investment committee all bring such different backgrounds and different skill sets. I think there's going to be great, great value to that. And it really emerged in the Alborne discussion and the discussions of hedge funds. I think that there's been some good back-and-forth between the two boards on those kinds of issues.

>> Lara Druyan: I agree with that.

>> Lara, also at the meeting we -- I was there as an alternate -- we had the two investment consultants make presentations. Maybe talk a bit about why we did that, what was the objective of having them --

>> Lara Druyan: I mean Mikita was there of course to present our -- I think both -- Mikita on our side, NEPC on P&F side, to present planned performance for both, right? And we have to, of course, approve -- you know sort of accept what they've said as Federated and P and F has to do it on their side. I also think that there's some interest on staff's part in trying to find one consultant, general consultant so we don't have, you know, two groups that are, and frankly giving somewhat different advice, in terms of who they recommend in terms of managers. I can only imagine what a headache that causes. And so we got -- I was interested in understanding the backgrounds of the people presenting. So we got some of that in that meeting which I think is important because if you are going to potentially have one consultant, be really nice to know who's doing the day-to-day work.

>> Russell Crosby: Well and we'd also like to think not necessarily in terms of just one consultant, but perhaps a roster of consultants.

>> Lara Druyan: Absolutely.

>> Russell Crosby: -- that are very specialized and rather than paying, both trusts right now are paying substantial amounts with retainer relationships with two consultants that perhaps over time and recognizing the skill set among the trustees is that perhaps we don't need that general overall retainer relationship, as in the past, with the board we've got, and the staff pieces and particularly if you add in a CIO or other elements on the side, back away from the high priced retainer relationships and just go to -- have a roster of consultants and specifically target for an issue that the board has or a question the board has. Go to a -- the best practices consultant in that one area, rather than keeping somebody on retainer all the time.

>> Lara Druyan: And at least from my perspective I have heard about NEPC from Russell, from the P and F guys. I've never seen them, at least I mean -- on Mikita I have a data set of one on general consultants. Now at least I have two, right? So I've doubled it. So that's -- at least from my perspective that's useful to understand what else is -- you know what else is out there because you know having talked to some other people in the -- NEPC is as well-regarded as Mikita. So to understand that is useful from my perspective and hopefully from the other members of the investment committee's perspective.

>> Matt Loesch: Any other comments or questions? Super, thanks. Item 4.2, discussion and action on the asset liability study. Before you get going, Carmen I just wanted to ask a question. We received in our packet initially a draft version and then last night we received something that's not draft, it's final. My information ended up on draft lapping, I just want to know what's different.

>> Carmen Racy-Choy: What's different is the fact that we updated performance of the plan. In the draft the performance of the plan was reflected until September 30. In the final we've reflected performance until October 31st. In large part this was due to the fact that Q1 as you know was a major downward spiral. And October picked up a lot of the losses of the first quarter. So we didn't want to present a very pessimistic view. We thought we'd update it till October what is a more up to date view and probably a more relevant number going forward.

>> Matt Loesch: Do we need to do anything on sunshine since you received it? You said on presentations we do not. Just want to be clear.

>> Mollie Dent: I think you do because you got this as an action item. And it's substantially different but that's fine, you can waive sunshine on it.

>> Matt Loesch: Just for purposes of comfort and everybody is all warm and fuzzy we'll do it. I'll -- somebody make a motion on sunshine waiver on the final version of the asset liability model report.

>> Edward Overton: Move we waive sunshine on the final asset allocation report.

>> Second.

>> Matt Loesch: All in favor, opposed, thank you. Even though we don't need to, we are double covered.

>> Carmen Racy-Choy: I'll comment that there are a couple of changes the investment committee asked us to make on the report and one was to add -- to show the type of returns that it would take for the plan to be fully funded. And so we added a slide in the report, fundamentally explaining that it takes returns annually in excess of 12% per year for the plan to be fully funded in ten years. The other -- we added also a few slides, the investment committee requested that we run scenarios on the correlation assumptions and so we added appendix C to the presentation. We created three correlation assumptions. The correlations changed significantly based on the type of economic scenario. So we created a growth scenario, and inflation as the primary driver of return scenario, and the third scenario was risk premiums across the asset classes being the primary driver of volatility of returns. And the intent was really to try and see, does the recommended asset mix change if we change the correlation assumptions? And I'll give you the answer immediately. The answer is no. But it's still nice to have run the scenarios. So this is kind of a synopsis of the changes. With that, I'd like to take you to page 3. What we're hoping to accomplish in the presentation is to really to review the evolution of the financial assets of the plan under the current asset mix. The second phase of the presentation we're going to run alternative asset mixes to try and look at the financial position of the plan. And key metrics such as the employer contribution, under different asset mixes. The third, really important part of this report is actually strategic liquidity. This report will, later on, describe the benefits of moving to a higher alternative asset allocation, and so the focus of the section was to ensure that basically the board is aware of the strategic liquidity needs, and that we are very much aware of the immediate and the longer-term cash flow needs of the plan. So with that, on slide 4 I'm just going to remind trustees, I'm sure you're aware at this stage with all the actuarial presentation, the funding ratio is a key indicator of the health of a pension plan. Funding ratio greater than one indicates a surplus, a funding ratio of approximately .6 indicates a severely underfunded plan. The funded actuarial liability is fundamentally just the deficit of the plan as of a specific point in time. It uses smoothed values as opposed to a smoothed actuarial value as opposed to the market value. With that said, I'll just describe briefly the -- what it is that we actually do to provide you with this

report. Typically, we -- you build a model to model the liabilities. Then you build a stochastic portfolio generator. The purpose of the stochastic generator is to show you the value of the investment risk. The generator will generate very high very low and normal scenarios and typically what you would do is look at the performance of the assets and you would recalculate the liabilities for every scenario. So fundamentally you're actually doing 500 actuarial evaluation for every scenario. And the result of that work you will see later in the report. I would like to take you to slide 7. Just very briefly, the investment committee suggested that staff group the asset classes into four broad asset classes. The first one was public and private debt. The current allocation, given our current long term asset mix, is 25% to public and private debt. The second broad category was public and private equity, and equity real estate. The current allocation is 60%. Absolute return strategies, the current allocation is 5%. Real assets, the current allocation is 10%. So this is your current asset mix in a snapshot. With that said, I'd like to take you to page -- to slide 10. I'm going to briefly explain the color-coded charts. And basically, discuss what the median -- you're going to see the median, the 75th percentile, the 25th, referred to throughout the report. Fundamentally, the median is, if you run 500 scenarios that middle value is your median. If the 500 scenarios are sorted, the 75th percentile would be your top 125th scenario and the same for the -- it is the opt for the 25th. The purpose of this color-coded chart is actually to show you volatility in a nutshell. With that, I will go to slide 11. What this slide is actually showing is the range of returns of the funding, the evolution of the funding ratio of the plan. Clearly, one thing to keep in mind is when we're discussing the fiscal year 2013 in this chart you're actually using a June 30, 2011 actuarial valuation. So the fiscal year 2010 numbers will reflect the actuarial valuation that you've just done. The comment that I have on this chart is clearly a graph shows that over a ten-year projection period the range of potential funding ratios is very, very significant. In fiscal year 2023, the plausible range, this is I'm going to refer to it throughout the report, it's the range between the 75th and the 25th percentile, and this is 94.4% to approximately 50%. This is the one way to measure the risk of the plan. A couple of observations on the median values. The funding ratio over -- in fiscal year 2014 and 2015, is expected to go down. This is due to the final amortization of the 2008 investment loss. And in fiscal year 2016, and 2017, the funding ratio will go up predominantly due to the amortization of the investment gains of 2010 and 2011. Beyond that, beyond 2019, the funding ratio is improving gradually and this is due to the extra payments that the city is making to fund the unfunded actuarial liability. Next slide is slide 14. So we were looking at the funding ratio of the plan. Another important consideration, another key metric is the employer contribution. This is a beginning of year contribution, you were just looking at a contribution in dollars from the plan actuary. I just want to convey that there are a few differences between their projection and ours. The first one is, the actuary will only reflect the fund's performance until June 30. So we've reflected four additional months of investment performance. That's approximately 75% of the difference between this projection and the numbers the actuary is showing. The other 25% is due to the fact that this study does not use the 7.5 return assumption. Clearly when the actuary is making a projection he will assume that the fund will earn 7.5%. In this study, the current asset mix is projectative. We have explicit assumptions for every asset class. We have also explicit volatility and correlation assumptions. The stochastic generator will generate scenarios that match these assumptions and ultimately the current asset mix has a median return of 7.3. So there is a bit of a loss in every year that comes due to that discrepancy between the expected return ton asset mix and the actuarial assumption.

