The following transcript is provided for your convenience, but does not represent the official record of this meeting. The transcript is provided by the firm that provides closed captioning services to the City. Because this service is created in real-time as the meeting progresses, it may contain errors and gaps, but is nevertheless very helpful in determining the gist of what occurred during this meeting.

>> Conrad Taylor: The Police and Fire retirement meeting for January, 2011. Is Dave Bacigalupi on the line?

>> David Bacigalupi: I'm on the line.

>> Conrad Taylor: Conrad Taylor is present myself. Sean Bill is not present. Vincent Sunzeri is present. Damon Krytzer is print. Sean Kaldor is present. What we will do is swear in the new trustees.

>> I'm going to swear in the new trustees. Please stand.

>> I have been sworn in. Should I be sworn in again?

>> Mollie Dent: No you don't need to be if you have been.

>> Please raise your right hand and repeat after me. Do solemnly swear.

>>> do solemnly swear.

>> To support and defend.

>>> To support and defend.

>> The constitution of the United States.

>>> The constitution of the United States.

>> And the constitution of the State of California.

>>> And the constitution of the State of California.

>> Against all enemies.

>>> Against all enemies.

>> Foreign and domestic.

>>> Foreign and domestic.

>> That I will bear true faith.

>>> That I will bear true faith.

>> And allegiance to.

>>> And allegiance to.

>> The constitution of the United States.

>>> The constitution of the United States.

>> And the constitution of the state of California.

>>> And the constitution of the state of California.

>> I take this obligation freely.

>>> I take this obligation freely.

>> Without any mental reservation.

>> Without any mental reservation.

>> Or purpose of evasion.

>>> Or purpose of evasion.

>> And I will well and faithfully discharge.

>>> And I will well and faithfully discharge.

>> The duties for which I'm about to enter.

>>> The duties for which I'm about to enter.

>> Congratulations.

>> Thank you.

>> Conrad Taylor: Congratulations. Okay. I would like too recognize Russell. I know you did a lot of hard work, you went out and beat the bushes and found these experts and experts in the field, high quality members. I recommend you highly, I think the board will grow tremendously with you on it. Thank you.

>> Russell Crosby: Excuse me, I don't know your name, excuse me. The other trustee will be here in about ten minutes. If you could either prepare to come back down or stick with the meeting so you can swear him in when he gets here. Thank you.

>> Conrad Taylor: Conrad. Dave.

>> David Bacigalupi: Yes as chair of the board I would like to welcome the new trustees, look forward to working with you. The entire board has been looking forward to this day. I apologize for not being there physically but I look forward to being with you in the future.

>> Conrad Taylor: Okay we'll just go under orders of the day. Under retirements. Under 2. Under Service retirements. We have two A. Evan S. bloom. Fire captain. Fire department. Effective January 22, 2011. With 25.05 years of service. 25.05 years of service. Do I have a motion?

>> Move for approval.

>> Second.

>> Conrad Taylor: I have a motion and second on the floor. All in favor, all that disapprove, that carries. 2B. Kevin G. conant. Battalion chief. Fire department, effective January 8, 2011. 25.02 years of service. Do I have a motion on the floor for approval?

>> David Bacigalupi: Motion to approve.

>> Second.

>> Conrad Taylor: All those in favor, opposed, approved. 2C. William James cooley. Fire engineer. Fire department. Effective January 22, 2011. 26.50 years of service. Do I have a motion?

>> David Bacigalupi: Motion.

>> Second.

>> Conrad Taylor: All those in favor, motion passes. 2D. Matthew F. Elvander. Police sergeant. Police department. Effective January 22, 2011. 27.91 years of service. Do I have a motion for approval?

>> Motion.

>> Second. All those in favor, motion passes. 2E. Alan Gerbino. Fire engineer. Fire department. Effective January 8, 2011. 26.50 years of service. Do I have a motion on the floor for approval?

>> Motion.

>> Second.