>> So Carmen, the scenario set that you used is the same set that Cheiron used?

>> Carmen Racy-Choy: Cheiron doesn't do a stochastic modeling. Cheiron will assume very simply on the investment side. But you, the fund will earn going forward in every year the investment return assumption of 7.5.

>> Then how are they generating -- they showed a scenario here where you had volatility of returns.

>> Carmen Racy-Choy: I think they used a historical set where they said okay, if history repeats itself, this is the --

>> Michael Armstrong: So more of a deterministic?

>> Carmen Racy-Choy: More of a deterministic guide. I think it's basically looking back in the past. So our projection is really using that -- the investment committee's capital market assumption on return, volatility and correlation. And it's using those as a basis for projecting what will happen in the future. And since we really don't know what will happen in the future, the uncertainty is reflected by the 500 scenario. Does that make sense?

>> Michael Armstrong: Yes.

>> Carmen Racy-Choy: I will go next to slide 16. The only comment that I will make on this chart is away you normally would like to see in the employer contribution as a percent of payroll is a flat number. And the reason you would like to see a flat number is because this kind of conveys the fact that you are adequately funding the plan. Fiscal year 2013, the expectation is, an employer contribution of approximately 44%. This will rise to a rate -- to an employer contribution of 50.3%. The main reason, there's two reasons for that increase. In one situation, it's because we've reflected the additional loss of -- for the October 30 investment loss. The other, and bigger, reason is really the tact that the amortization method that is currently used does not pay the interest for the first few years of a specific amortization schedule. And as a result, we are still in a phase where the employer contribution has not quite leveled off. I see questions, faces with questions.

>> Arn Andrews: When I read that part of your presentation about the interest not being paid, that was a new nuance to me. Could you speak a little bit more about that?

>> Carmen Racy-Choy: Absolutely. The actuary uses a percent of pay amortization method. What that actually means is, they will project the amortization, the payroll over 20 years. Now, as you can imagine, if you grow the payroll at 3.25, or I believe 3% is our assumption currently, the payroll in 20 years is probably four times the current payroll. And then if, based on payroll, you amortize the unfunded as a percent of that payroll, you're really pushing back a very significant portion of the payments. And as a result of that methodology, in a 20-year layer, which is the change methodology, you will not pay the interest on the unfunded for the first three to four years. Prior to June 30, 2009, the amortization period was 30 years. And over such a long period, you end up not paying the interest for ten to 12 years, easily. And that's really what's driving this slightly increase in the payroll, the employer cost as a percentage of payroll so the amortization is not really working like a mortgage, where typically you pay the interest and a portion of the principal.

>> Arn Andrews: Right, we've deferred internet payments for a substantial period.

>> Carmen Racy-Choy: Right. I wanted to make sure everybody understood that component. Next, slide 19, this is just a brief --

>> Arn Andrews: Sorry, one last thought.

>> Carmen Racy-Choy: Sure.

>> Arn Andrews: Is there an amortization methodology that captures the interest?

>> Carmen Racy-Choy: Absolutely. I mean -- the -- the board can definitely explore that, it was the desire of the board to capture at least the interest for the first few years.

>> Arn Andrews: Like I said it was just a new concept. I think exploring it more would be helpful.

>> Carmen Racy-Choy: We can definitely ask the plan's actuary to do so. Slide 19, the comment there is that the employees do not share in the investment gain or loss. So this pretty much wraps up the view of the current financial situation of the plan. Next, we're going to move to slide 23. Where we're going to start exploring new alternative asset mixes. The asset mixes that will be analyzed represent two very different trajectories that the board could choose to take. Asset mixes A, B and C, represent varying decrease in increasing alternatives. So asset mix A has the allocation to absolute return strategies and real asset increase to 15%. Asset mix B has absolute return and real assets at 20%. And asset mix C has absolute return at 25% and real assets at 20%. The reason for this gradual change is to really show the board the impact of introducing alternative into the long term asset mix. Then we have a very different type of direction that the board could take. And that is, to increase equity. So we increase the allocation to equity from 60% to 70%. At the expense of fixed income. And the key component is, there is a gradual increase in the median return for the asset mixes as you go from left to right. What is significant, though, is, for example, looking at asset mix C, the current volatility of the portfolio, which stands at 15%, could be reduced by almost twofold percentage points. And it would go down to 13% with asset mix C. What I want to point out is, going the opposite direction, and increasing equities, results in a very

significant increase in volatility. The volatility would increase to almost 17% if that was the avenue that was chosen. So this really is just showing you asset volatility. As I'm sure you're aware, the key is to manage surplus in a pension plan. And the key is to focus on employer contribution and the funding ratios. The analysis that you're going to see over the following pages is going to convey that cutting volatility by three or 3.5 percentage points, could actually decrease the volatility of the funding ratio by as much as 40%. It would decrease the volatility of the employer contribution by almost a third. And that's a goal of running the analysis that you're going to see in the coming section. So with that I'd like to take you to section 24. Sorry, slide 24. So again, just looking at the graph. The size of the various boxes conveys the volatility of the asset mix. Starting from the current asset mix, you see a very gradual reduction with every asset mix until asset mix C, in the size or the length of the box. And hence, in the volatility of the allocation. At -- once you get to asset mix C you can see the volatility of potential funding ratios is significantly different. The difference between asset mix D and asset mix C if you compare the 75th to the 25th boxes, asset mix C shaves off approximately 40% of the potential volatility of an asset mix such as asset mix C. The other comment that I would make on this graph is just the -- there is a gradual improvement in the median funding ratio. This is due to the fact that the asset mixes present slightly increased returns as you go from left to right. Basically what this is conveying is that asset mix C has approximately the same median returns but pro possesses a significantly lower volatility of the funding ratio and you will see that the same holds true also for the employer contribution. So unless there's questions on this slide, we will go on to slide 27. Fundamentally the same comments hold true. I will just convey that the range of potential employer contributions, if I look at the plausible range again, asset mix C reduces the potential range by a third comparatively to asset mix D. So the same trend can be observed which is each asset mix, starting from asset mix A all the way to asset mix C has a slight reduction in the volatility. The expect -- the median employer contribution decreases, again as you move from left to right, this is due to the fact that the expectations are returns often the asset mix increases slightly. So again, it's fundamentally the same result. Since the asset mixes are showing a very significant increase in the allocation to alternatives, we wanted to make sure to consider strategic liquidity needs. And so for that I would like to take you to slide 30. What this chart is showing is the -- we first, for every stochastic scenario, we looked at the cash inflow and the cash outflow. So the cash inflow would be the investment return specific to the scenario plus the employer and employee contribution specific to the scenario. The cash outflows are obviously benefits and admin expenses. We present-value over the forecast period, the present value of those cash outflows, and we divided that by the present value of the market value of the funds. The intent was to try and convey the level of strategic liquidity that is needed. And it is interesting to note that at the median, clearly, the benefit payments over the next ten years will more than double. So this is really the underlying factor in the numbers. At the median, an allocation to liquid assets at 5% would be sufficient, and even at the 95th percentile, an allocation depending on the chosen asset mix, an allocation to liquid investment of 14 to 18% would be sufficient. This is clearly requiring a liquid allocation that is well below the allocation to liquid asset classes of any of the scenarios that are considered, because the significant portion of the equity allocation, a good portion of the fixed income allocation as well as the majority of the commodity allocation or the real asset allocation is liquid. Any questions?