>> Conrad Taylor: All those in favor, item passes. 2 F. Mark heller. Police officer. Police department. Effective February 11, 2011. 26.91 years of service. Do I have a motion on the floor for approval?

>> David Bacigalupi: Move to approve.

>> Second.

>> Conrad Taylor: I have a motion and second. All those in favor say aye. Motion passes. Item 2G. David Huseman. Fire captain. Fire department, effective January 22, 2011. 27.50 years of service. Do I have a motion for approval?

>> Motion for approval.

>> Second.

>> Conrad Taylor: I have a motion and second. All those in favor say aye. Motion passes. Item 2H. Byron Jones. Police sergeant. Police department. Effective January 22, 2011. 25.05 years of service. Do I have a motion on the floor for approval?

>> David Bacigalupi: Move to approve.

>> Second.

>> Conrad Taylor: I have a motion and second. All those in favor say aye. Motion passes. Item 2I. Scott H. Kennedy. Police officer, police department. Effective January 22, 2011. 25.05 years of service. Do I have a motion on the floor for approval?

>> David Bacigalupi: Move to approve.

>> Second.

>> Conrad Taylor: I have a motion. All those in favor, say aye. Motion passes. Item 2J. Timothy P. Leong. Fire captain. Fire department. Effective January 8, 2011. 27.57 years of service. Destroy a motion?

>> Motion.

>> Conrad Taylor: All those in favor say aye. Motion passes. Item 2 K. Michael Ponte. Police sergeant. Police department. Effective January 22, 2011. 25.05 years of service. Do I have a motion?

>> David Bacigalupi: Motion for approval.

>> Second.

>> Conrad Taylor: All those in favor, motion passes. 2L. David Salazar. Fire captain. Fire department Effective January 22, 2011. 27.62 years of service. Do I have a motion?

>> Motion.

>> Second.

>> Conrad Taylor: All those in favor say aye. Motion passes. 2M. Brian S. Smith. Firefighter. Fire department. Effective January 22, 2011. 27.44 years of service. Motion?

>> Motion.

>> Second.

>> Conrad Taylor: All those in favor say aye. Motion passes. Two N. Wayne D. Vangundy. Fire captain. Fire department. Effective January 30, 2011. 25.09 years of service. Motion?

>> Conrad Taylor: Motion passes. John A. Wells. Fire captain. Fire department. Effective January 22, 2011. 27.65 years of service. Do I have a motion on the floor for approval?

>> Motion.

>> David Bacigalupi: Second.

>> Conrad Taylor: All those in favor say aye. Motion passes. I don't see any of the individuals out on the floor. Okay. Item number 3, service connected disability. It's Kevin Ray, Police officer. Police department. Request for a service connected disability retirement. Effective January 6th, 2011 with 11.69 effective years of service. Mr.

Ray. Step forward. Mr. Ray is for the record Mr. Ray is present representing himself. If we could just take a break.

>> Sorry I was told to do this in the microphone. Okay. Mr. Flaherman, could please stand and raise your right hand and repeat after me. I, state your name.

>> I, Michael Flaherman. Do solemnly swear.

>>> do solemnly swear.

>> To support and defend.

>>> To support and defend.

>> The constitution of the United States.

>>> The constitution of the United States.

>> And the constitution of the State of California.

>>> And the constitution of the State of California.

>> Against all enemies.

>>> Against all enemies.

>> Foreign and domestic.

>>> Foreign and domestic.

>> That I will bear true faith.

>>> That I will bear true faith.

>> And allegiance to.

>>> And allegiance to.

>> The constitution of the United States.

>>> The constitution of the United States.

>> And the constitution of the state of California.

>>> And the constitution of the state of California.

>> I take this obligation freely.

>>> I take this obligation freely.

>> Without any mental reservation.

>> Without any mental reservation.

>> Or purpose of evasion.

>>> Or purpose of evasion.

>> And I will well and faithfully discharge.