>> Stuart Odell: While the scenarios paint sort of the outside chance results, I would say in practice, in terms of how much liquidity you need, you went outside the 95th percentile in 2008. So you would never -- in terms of determining your actual liquidity needs, the buffer that you'd want to have here is going to be significant above probably even your 95th percentile. Maybe it's double it, you know, I don't know the answer right now. But you'd have to figure that out. But you're somewhere in that range of maybe worst case world ends by the way your fixed income isn't tradeable either in 2008. So you have to be really careful. But maybe it's 40%. If I just double the 18, add a little bit. That still implies you could have as much as 60% of your plan assets locked up. And never have a problem meeting your liquidity requirements for the plan. So that's sort of an outside kind of think about how much could you do, in illiquid and then of course illiquidity is variable. So it's really how much liquidity could you get in a month, in a day, in six months, in a year, because a lot of this stuff comes up. So if you're in hedge funds, you know there may be redemption periods, notice periods, lock-up periods et cetera. But you can model all that out to determine when is my cash coming?

>> Carmen Racy-Choy: Coming, absolutely. And again we're looking at a ten year period what's needed over the ten-year period. The immediate needs are even lower because really the benefit rises for the last part of the forecast period.

>> So I was going to ask over the ten year period some of the insurance clients I work with are looking at you know far more long-dated kind of analyses. What's --

>> Carmen Racy-Choy: Really, the period should be in tandem with the frequency of review of your asset mix. So from a policy perspective, the -- we believe that reviewing at least every five years is appropriate. So really the period you want to look at is more in the five, maybe ten-year range. This doesn't mean that the analysis can't be done going forward but clearly as the plan matures, you have a greater need for liquidity. So this, you would need to redo the analysis. We do have the cash flows going quite a bit in time. So I mean the analysis could be done for a longer period of time. So the key is, the more you move over five years, the less you can actually count on the numbers. Because I think the picture will change very significantly every five years as the plan matures.

>> Arn Andrews: And just in a similar vein, I had a similar question. On the 10-year horizon for the stochastic, wasn't it 20 last time you presented? I was just curious.

>> Carmen Racy-Choy: You mean at the investment committee?

>> Arn Andrews: No, the last time we received an analysis on median rates of returns, about a year ago, I thought you used a 20-year horizon.

>> Carmen Racy-Choy: For the actuarial discount rate discussion?

>> Arn Andrews: Yes.

>> Carmen Racy-Choy: We did do a 30-year capitol market assumptions, and so that was the -- that was what was quoted. The difference between the assumptions, the asset liability study typically you do approximately a ten year projection. And so we developed capital market, ten-year capital market assumptions. The only difference between these and the 30-year is the fact that everybody agreed on the investment committee that fixed income

rates were fairly low, and that the expectation is that over a longer period of time, that you should be able to earn a little bit more from fixed income. And so there was a difference, I believe, of 1 percentage point between the fixed income rate of return here and what we assumed for the actuarial discussion.

>> Arn Andrews: Thanks.

>> Carmen Racy-Choy: Are there any other questions?

>> Edward Overton: Is there somewhere you give the return contributions for each of the asset classes?

>> Carmen Racy-Choy: The entire contribution for?

>> Edward Overton: The return-c. What's assumed to be contributed by real assets? What's --

>> Carmen Racy-Choy: Absolutely. That's in appendix A on slide 34. I'll just briefly go through them. The absolute return assumption is 6.5%. Public, private equity and real estate is 7.75. Public and private debt is 4.75. Real assets is 6.50.

>> Edward Overton: Okay.

>> Carmen Racy-Choy: If there are no further questions I will just go to the conclusion. Fundamentally, the main -- the thing to really draw from the analysis is that the funding ratio and the employer contribution are even more volatile than asset based volatility alone. You were able to see the impact that reducing the volatility by a couple of percentage points made on the funding ratio. And on the employer contribution. The other key take away is that adding alternative investments to the current structure really increases slightly the median -- sorry, reduces slightly the median level of employer contribution and lowers the volatility of the employer contribution, as well as the funding ratios. Consequently, the staff is recommending that the board adopt asset mix C as the long term asset mix.

>> Matt Loesch: Questions or comments? Anybody? Mr. Odell.

>> Stuart Odell: I didn't raise my hand. I was going to wait to see who was going to comment first. But I think it's -- I think the analysis is straightforward. And I like the simplicity of the asset class the way we've broken out the asset classes. Because you are trying to project something very far into the future. Your margin of error is humongous. And I think bucketing these into the broad asset classes that are going to be the drivers going forward is very good. And if you look at the scenarios, A, B, C, what you see is a very different potential asset class structure. But the return assumptions are not materially different. However, the volatility on the portfolio, the change in volatility, and clearly that's due to the use of the alternative investments, probably the absolute return is probably having the biggest return on that is my guess, is significant. So you know, I think this is a very clear demonstration about the value of the investments you ultimately select behave in some way like the assumptions that you're setting. And when you use terminology like absolute return we're talking about a world that can mean pretty much anything. So it's how you implement that, that will be critical. But I think this does give us a very good starting point for setting boundaries around how staff or outside consultants or the board can work within those asset classes to try and develop an actual implementation strategy within that. So I think it -- I like the simplicity of how this was put together. And I think getting overly complicated in trying to understand what the correlations between sub-asset classes will be and things like that is a level of detail that's going to create more confusion as this will have to be explained to other people that are going to look at this. But it's not going to necessarily result in a better outcome at the end of the day. So those are my thoughts.

>> Matt Loesch: Mr. Andrews.

>> Arn Andrews: My only thoughts are at the end of your comments, the implementation part, because this is kind of the nexus to the conversation we had earlier, about the fact that currently we don't have sufficient due diligence on the asset class that looks like based on this presentation is where we should be going. So you know I'd agree, from whatever perspective whether it's an employer contribution funding status you do get significant benefit there. I'm just concerned having been one of the participants on the last one and seeing how difficult it was

to get traction, to get that asset allocation implemented, you know making sure that we think you know the folks who are on the investment committee that you actually think implementation is feasible based on, you know, significant increase in an asset class that we've had trouble getting traction on.

>> Stuart Odell: Well you know we're going to need the resources. Bottom line whether it's the consultant groups or staff or CI outsources work, the resources aren't there right now to do this. So it's still an issue.

>> Mollie Dent: I have a small technical question really. Since the asset allocation is imbedded in the investment policy I'm just trying to understand whether or not the sense is that you'd like to have a simpler asset allocation, actually, in the investment policy that tracks this kind of approach, or the more bucketed, that's just a technical question.

>> Carmen Racy-Choy: I think the intent is to, for the board to approve basically the broad asset classes in order to give the investment committee and staff the capacity to move within the broad asset classes.