>>> And I will well and faithfully discharge.

>> The duties for which I'm about to enter.

>>> The duties for which I'm about to enter.

>> Congratulations.

>> Let me just start also for apologizing to everyone for being late. That isn't how I would have wanted to start off my tenure.

>> Conrad Taylor: Michael, congratulations.

>> Thank you.

>> My name is Russ Richeda. I'm conflicts counsel for the board of administration.

>> Mollie Dent: I'm Mollie Dent, City Attorney appointed.

>> Russell Crosby: Russell CBOs.

>> Conrad Taylor: Conrad Taylor. Representing the active police officers. Sean Bill.

>> Sean Bill: . [Introductions]

>> Donna Busse, deputy director of retirement services.

>> Dr. Das: [Introducing]

>> Conrad Taylor: Welcome again, everyone. If we would proceed, with number 3, service connected disability. Mr. Ray is present representing himself. Donna could you read the medical records in.

>> Police officer Kevin Ray is requesting a service connected disability based on orthopedic injury sustained to his right foot, 36.8 years old, 11.69 years of services. Cannot run or jump he cannot pursue or apprehend criminals, should avoid sustained standing. Currently using sitcon while on disability leave. No permanent duty available.

>> Conrad Taylor: Dr. Das do you have anything to add?

>> Dr. Das: I have nothing to add.

>> David Bacigalupi: Move to approve.

>> I'll second that.

>> Conrad Taylor: We have a motion and second on the floor. Sean.

>> Sean Kaldor: I understand you are thrown from the Segway caused the fracture. What happened to the healing process that was beyond the normal six weeks or six months for an ankle like that to heal.

>> Initially when they put the first rod in for some reason it didn't heal right. I had two additional surgeries, including a mate and external fixator. I understand it is a malunion and nonunion. It is forced together incorrectly. I

don't know what about the accident that was extraordinary and it didn't heal. It seems to be one of those things that happened.

>> Sean Kaldor: Doctors say there is no chance of that happening and you can't perform the job with that on you now, is that correct?

>> Yes.

>> Sean Kaldor: Thank you.

>> Conrad Taylor: Any further questions? We have a motion on the floor for approval. All those in favor? All that disapprove? Motion passes. Kevin, I know this incident was a tragedy to you. It ended your career early. Take care of your severely and you have another surgery coming up hope that works out. Congratulations.

>> Thank you.

>> Conrad Taylor: Under 4 is nonservice connected disability, we have none. Under knife is a change in status. Bruce W. Unger, police lieutenant. Police department. Requesting change in status from service retirement to service connected disability retirement effective July 11, 2009. With 29.29 years of service. Mr. Unger is present with his attorney Mr. Jeffers. Good morning.

>> Good morning.

>> Conrad Taylor: Donna read please.

>> Medical reports are listed in your packet. His work restriction is that he cannot pursue and or apprehend suspects. He is currently service retired effective July 11, 2009. At the time of separation, at the time of application he was on duty. There is no modified duty available.

>> Conrad Taylor: Dr. Das do you have anything to add?

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

>> Conrad Taylor: Anything further?

>> David Bacigalupi: Move to approve.

>> Conrad Taylor: I'll second that. We he have a motion for approval, all those in favor, all those that disapprove? I would say Bruce, congratulations, but hopefully that back you will go through retirement without pain. Congratulations.

>> Thank you.