>> Mollie Dent: And that's what I wanted to confirm, so that when we bring the investment policy back, we can have it track with what we're looking at.

>> Lara Druyan: Absolutely.

>> Arn Andrews: And so going forward then, private -- I'm sorry, public and private debt, instead of it being described as 20% fixed income and 5% opportunistic and all these various gradients we have, it will be just understood that those gradients are implied in these four new buckets.

>> Correct.

>> Matt Loesch: Ms. Druyan do you have a comment? Mr. Armstrong.

>> Michael Armstrong: In terms of implementation are there things we can do synthetically to move ourselves towards these allocations as we go through the process?

>> Russell Crosby: Well, we had a brief conversation with your consultant the new Albourne team yesterday and the absence was no, don't do it.

>> Carmen Racy-Choy: Obviously there is an alternative and you can adopt productions such as AQR that fundamentally they are not a hedge fund per se. What they try to do is to build an allocation, or an investment portfolio that reproduces the broad hedge fund phase. For the various specific strategies that they typically the hedge fund space is divided into. And their suggestions was one, this exposes the plan to key modeling issues, to model risk. Meaning AQR or whomever the index provider, has built an economic model, there hasn't been sufficient transparencies to necessarily allow staff to know when this model would fail or under what economic scenario there would be significant nonperformance to the broad hedge fund universe. And so that creates a bit of an issue where you might be implementing as a short-term solution something, in a difficult environment the investment might not live up to the task that it should have. The other key issue is, if you use an index on a large asset allocation then you're allocating to a single manager, 25% of your assets, and that typically isn't necessarily a great way to proceed. So Albourne's recommendation was very much stay where you are, and when the -- you know basically they start -- they will start bringing forward recommendation on managers as they do that, we will move the money. And to the actual hedge fund managers. So currently, if the board were to adopt any of the asset mixes, through overlay, we would take the allocation to hedge funds and we would pro rate it across the other liquid components of the asset mix, as we have been doing since May. So we will continue to follow the same strategy but we will work with Albourne on implementing the allocation. Just to be clear it will involve a very significant number of managers and so this is not a situation where they're going to come in, in one month, with 20 managers and here you go. So we will be working on the implementation, probably over a period of six to nine months. So just to give you a heads-up. It's not going to happen immediately. But it will happen.

>> Matt Loesch: Would your thought be to, because last time we transitioned whole hog as quickly as we could. Sounds like this approach might be not as one big fell swoop but to kind of peel it off gradually or what

would be your thought here? Obviously we would be peeling it from our current equity managers and so forth to fund these, the bigger allocation. What would be your thought as to how to implement that?

>> Carmen Racy-Choy: We're going to implement in three phases. The first phase is, the board has an agreement with Russell investments to implement the board-approved policy through the overlay. So over a period of 1 to 5 business days, they could implement the asset allocation in an approximate way and with the caveat that the allocation to hedge funds would be split across the other liquid portions. Then, staff will start actually immediately working on a transition. As we had done last time, where first, we'll work actually with the investment committee on the structure. And once that is set, which shouldn't take a huge amount of time but it will take a few weeks, once that is set, then we will actually do physical asset moves. So the overlay is a synthetic use of really the Russell investments overlay to make sure that the risk levels that the board approved long term asset mix is implemented immediately. Then the physical will come probably in a couple of months. And again, that process will happen as it did last time. That will be immediate in the sense that as soon as we have a structure, we will go forward, and implement the -- a physical move. But I just wanted to convey that the hedge fund piece will be ongoing for many, many months whereas the rest of it could actually be completed much, much sooner.

>> Matt Loesch: And this document is not done yet for Police and Fire if I'm correct right? And the understanding is if we are going to move as much in tandem with them as we talked about would you try and wait until this is done with Police and Fire so we can do the hedge fund things and any of the alternative stuffs that we'll be using Albourne for on our behalf are you planning, to start some of the initial discussions but as far as actually making moves and investing and things, waiting until Police and Fire would be done with theirs as to what their mix would be?

>> Carmen Racy-Choy: So separate from the transition issue on the tricks we wouldn't wait at all until Police and Fire decide. For purposes of the actual investing in hedge funds, the next investment committee is the end of January. So Police and Fire are scheduled to have their asset liability study presented at that point in time and really, we've asked Albourne, we're working with Albourne to see if they'd be in a position to come and start

talking to the investment committee about how to structure the allocation. So very much our thought is that this is going to happen. We're moving as fast as possible. But it will happen jointly, with Police and Fire. We do not expect that there would be situations, we hope actually, that most of the investment decisions in the hedge funds would be common.

>> Russell Crosby: But they can proceed on and continue with Federated. It's not -- you know you're going to have hedge funds in Police and Fire. You know you're going to have some percentage that's going to be in the ballpark of where Federated is. So the whole hedge fund selection fees can move along regardless of the where they are, in their asset liability modeling. If that makes sense.

>> Matt Loesch: Yes, absolutely. I just wanted to kind of have that conversation so we can understand how we're going to start the general transition but then how we're going to -- these other pieces, the hedge fund allocation that we have been waiting for since March of 2009 -- 2010?

>> Russell Crosby: 10.

>> Matt Loesch: That's why the wait wait wait wait wait, I didn't want to keep waiting. If they had their stuff at the end of January they could have the information before the board the first of February, right, the actual document, so then -- okay.

>> Carmen Racy-Choy: And I mean, Albourne, if they did come at the January investment committee, I think the first discussions have to be the goal of the hedge fund allocation, and then they'll come back with a recommendation on how to structure the allocation. So they're not going to proceed, they're not going to have in January the recommendation for specific manager. The discussion on how to structure the investment and the goal of the allocation must happen first with the investment committee. And they will only start bringing managers once they understand the goal of the allocation and have proposed to the investment committee an investment structure that the committee has agreed to.

>> Matt Loesch: Sure. And we haven't obviously discussed which way we're going. Seems like there's going to be a change but regardless if we can kind of come up with a plan of communicating what's going on, obviously it's going to be part of our old business agenda item and whether we capture it in the investment chair's conversation, maybe, but it would be a brief status update each time as to where things are and a projected schedule, very conceptual oriented brain, when we would accept them, if the schedule slips or gains, whether it's part of the chair's comment on it or whether it's just a staff memo that gets, you know, not hyper-detailed but kind of as things lay out so we can keep up to date.

>> Lara Druyan: We have the same sense of urgency.

>> Matt Loesch: If we could just know what's going on, without having to nag. Questions overall and we can start talking about what direction we would like to go.

>> Arn Andrews: I just have one other question. Clearly this all works from a volatility dampening standpoint, a median return standpoint, I was just curious, at the investment committee level, is there a tactical approach here in a sense we're trying to move out of fixed income at a time when we think in the next five to ten years. Was any of this tactical in nature?

>> Lara Druyan: Huh-uh. There was discussions about doing some very tactical things that we killed. We're not -- we don't want -- you know, we are very firmly opposed to trying to market time and do very tactical things. We think that will not serve us well.

>> Stuart Odell: I think at a minimum you start with the strategic. If the board, the committee, the CIO is going to take tactical changes, you got to have at least, we are on the same base starting point, not we think bonds are, you know, overvalued.

>> Arn Andrews: I just want to pull back one layer, having not been there.

>> Matt Loesch: Any other comments or questions on the meat of it before we make a decision which direction to go? Okay. Seeing none, is there a direction you'd like to go? Would you like to --

>> Lara Druyan: Move we accept the asset liability study.

>> Matt Loesch: I think there was a direction to choose which one of the asset mixes, the recommendation was for asset mix C.

>> Lara Druyan: Right.

>> Matt Loesch: So is it the motion to follow staff's recommendation?

>> Lara Druyan: Yes, motion to follow staff's recommendation on asset mix.

>> Arn Andrews: I would second.

>> Matt Loesch: Any other comments or questions on it? Okay, all those in favor? Opposed? Thank you, Carmen. I'm going to call a ten-minute recess.

>> Matt Loesch: Come back to order, please it will the Federated retirement board. And we are on item 4.3. That's a presentation of the September 30th, 2011 quarterly performance report and there's an additional item A, October 31, flash report. So we're back to the same folks.

>> Carmen Racy-Choy: I will refer predominantly to the October 31st record in part because the September 30 performance is significantly worse. So we'll go to the most recent. Overall, fiscal year to date, the performance of the fund was negative 3.6. Till the end of October. The policy benchmark was also negative 3.six. So we're pretty much hugging the benchmark. I do want to bring forward, I do want to point out, a few managers that have done really well. Artisan, Tradewinds, on U.S. equity, R.S. Investments as well. Very significant out-performance in the

three cases. And I apologize, your October flash report doesn't include the manager performance. But I believe artisan outperformed the benchmark, its benchmark by 10% as of October 31st. I did want to point out to the board that there's been ongoing organizational challenges at Sykes, Sykes has a bank loan and high yield mandate. They also have a similar mandate for Police and Fire and a core mandate. Over the past few years ago the founder and the CEO of Sykes have resigned. As of September 30, 2011, the head of the high yield division also resigned. We don't necessarily view this as a crisis situation. We have simply entered in contact with Sykes to try and understand what is ongoing, and what are the challenges. The existing portfolio manager, our portfolio manager is still managing the portfolio. It is a buy-and-hold currently, so we don't view that there are currently any investment issues that need significant scrutiny, scrutinization. However, we have initiated discussions with Sykes to really understand what is ongoing. And to the extent staff feels that further attention is required, we will actually bring them to the investment committee later in the year.

>> Edward Overton: Did anyone articulate to us the rationale for the departure of those key people?

>> Carmen Racy-Choy: Absolutely. The consultant believes this is a bad relationship between Sykes and SunTrust who owns Sykes. It is clear that really, the leadership is being emptied and at certain point this will -- our concern is that at a certain point in time, this -- it could be our portfolio manager that's leaving. So we just want to be aware of what are the ongoing challenges. And then, try and address them, if possible.

>> Matt Loesch: My humble recommendation might have them come to January regardless of what's going on and make sure a presentation is made to the investment committees what's going open so they can have a conversation and ask those questions directly. That would be my recommendation. At least have it scheduled. You can always cancel but if something else happens you might be able to have that agendized, make a recommendation to the board if something serious needs to happen so we can get going quickly.

>> Edward Overton: I agree with that. You don't know whether the foundation of the organization is shaking or what's going on.

>> These are the kind of actions that happen when they are commingling assets or something.

>> Matt Loesch: Yeah, you're right. Yeah, we need to get in front of that quickly.

>> Stuart Odell: Are the assets in a separately managed account or are they part of a commingled portfolio?

>> Carmen Racy-Choy: Good question. Ron is there. Sykes is it a separate account mandate? It is, okay. It is a separate account mandate. And again our portfolio manager is still in place. So the key is, basically, the leadership on top of him has almost disappeared. And so to the extent that this trend continues, then, you know, he could be the next one out the door. And so I think absolutely, we'll bring them over to the January investment committee meeting.

>> Lara Druyan: That would be great.

>> Arn Andrews: Considering we just accepted an asset allocation with a significantly reduced fixed income exposure, we should have somebody take a look at this. They might help us effectuate our asset allocation change.

>> Very tactical.

>> Lara Druyan: Super-tactical.

>> Where is the active?

>> Carmen Racy-Choy: The other significant allocation, negative 1.5, still fairly preliminary but I thought I would give you the most up to date picture. And that's it unless there are questions specific to the report.

>> Arn Andrews: I just had one and it's in the September report. And it's where we compare and contrast our fund versus public pensions. It's I think slide 28. You know, I'm just curious because it seems like on previous slides we do fairly well in our universe. And then when you look at this one, it seems like we're lagging, you know, when you compare and contrast us versus other pension funds. And do we know, is that indicative of them having, you know, different asset allocations and perhaps already exposures in areas that we discussed today?

>> Carmen Racy-Choy: This was a good point. I will actually try and look into it in greater detail and provide you the answer actually at the next board meeting. But fundamentally, since we're tracking our policy benchmark very closely then would I say that this is a due to a difference in asset allocation.

>> Arn Andrews: That's what I was wondering, okay.

>> Carmen Racy-Choy: If we are underperforming the policy benchmark it could be due to a different asset mix or potentially due to managers, for example, to attract manager alpha. But in this particular situation since we are very close to our policy benchmark my guess is this is due to a different asset mix. I will ask more questions, though, and come back with a definitive answer.

>> Arn Andrews: Thank you.

>> Matt Loesch: Any comments or questions from the board on this? I have a humble recommendation. Hopefully it's humble. Because I mean this one, this particular case it went through the investment committee first. And so the investment committee was presented by Mikita on this report and they were able to voice their questions or ask their questions. I guess going forward I think we should probably decide how we're going to do this. If we're going to have I mean if Mikita is only going to present on the investment committee, those of us not open the investment committee are not necessarily privy to all those questions and what that discussion was. Unless we force the investment committee chair to report out on that I don't know if we want Mikita to do it just once and do it to the full board or what the thoughts or desires are. This could have just been a manifestation of timing for other things, and that's not my point, to what this previous time. But I think if

there's at least a quarter opportunity for the entire board to hear from Mikita as well and this might be the mechanism that makes it happen, the quarterly report. I don't know what the thoughts are of the board as to the timing from staff, interesting editorial on this instance but moving forward I would like to schedule. What are your thoughts?

>> Carmen Racy-Choy: It's really up to the board to decide I think the issue is would you like to bring Mikita to the board. I think that's the discussion item, that you'd like to see Mikita?

>> Matt Loesch: I think, at least a quarterly opportunity for the board, I would like to hear the benefit of the questions from the investment committee as well, to hear where they're leaning with their thoughts, because that is the time for us not on the committee to chime in, regarding summaries, or listen to the many hours of fun that happen at those investment committee meetings. What are your thoughts? Is that better, worse, different?

>> Carmen Racy-Choy: We have absolutely no objection. If the board feels that getting a quarterly presentation from Mikita on performance makes a lot of sense, if you find value in it then we will gladly bring them over.

>> Stuart Odell: Whether it's quarterly or not, maybe you can start, if that gets you comfortable. Personally, and I'm on the investment committee so I'm going to get the quarterly updates. Question is at the board level do you want Mikita in every quarter, maybe once a year. But I certainly don't see any problems bringing Mikita in.

>> Matt Loesch: Just a question whether they'll present a quarterly report to the investment committee and come to the same presentation. That's why I think it's just --

>> Lara Druyan: I know, that's -- I don't think you want to do that. We could have it presented by staff and then ask our questions and Mikita could then come present it to the rest of the board. I think that makes the most sense.

>> Matt Loesch: I mean I'm --

>> Arn Andrews: I agree that at some point it would still be nice for the full board to get a full report out from Mikita. Not to revet issues that have happened at the investment committee level but at some point for us to be part of the dialogue and hear the dialogue. Whether it's quarterly or whatever. But I think it's good for them to still come before the full board.