>> Conrad Taylor: Number 6 deferred vested, there is none. This is part of the area that I do not like, death notifications, I'm going to go through all of them and after I read them I would like a moment of sieges. Number 7 is a notification death of George W. federoff, retired fire captain. Retired 9/2/93. Died 11/15/10. Survivorship benefits to Lynda M. Federoff, spouse, and survivorship allowance Taralyn Federoff, daughter. 8. notification of the death of George Lucchesi, retired firefighter. Retired 3/30/80. Died 11/2/10. Survivorship benefits to Marguerite Lucchesi, spouse. Number 9. Notification of the death of Dexter O'Day. Retired police sergeant. Retired 7/12/97. Died 10/14/10. No survivorship benefits. notification of the death of John Jack Salois Retired firefighter, retired 3/7/96. Died 11/27/10. Survivorship benefits to Freda Salois, spouse. If coy just have a moment of silence for these individuals who put in a -- [Moment of silence]

>> Conrad Taylor: Thank you for that. If we could just have that will be a note and file. Under new business. Number 11. Discussion and action regarding a process and schedule for recommending the ninth board member to city council. What I would like to do is, if we can, if we could defer this, and get together with

both retirement boards, the Federated and police, and do the interview process with both boards, and we could go through the full, it's my understanding that the Federated board will defer, and let the police go first, on the picking of the individual that we pick. I think that way all of our minds come together and we could pick next trustee.

>> David Bacigalupi: Mr. Vice chair.

>> Conrad Taylor: Yes.

>> David Bacigalupi: The only thing I would include is we pick the ninth trustee from the folks that have already been interviewed by council and reviewed by council. That were on the list with the current new board members. And that I agree with you, work with Federated board on an interview process, and then make the selection from that.

>> Conrad Taylor: Okay, I would take that motion. I will make a motion for that.

>> Second that motion.

>> Conrad Taylor: Russell can you just read that? That way we can have a motion.

>> Russell Crosby: The motion was to coordinate a joint meeting with Federated board to select the 9th member for this board and the seventh member for this one.

>> Conrad Taylor: Unless we have any further discussion, all those in favor of the motion? Motion passes. Number 12 is going to be Approval of change of retirement date of Antoinette Igno from early service retirement effective December 11, 2010 to an early service retirement effective December 19, 2010.

>> Motion to approve.

>> Conrad Taylor: Second to that motion?

>> Second.

>> Conrad Taylor: We have a motion for approval. All those in favor, say aye. Motion passes. Item 13. Approval of change of retirement date of Karen gall from January 8, 2011 to January 22, 2011. Do I have a motion?

>> David Bacigalupi: Move to approve.

>> Second.

>> Conrad Taylor: Air Force? Motion passes. Item 14. Approval of change of retirement date of Larry McGrady from January 22, 2011 to January 23, 2011. Motion for approval?

>> David Bacigalupi: Move to approve.

>> Second.

>> Conrad Taylor: Motion and second. All those in favor say aye. Motion passes. 15. Approval of change of retirement date of Jim Wyatt from January 22, 2011 to January 30, 2011.

>> Motion to approve.

>> Second.

>> Conrad Taylor: I have a motion and second. All those in favor say aye. Motion passes. Approval of change of service retirement date of Oscar Bazurto from December 25, 2010 to January 8, 2011. Motion for approval?

>> Motion to approve.

>> Conrad Taylor: Second?

>> Second.

>> Conrad Taylor: We have a motion and second. All those in favor, say aye. Motion passes. Item number 17 is the Approval of lifetime monthly payment option to be paid to Eileen efigenio, ex-spouse of police officer Mark efigenio, to be effective December 1, 2010 under part 17, section 3.36.3600 of the San José Municipal Code.

>> David Bacigalupi: Move to approve.

>> Second.

>> Conrad Taylor: We have a motion and second. All those in favor, say aye. Motion passes. Number 18 is going to be the discussion and possible action regarding actuarial equivalence factors for optional forms of payment.

>> Yes, board members, staff has looked at the Municipal Code, in terms of what the charge is to a member who chooses an optional form of payment. And the factors used for that calculation are embedded in the Municipal Code, and they've been there for a significant number of years. Particularly, the mortality table is outdated. It is a 1983 table. So our goal is to get this fixed in the Muni code so it's really a floating basis so if the board changes assumptions for funding, that those become the actuarial basis. So we asked Segal, the plan's actuary to come up with their assumption and you have in your packet their recommendations. Andy or Paul if you want to speak to that we'd be glad to hear your recommendations. And by the way, the staff agrees with the plan's actuary's recommendations. We think it's a good move forward.