>> Lara Druyan: Yeah, I mean too things that we brought up in our meeting were, one, they're still using a benchmark I don't particularly like for private equity. I asked them to change that. Right now they are benchmarking to Thompson, I asked for Cambridge. And second, there -- in their reports there is no measurement of alpha for any of this stuff. And I said to the extent people are generating to alpha, I'd like to understand that. So I don't know that there were other things that we discussed at length at our meeting, but I think certainly having Mikita present to the board would you know makes a lot of sense.

>> Matt Loesch: It would then take one of the -- if they did a general presentation like this it would take one of the items off the investment committee's discussion maybe so you could be working on more of the action items that could be brought to the full board as well. I mean as one of the thoughts, so we'll try for the fourth quarter of 2011, we'll see what happens and so we're talking January-February time frame, not January probably February. Okay, any other questions on the report? All right. Great, thank you. 4.4. Approval for the secretary to negotiate and execute an agreement with Albourne America LLC for hedge fund consulting for an amount not to exceed $250,000 annually for a three-year term. We have a memo in our packet.

>> Sure. This item the numbers in the packet the item has been discussed and approved to move forward to the board level so I would take any questions.

>> Edward Overton: Move approval.

>> Arn Andrews: Second.

>> Matt Loesch: Motion and second any discussion or questions?

>> Stuart Odell: Just one question. Are you -- is the structure of the contract such that you are able to cancel it on 90 days notice on your side?

>> It's actually 7 days without cost.

>> Matt Loesch: Any other comments or questions? I guess if you could walk me through because this is again the first time we've actually done a hiring process, this current structure of the investment committee, how they were vetted, who did the due diligence and so forth so we can understand exactly how we got to Albourne, with just the chart.

>> Sure. Friar to the issuance of RFPs staff and including some trustees have already been conducting calls and meetings with a variety of consultants. So Albourne and all of the finalists have all been either meeting with staff individually or also including trustees. So after the RFP has been issued, at I think the August investment committee meeting, we are instructed to focus only on the hedge fund piece or the alternative investment consulting, as opposed to also real estate and private equity. So with that we narrowed down the list to those that provide specialized hedge fund consulting services which are the four finalists that were listed in the memo. So with that process we reviewed the RFP in detail and also conducted reference checks with what's provided in the RFP and with that I discussed with carb Carmen and presented our conclusion and this is how the process was conducted.

>> Matt Loesch: Okay. What are the thoughts of, dealing with the larger alternative asset pool, as it would be the thought to expand Albourne's approach or have them just be for hedge funds only?

>> Carmen Racy-Choy: Their expertise, I mean in hedge funds they're really the 190 pound gorilla. They are fairly new in private equity and other asset classes. So I would say that we're quite comfortable with their expertise on the hedge fund side. But at the stage where we don't know enough about some of the other asset

classes they might be in. So our thought is that Albourne is really a specialist for hedge funds. And when the plan is dedicating a significant portion of its asset to the asset class, it's definitely worth the money to have a specialized consultant and to have the leading consultant.

>> Matt Loesch: I like the idea if pooling with Police and Fire we get a much reduced fee, it's a great idea.

>> Carmen Racy-Choy: They have given us a break. The normal public plan fee, which includes fiduciary coverage is $400,000 per plan. Currently the agreement with the two, Albourne gave us a break, from $400,000 to $240,000. We are asking in this memo to have $250,000 just to have a little padding for potential minor expenditures. So they did give a significant reduction and they have taken into account the fact that they're getting two plans.

>> Matt Loesch: All this will be coming out of their San Francisco, their San Francisco office? That's the plan?

>> Carmen Racy-Choy: Yes.

>> Matt Loesch: Mr. Odell, do you guys currently use Albourne at Intel?

>> Russell Crosby: This would be the same consultant, I believe.

>> Carmen Racy-Choy: Yes, it's the same lead consultant.

>> Matt Loesch: I assume there is no reservation for this?

>> Stuart Odell: I don't have any reservation with this, I've been working with them for four years.

>> Edward Overton: There is no reservation, maybe the lawyers could speak to it.

>> Mollie Dent: Conflict of interest you mean?

>> Edward Overton: Yes.

>> Mollie Dent: I believe it is not a financial interest that Mr. Odell has from his consultant to the pension plan. So it's not a financial conflict of interest. If he feels like he can't -- if he feels like he had some predisposition to them or something, he could -- there could be a common law. But there's no financial conflict of interest. It's up to him to say whether or not he feels like he can act as his role of a trustee in formally evaluating them for this plan.

>> Matt Loesch: My only thought is your experience has been positive.

>> Stuart Odell: No, the experience working for Intel has been very, very good. And I think I've given Carmen feedback on them in the past. You know, not only is the research team that does the actual reports very strong in each of the sub-asset classes, and you have an opportunity to interact directly with the investment professionals that are doing the research in those asset classes, but also, the key consultant on your relationship, and that's really, if it's the same team that we're using, you know, I think I suspect you're going to end up having a very positive experience out of this group.

>> Carmen Racy-Choy: It's the same lead consultant. I don't know if it's the exact same team. But it is the same lead consultant.

>> Matt Loesch: Mr. Dirks.

>> Martin Dirks: I've spoken to other clients who have been very happy with their services.

>> Matt Loesch: Motion to approve staff's recommendation. All those in favor, opposed, super, thanks. 4.5, the approval of the third continuation agreement with Saltzman and Johnson law corporation, the board's outside

conflicts counsel, to extend the term of the agreement through June 30, 2012. Ms. Busse, do you have a comment on this or just --

>> Donna Busse: No, I think originally we though the RFP for legal services was going to be completed by the end of December. So we only extended Saltzman and Johnson's contract until the end of the year. But given that it's going to go into the next year, we need to extend it, if we want to continue to have its services.

>> Matt Loesch: Questions of the board? Aisle entertain a motion.

>> Edward Overton: Move approval.

>> Second.

>> Matt Loesch: All those in favor, opposed, none. 4.6, approval of the draft Federated city employees retirement systems comprehensive annual discussion report for the fiscal year ending June 30, 2011. Ms. Niebla.

>> So in your board packet you have our draft financial statements, our comprehensive annual financial report. As you will notice the financial section is in a different format. At the time that we came to the board, for review, we didn't have it in the final version. We do have, now, graphic design format of the financial section and we are going through and making some minor you know wordsmithing type of edits of the documents. But we bring forward a draft to this board because of the deadline that we have with filing our state controller's report and our GFOA certificate which means this report has to be finalized and done by the end of December.

>> Matt Loesch: Okay. Councilmember Constant.

>> Pete Constant: I have a question, on page 114, I asked a similar question for Police and Fire plan. But now that we have the actuary's report, I'm having trouble reconciling the solvency test in the CAFR with the solvency test on page 23 of the actuarial report. I don't know if I'm just not understanding it or if it's the exact same thing.

>> Matt Loesch: You said 114?

>> Pete Constant: Page 114 in the CAFR and page 23 on the bottom of the actuarial --

>> Russell Crosby: It's different years. You've just now approved your 2011 valuation that would generate the numbers that you saw this morning. This is based on the prior valuation that existed at the point of June 30th, 2011.

>> Pete Constant: So even for the historical you're going back and looking at 06 for example or 07, it's the numbers we're using to generate it now are giving us the difference, is that correct?

>> Russell Crosby: Correct.

>> Pete Constant: Thanks.

>> Matt Loesch: So if there's other comments or questions from the board about the document itself, would you like to have any more discussion on it? Are there things you noted in there that you'd like to get feedback? I'd noted a couple things that made references to pages. That didn't have tables. I'm assuming that's what you're talking about, the wordsmithing where things are going to be taken care of.

>> Yes.

>> Russell Crosby: There's a lot of back and forth each day between Veronica and Ron and the people who are actually setting this up for printing.

>> Matt Loesch: Okay. And just for clarification sake then, as far as our ability to affect -- it's already -- things are already in the works, it's already ready to be printed, right? And so --

>> They're not printed yet so if you have a comment we definitely could take it into account. But this would be the last week to kind of make any edits in order to use the deadline.

>> And in the table of contents (inaudible).

>> Matt Loesch: Noted it says things like I'm on 1 of 55 for the -- Mr. Crosby's, I don't know what you call it, memo to the board I guess.

>> The management discussion and analysis.

>> Matt Loesch: Yes, that's the section. In the second diamond down, it references a return, and increase by 17%. And then, you cross-reference that to the tables, it said something in the initial board chair letter and also in the secretary's letter of 18.8.

>> There may be a difference in whether it's a net or gross return that we're looking at.

>> Matt Loesch: I think I was looking at the same numbers. That's why I wanted to bring it to note to do another check to make sure those numbers are right. Apologize, most of my comments were --

>> Is there some reason why Mr. Odell does not have his photo?

>> Stuart Odell: Because I'm trying to avoid jail time here. I am woefully late in getting my photo submitted. It will be there in time, though. Sorry.

>> Russell Crosby: Ron has it now, is that what you said, Ron?

>> Stuart Odell: It will be in there in time.

>> Edward Overton: Holding out for 15 minutes of fame.

>> Matt Loesch: On page 11 of 55 --

>> Arn Andrews: I might have the same question.

>> Matt Loesch: One two three fourth paragraph down, the paragraph starts the June 30, 2010 valuation. The discount rate and wage inflation for the June 30 valuation are 7.75 and 3.83. I think the wage inflation was 3.25 and the discount rate was 7.5.

>> Yes the discount rate was -- you're talking about the 2010 valuation.

>> Russell Crosby: You're talking about the 2010 valuation. See, the valuation you're doing right now postdates this document. This is a snapshot as of June 30th.

>> Matt Loesch: That's what it says the discount rate last sentence says the discount rate and wage inflation for scheduled for June 30, 2011 are --

>> Russell Crosby: Gotcha.

>> Matt Loesch: Either the number is --

>> When we put these numbers together originally it was with the assumption these were the numbers going forward. So we'll make that correction.

>> Arn Andrews: On the same page last paragraph, where we're talking about the net deferred investment loss also includes 80% of the investment gain for fiscal year 2010 that will be recognized over the last four years. Doesn't it include 20% and 80% has not been recognized yet or am I --

>> 20 has been recognized and 80 is deferred.

>> Arn Andrews: Gotcha, okay.

>> Carmen Racy-Choy: Just to answer the question from the chair, the first we, the difference in the number, and the second bullet on page -- I think it's title page 1 of 55 of the management discussion and analysis, the 17% change, that's the change in net assets. That's not the performance of the plan. The other number, which is on page -- first page of the board chair letter, shows that the actual performance of the plan to be net of investment, admin and securities -- well, investment admin and SRBR to be 18.6. So the difference is, one is performance and one is just the change in the system's assets. And so the reason for that discrepancies is obviously you pay out benefits and you receive contributions. The contributions really, so one captures thing that shouldn't be in performance versus the other one doesn't. You don't expect them necessarily to be equal.

>> Matt Loesch: Gotcha, okay. On 33 of 55. In the table above, in the top part, where it says second column in, net value of assets through June 30,.

>> That's just formatting, I apologize.

>> Matt Loesch: That's what I'm noting and in the same row below that it's the same thing. It's just an Excel spreadsheet, something to do with lock-outs there. The third line from the bottom, and it might be purposeful, but it's the last sentence reads, as of June 30, 2010, total commitments for the forward currency contracts to purchase and sell international currencies were the exact same number, respectively? Were those supposed to be the exact same numbers?

>> On the commitments, yes, because we're buying and selling for the same amount. The fair market value would be equating the gain or loss.

>> Matt Loesch: Flipping to 39 of 25. Apparently I had a lot of time reading on my hand, I apologize.

>> Stuart Odell: Too much time on airplanes late.

>> Matt Loesch: On the table, something seems to be weird about the dates. It says 6-26-11 to 6-30-11 to 7-1-10 to 6-25-11?

>> It's because we're covering the fiscal year.

>> We have a number that becomes effective at the beginning of the pay period which starts at the end of the prior fiscal year.

>> Russell Crosby: So it's an adjustment to the pay period.

>> Donna Busse: For the four days you really had a different contribution rate. It's because the way the city, the pay periods, the timing of the pay periods.

>> The pay periods are biweekly.

>> Donna Busse: And when they become effective for the employees in the city.

>> Matt Loesch: Massive savings over those four days, right? Just kidding. It's meant to stump us. I guess the same, similar comments I guess the reason it came up is because on page 42 of 55 I think they're discussing the same things, the contribution rates at a period in time, and those dates didn't match up to what the pension

was. Because one is note 5 and that's the pension plan contribution rates and the other one is the OPEB contribution rates, the periods didn't match up and that was I guess the reason why. A little confusing.

>> The period may be a little different because of the different valuations for OPEB versus pension. So OPEB wasn't always on the same time period as pension. Because they had different --

>> Matt Loesch: Page 48 of 55. Wrong here, one two three for fifth line down where it ends in 8.25. It says net of expenses. Was it gross of expenses?

>> Carmen Racy-Choy: It was 8.25 net of investment expenses. Admin expenses and SRBR. And as of this year it is only net of investment expenses. So admin expenses and SRBR have now been reserved for through the actuary which they weren't.

>> Matt Loesch: Okay. I think that was most of my comments, sorry. Assuming we're getting on page 68, investment section, assuming you're getting a cleaner scan of Mikita's document rather than all the cloudy stuff and the stuff you can't read at the bottom? I'm sure it's crystal clear on that one. Sorry that's all my nitpicking.

>> Arn Andrews: I just had one general question. The auditor's report, the pages were blank. Were there any findings of substance or --

>> No, there weren't any findings of substance. I believe our opinion, we were waiting for one final legal confirmation, our final opinion should be on the January agenda, any communication from the auditors.

>> Arn Andrews: Thank you.

>> Matt Loesch: Any more comments or questions from the board members? I'll entertain a motion to approve or not the CAFR.

>> Edward Overton: Move approve.

>> Arn Andrews: Second.

>> Matt Loesch: All those in favor? Opposed? None. 4.7, discussion and action on the selection of chair and vice chair for calendar year 2012.

>> Arn Andrews: And I've learned in the past that if you're the first one to speak you're the least likely to occupy either one of these seats so I'm going to speak first. Seeing that the current chair was sworn in again this morning, and being someone who has had the benefit of watching him the last couple of years and I greatly appreciate the way he manages this board and manages our meetings, I would move to have Matt be the chair again. And then, on the vice chair, kind of keeping in the spirit of how we're starting to see our new government model provide benefits to the entire board and to the plan, and seeing the effects that they've had, you know at the investment committee level, I would like to recommend that one of the new board members serve as vice chair. And unfortunately, for Lara, proximity is everything, and since I sit next to her, and appreciate the commentary that I have with her, I would like to nominate her as vice chair.

>> Is that a motion?

>> Arn Andrews: That is a motion.

>> I second the motion.

>> Matt Loesch: Are you willing?

>> Lara Druyan: Sure.

>> Matt Loesch: Then sign up for 2012 we'll see how it goes. Any other comments or -- okay. All those in favor? Opposed? Thank you.

>> Arn Andrews: Sorry about that.

>> Lara Druyan: No good deed goes unpunished.