>> Thank you Michael and good morning, members of the board, I'm Paul Angelo with the Segal company and I'm joined by Andy Yeung. December 8th, 2010 report, as Michael outlined, there are three major parts, differently survivor benefit than that that is automatically available to the members. When we sway they are actuarial equivalent, there is a calculation that involves time value of money, it involves how long the members and the spouse will live and involves also the cost of living. So as outlined in our letter, currently the assumptions that are used to do these calculations are an interest rate of 8% and a somewhat out of date mortality table, a 1983 mortality table. The board recently changed the valuation assumption for investment return to 7.75%. That would have some effect on these factors. But more importantly your current mortality tables are 2000 tables. RP 2000. If you make those two changes, it has a significant impact. It actually provides a larger benefit to the member that elects these options and there are illustrations of that at the back end of our report. The only I think split hair to make is you want to be sure when the legislation is written, when we do the valuation we actually use separate mortality tables for males and females, it is against the law to have different benefits for males and females. That would be against the law. It would be based upon the tables used in the valuation. Just want to make sure the legislation has that clear. Other than that this is just really a matter of when you as a board change your estimates on future earnings and on future life expectancy you want those changes to also be included in anything that involves an actuarial value, included in these forms. That is the base of our recommendation.

>> What we would need to implement the change would have Mollie look at the municipal code and incorporate those changes there but also administratively it would take a while to implement these factors and have the factors tested, and put in place in our pension gold system.

>> Conrad Taylor: What would be the time frame?

>> My understanding, it would be maybe May, roughly a May, early June time frame to get this implemented.

>> Mollie Dent: So just so that I can -- so that we can be clear especially with the new boards members, the board can't make the changes to the Municipal Code. The city council has to make the changes to the Municipal Code. So the process for this is, if this is something that the board wants to implement, is to make that

recommendation to the city council. And that recommendation, then, will also go to the city management as well as to the bargaining units for review. But you can move forward saying you want to implement this and making that recommendation to the council. But it will actually be up to the council to make the -- to adopt the ordinance amending the municipal code.

>> Conrad Taylor: Michael.

>> Michael Flaherman: A question for the actuarial, for Segal. Is this the only place that the issues are embodied?

>> Mollie Dent: I don't think so. There maybe other places in the code I think.

>> Michael Flaherman: Would it be important to do a global find and replace?

>> Mollie Dent: We can talk to -- the other references may be floating and so we can do a search-through and have Segal take a look at the other revenues to mortality tables that are in the code. We can certainly do that.

>> Michael Flaherman: It seems it would be best to use the current mortality tables and also be consistent in the mortality tables.

>> I have a few questions as well.

>> Conrad Taylor: Sean and then --

>> Sean Kaldor: Would our recommendation move forward that they fix it or specific change to the legislation in chapter and verse?

>> Mollie Dent: No the proposed change to the legislation would come from our office, we would draft the change. The motion from this board if you want to make it would be to make this recommendation for this change to the council and no also direct that the attorneys and the actuaries look at whether or not other provisions in the code also need to be updated for mortality tables.

>> I believe one other important item would be the effective date. Because there are recalculations that are done, and I don't think we want to go back, every time there is a he recalculation. But it would be for effective -- retirement effective dates however that's worded on or after a particular date.

>> Mollie Dent: Ordinances would always be a future effect unless they were specifically made retroactive. So if the ordinance were approved by council in may, it would become effective in mid July.

>> Somebody retired five years ago, but had to have a recount for whatever reason --

>> Mollie Dent: I understand. That would have to be included in the ordinance.

>> So first question I have is what percentage of the beneficiaries are on the optional side?

>> I believe it's about 20%.

>> So this could have a significant impact on the plan because of that number?

>> Going forward yes.

>> That would only be going forward.

>> Is this related to the spouse as beneficiary, or other individuals they name that wouldn't come into effect?

>> It would affect -- my understanding any member could change any individual as long as they have an insurable benefit on the life of the member. Siblings or spouses or whatever.

>> One of of the things I notice in the analysis is you're talking about the fact that the survivability of the retire eis mayor he owing but we have a population that maybe changing where it play not be the spouse that the the beneficiary. The gap may potentially widen down the road and you're suggesting we use this uni sex table that may not be applicable .

>> To the extent we're talking about the age relationships between the member and the survivor, that is in the current factors and will be in the new factors. That is unisex, if the member has a very young survivor, there is a higher price that is paid for electing the option. That is true before, that continues to be true now.

>> A fixed percentage you're trying to go to a 90-10 ratio or so, where in reality if we have a wide things age gap that ratio could be inaccurate?

>> Exactly. And the other thing we do when we do our review of assumptions we look at the sex relationship between members and beneficiaries. Because of domestic partners and because of nonspouse beneficiaries, it's possible that that mix could change. We would capture that when we do our periodic review of assumptions. So that is updated and every time we do that we would build the latest current assessment of that into the recommended assumptions. So you're right. That may change over time but we will capture that as we move forward.

>> So that would require we go back to the municipal code and amend?

>> No, I think the idea is to set the code in such a way that going forward, whenever this board changes the valuation assumptions it would automatically have the authority to change it without going back to the Municipal Code. The idea is not to amendment the table in the code, it's to take the table out of the code and simply put in the code a reference to decisions made by this board going forward.

>> Conrad Taylor: Any further discussion? You said you're capturing the difference in sex relationships, too?

>> Yeah. For example, currently, let me just look it up so I get it right. The assumption that we recommend is a -- I think it's 90-10. If you're looking in the December 8th letter, it's at the -- top of page 3. So what we currently do is, we adopt for the valuation, this is again page 3 of our December 8 letter. We adopt in valuation, a separate mortality level for male and female participants. And then what we do is, we assume that the member table using these options is 90% the male table, 10% the female table. Because for the folks who elect these options that is your current rough mix in terms of sex between male and female members. And then we make a corresponding adjustment for the spouses which goes the other way, it's 10-90. Now by the way, the presence of domestic partners and nonspouse beneficiaries, the members won't necessarily be 10-90. What we have found is the data, we have not found a statistically different calculation. We are watching that in the data.

>> Conrad Taylor: Any further questions? Well, I would like to make a motion to recommend staff's recommendation. To council. And have the attorneys review to make sure that it's updated and that it can be done.

>> David Bacigalupi: Second.

>> Conrad Taylor: Any further discussion?

>> Sean Kaldor: Will this be coming back to us then in the draft form or will this go for it?

>> Mollie Dent: Yes, it will come back to you for review once it's drafted.

>> Sean Kaldor: Thank you.

>> Conrad Taylor: Motion and second. All those in favor, say aye. All those that say no? Motion passes.

>> Mollie Dent: He does have to announce his vote verbally.

>> Conrad Taylor: I can hear him chiming in but it may not come over others' voices. Dave, they're asking you to chime in.

>> Conrad Taylor: Okay, number 19, Discussion and possible action regarding supplemental retirement benefits reserve, SRBR. under 19 A. Discussion and possible action on SRBR calculations from the Segal company. Under December, 2010 meeting.