>> Matt Loesch: That's right. 5.1, nothing. 5.2, investment committee, next meeting is January 25th, we have 5.2A, meeting minutes of October 26th, 2011. Comments or questions about that? Otherwise I'll entertain a motion.

>> Lara Druyan: Move to approve the minutes from the 26th of October.

>> Arn Andrews: Second.

>> Matt Loesch: Comments or questions? All those in favor? Opposed? Okay 5.3. Our ad hoc governance committee, January 5th.

>> Russell Crosby: Yes has now been scheduled for January the 5th.

>> Matt Loesch: Okay.

>> Russell Crosby: It will be after the Police and Fire meeting in the afternoon.

>> Matt Loesch: About 6:30 in the evening. If we could get a little tighter time frame on that that would be good. Set for 1:00. Do they have a bunch of disabilities or 96? That is one thing that could really push that time. If we could get a better gauge as we get an idea of what's on that agenda.

>> Russell Crosby: We'll have the agenda on Tuesday, we could nail that down pretty well for you.

>> Matt Loesch: Tentatively it's at 1:p.m.

>> Russell Crosby: Uh-huh.

>> Matt Loesch: Okay. Education and training, 6.1 to 6.3 is a note and file. Future agenda items? Are there any? Okay. Public or retiree comments. None. Move adjournment on the pension board agenda. I'd like to open the Federated retiree health care trust fund. I have no orders of the day. 1.1 we have approval of the retiree health care trust fund minutes for November 17th, 2011. I'll entertain a motion.

>> Arn Andrews: Motion to approve the minutes.

>> Lara Druyan: Second.

>> Matt Loesch: All those in favor, opposed, item 1.2, discussion and action regarding the withdrawal of the private letter ruling request number 3 related to whether the contributions paid to the trust fund by the city and by the employees and benefits paid from the trust are executable from gross income of employees retirees and dependents. Okay.

>> Mollie Dent: So I spoke too soon last month in suggesting that we would only have to have this meeting quarterly. The -- our private letter ruling was filed with the internal revenue service. It was in three parts. The first ruling request was that the accumulation of income in the trust is not taxable. The second request was that the plan is not required to file tax returns. And then the third request was this combination of requests, related to personal income taxation, our outside counsel was informed 50 internal revenue service was that they would decline to rule or ruling request number 3. The internal revenue service is not required to issue private letter rulings. It is discretionary with them. They have indicated and have indicated to other plans that have recently filed similar private letter ruling requests that they are not going to rule on the personal income tax issues. That's not

an indication that they would necessarily deny it, I mean if they wanted to rule on it and deny it they would have told us they were going to rule on it and deny it. So they have suggested that we withdraw ruling request number 3 so that they can continue with acting on the two ruling requests that are at the plan level. Our outside counsel recommends that we do that, because the alternative would be to most likely have a judge decline to rule on the entire ruling request. The outside counsel has as you know the city contributions are going into the trust now. And the outside counsel has not recommended that that change. They have not made any recommendations -- we're not paying benefits out of the trust right now, we are paying benefits out of the 401 (h) account right now. We don't know how soon we might need to start paying benefits out of this trust, but it's possible that there will be some further action at the Internal Revenue Service available before we would need to. We can refile ruling request number 3 of the stand alone request if there is a point at which we think that the IRS will recommence ruling on the personal income issues. And with respect to the taxability of the employee contributions, the pretax nature of the employee contributions, those are not currently going into the trust. The -- it's our understanding that the city does want to implement that. And I think there will be a promote to the city council to amend the municipal code so that it can go ahead and be implemented without the private letter ruling. The other thing that we're recommending that the plan actuary look at and that the plan actuary will need to look at as part of their OPEB valuation is what the 401H limit is for the plan. So that we can know whether or not, depending on what happens at the council level, whether or not the entire employee contributions could continue to go into the 401 H account. So that can proceed so there will be two alternatives with respect to where the employee contributions go and want to know what the limits are. The recommendation is to withdraw private ruling request number 3 at this time.

>> Matt Loesch: Questions?

>> Edward Overton: I don't think that's much alternative. Motion to approve.

>> Second.

>> Matt Loesch: Any other comments or questions? Quick question. In the 401 (h) account we have roughly, what, like $80 million? In that vicinity, right?

>> Something like that.

>> Matt Loesch: Between that vicinity, it's not like 400 million, it's like 80 to 100. How much do we pay out in premiums in a given year for health care premiums?

>> Need to look at the income statement on here.

>> Stuart Odell: Just premiums or claims?

>> Donna Busse: Premiums are on there too.

>> Matt Loesch: Than would give a gauge in what the 401 (h) account before we would have to is start paying out of?

>> Mollie Dent: I understand from staff that we are paying out more than we are taking in in contributions. So at some point yes, that balance is going to be --

>> Donna Busse: In 2011 our premiums were $27.3 million. And our contributions was $33 million.

>> Mollie Dent: But that included employer contributions.

>> Donna Busse: Included employer contributions. Employee alone was 16. And then the balance --

>> Matt Loesch: Like half right?

>> Donna Busse: Our assets in the post-employment plan is $108 million.

>> Matt Loesch: It would sound quickly did that was burned straight out of there --

>> Russell Crosby: Based on that conversation yesterday with the outside counsel and the city attorney's office I e-mailed Cheiron while I was there to say we've got to have that calculation quickly this year.

>> Matt Loesch: Yep, right.

>> Russell Crosby: They'll have your OPEB valuation results at the January meeting.

>> Donna Busse: The assets are 185 million as of June 30th.

>> Matt Loesch: Any gauge as to how quickly our issue becomes really burning. We have a motion to approve. Any other further comments or questions? All in favor? Aye. 2.1. Update on the formation of the group trust. Is that moving? If it's not moving, what do we need to get it moving if we could use our council liaison to put pressure on the city council to make that happen?

>> Mollie Dent: I don't think there's been any, from a legal standpoint the recommendation would have to be forwarded to the council. I don't even -- I don't know if there's been a recommendation sent to the council. So --

>> Matt Loesch: There's a waiver of legal opinion from the city attorney's office to create it?

>> Mollie Dent: No, it's up to staff to recommend to council on the formation of the group trust in terms of the policy issues surrounding it. There aren't any leg problems with formation of a group trust. You'd have to decide who -- they're going to have to make a recommendation for who they want the trustees to be, whether or not they want to have one group trust. It's not -- that's not a leg issue.

>> Matt Loesch: Would I like to have the group trust formed as quickly as possible. Is there something that our council liaison could help to make that happen, so we will be investing as quickly as we possibly can be?

>> Pete Constant: If we get the recommendation from whoever --

>> Russell Crosby: This is the first we've heard that there's a recommendation coming from staff and that we need to do something around this. We've been sitting on hold each month waiting for the city attorney's office. So okay, we'll make a recommendation now. Now that we understand that.

>> Pete Constant: So I think once that's done then I can start seeing what can happen on the council end of the process.

>> Mollie Dent: We'll be glad to work with staff. There's not a legal impediment though to forge a group trust. We've had a -- had Ice Miller on board with how you do it. And the real issues are surrounding sort of who sits on the Board of Trustees, whether or not it's one trust for both Police and Fire and Federated. And it's -- those are policy issues.

>> Matt Loesch: Sure. And so they could haggle that out on their end and they'd notify the bargain units what's going on and so people could be aware and participate. If it means that staff need to recommend that, there will be something in front of us in January to approve on that, right?

>> Russell Crosby: It's not likely to happen for January.

>> Matt Loesch: No, no, but the recommendation that something should be happening?

>> Russell Crosby: Oh, yes.

>> Matt Loesch: That recommendation, not that it's done-done. Further agenda items, future agenda items, public retiree comments? We're adjourned.