>> I'd like to provide more on SRBR, Supplemental Retirement Benefit Reserve, established within the pension trust approximately ten years ago to provide supplemental benefits beyond the benefits called for in the basic pension formulas. It was established through the use of what was considered excess assets about ten years ago. And the annual process is to have the actuaries could a calculation of what the regular earnings are on that supplemental reserve plus any excess earnings over the assumed rate. So regular earnings are earnings up to what till now has been 8%. If there are earnings above 8% there is a calculation of how much of that excess earnings move to the supplemental reserve. The regular earnings typically have been paid out once they're declared by actions of the board. The excess earnings if there are any, go to principal and are never paid out. But they sit in the reserve to accumulate additional earnings in the future. We had asked Segal in the normal course of their review to do a calculation of the regular and excess earnings back in November and they came back with the calculation of roughly $1 million of regular earnings, there are two pieces to that, there were no excess earnings. So there were regular earnings, on the reserve of approximately $1 million. Part of that, there was the $300,000 retroactive adjustment, due to action the board take, to make a change in a methodology, a year ago, now normally the board would have moved to distribute that $1 million. That's the typical practice once they've been declared. In the meantime, last fall the city council I believe it -- was it a resolution that was passed or --

>> Mollie Dent: No, it was an ordinance. The ordinance was amended.

>> The ordinance session you can still move the money over but they ask the board defer distribution of any moneys until I believe next June 30th or July 1st.

>> Mollie Dent: So the ordinance directed that there wouldn't be any distribution for the remainder of this fiscal year.

>> Okay.

>> Mollie Dent: So there can't be a distribution under the ordinance until July 1 of 2011. But the ordinance didn't change the provision for the declaration of excess earnings. So the money -- so the excess earnings still need to be declared and transferred over.

>> And at the last two meetings especially at the December meeting there were several motions made by board members to move and/or make distribution and under those passed I believe it was 3 to 3 votes, so no action was taken. Our recommendation, we have a memo in the packet, is to move the money. Because as we understand it, there's no restriction on moving the calculations of earnings that Segal has prepared over to the reserve.

>> Mollie Dent: That's -- so just to give the board a little bit more background. The reason that this was deferred from the December meeting, primarily, was because as you can see from the staff memo, there are two pieces to this transfer. One is the current-year excess earnings piece which is the $719,000.

>> That's the regular earnings.

>> Mollie Dent: Right. And the other is a retroactive piece of it.

>> Yes.

>> Mollie Dent: So the issue was, whether or not in adopting the resolution declaring the excess earnings, the board needed to or was required to include this retroactive piece. And staff is, again, recommending that the retroactive piece be included. We had pointed out to the board that we didn't think the board was required to include the retroactive piece. But it probably is not prohibited from doing it either. It was redoing what was done last year. So that was -- the vote was 3 to 3 and there was no real agreement on how much should be included in this resolution. And now for today, the vote that's needed to adopt a resolution just so that we all are on the same page, it's five votes are required to adopt, to take action today. The board is required to take action by quorum and that takes five.

>> David Bacigalupi: Mr. Vice chair.

>> Conrad Taylor: Dave, go ahead.

>> David Bacigalupi: My recollection is a little different than Mollie's in that we took a vote for not only the retroactive and the transfer of the 2009-2010 and both of those issues failed to get a majority vote. It was not just the retroactive that failed but they both failed. I think the staff memo as it recommends to transfer the $1,015,889 into the SRBR reserve, is the appropriate action for this board, and I would so move that we move staff recommendation.

>> Conrad Taylor: Thank you, Dave. I concur with Dave, consistent with prior practice and staff is recommending this transfer.

>> I have a question.

>> Conrad Taylor: Yeah, Damon.

>> Damon Krytzer: Is there a required action?

>> Conrad Taylor: Mollie.

>> Mollie Dent: When the money is transferred into the Supplemental Retirement Benefit Reserve it comes out of the regular retirement fund. So the only piece of it that is questionable, I really -- is the retroactive piece. And again I'll say it again. It is our legal opinion that you don't have to make that $296,000 transfer. But you can make it.

>> Our understanding is that to the extent any moneys are moved it will affect the unfunded liability in the regular pension plan. Our review of the statute that we had undertaken last fall is that the statute called for the movement of both of these sets of moneys.

>> I have some questions. Do you want to go first Michael?

>> Michael Flaherman: Thank you. I'll start by acknowledging I'm coming in in the middle of a movie, maybe at the end of a movie. So there's quite a bit I don't know about the context of this and I'm wondering if you could collectively indulge me with some very basic questions. I would start by asking a question about what was just raised about, is there another side to this issue? And it's a question for Segal really. Is the other side of the argument fundamentally that, that this benefit is like the benefit that exists in a lot of defined benefits plans, where some defined benefits plans, you're sweeping off excess earnings whenever you have them, but then, when you have sub-par earnings, you're stuck trying to make those up? And so you don't -- you're not getting the benefits from the ups and the downs, it's kind of a ratcheting concept?

>> Well, that certainly could be levied as a critique of the SRBR structure from the beginning. However, I think that is part of your established practice and your legal framework. So those are the cards you're dealt, I believe. So now the question is how do you operate that? The question of what is the theoretical justification, arguments pro and con, that is a deep challenging he question. Our understanding is, that that decision is already been made and institutionalized in ordinance. Therefore your decision today is to operate that structure.

>> Michael Flaherman: Then to ask a very basic question. Does the plan have a cola for retirees? What is the structure of the cola?

>> It is a scheduled 3% increase in retirees benefit each and every year.

>> Michael Flaherman: So it's a fixed cola?

>> Yes.

>> Michael Flaherman: I know sometimes the benefits were put in place because the fixed cola didn't keep up with inflation. Was there a desire that way?

>> Yes.

>> Michael Flaherman: I'm trying to get a sense of what this year's --

>> We have approximately 1800 retirees in the plan.

>> Just to further answer his question, can you talk a little bit about the formula, not a flat distribution across all retirees, is that correct or do you get involved in that formula?

>> We were not involved in that formula.

>> Mollie Dent: I'll give you a little bit more background an the Supplemental Retirement Benefit Reserve. This is a little bit different than some of the others in the sense when there are losses if the losses are large enough for it to cause the City's contribution rate to increase, money will flow out of the supplemental retiree benefit reserve to offset that.

>> It is not a true ratcheting?

>> Up to $1 million.

>> Mollie Dent: There is some fluctuation on this one to the down side. Not always but-d.

>> It is relatively minimal on the down side though .

>> Mollie Dent: There is a formula for distributing the benefit, and that formula does favor retirees who have been retired longer. And also, it does favor retirees who are receiving a lower pension. So the formula is fairly complex. So it's not an even benefit for the retirees at all. The -- so I do want to make it clear that we agree that under the municipal code, the $700,000 transfer needs to be made. The excess earnings for this year need to be declared. There's a requirement to declare them within 90 days of when you receive the financial reports and the financial reports were turned in, in November or December. So there is a need to do the excess earnings declaration and to do at least the $700,000. Again I'll say it, we don't disagree with doing the $296,000 transfer. We're just pointing out it's not required because the time for doing that, the time you were required to do that was last year and it wasn't done.

>> Conrad Taylor: Let me go with Vincent and Sean and then con raird.

>> Can we get some background as to why that corridor was changed? Because it was changed in February of 2010. And it went from an 80-120 corridor. That initially what created a deficit and by changing that corridor to a 70-130 corridor it created a surplus, which is this 269,000 dollar retroactive amount.

>> Conrad Taylor: Carmen.

>> The main reason the corridor was changed, the corridor, downturn in the equity market.

>> Conrad Taylor: Correct.

>> The corridor controls fundamentally how quickly that loss is taken into consideration. Fundamentally the smoothing mechanism in place if there is no corridor typically will recognize 20% roughly of a loss. In each of the next five valuations. That is a smoothing, doesn't affect the actuarial numbers in a very big way. Now the corridor was increased, what that does is, it allows the smoothing mechanism to work fully. With the corridor in place, at AT 120, it would -- what the corridor would have done is you can smooth up to a loss of 20% fundamentally. Beyond that the losses need to be recognized immediately. Now, extending the corridor to 70-130, fundamentally allowed, I believe, 98% of the loss to be deferred. What that actually does is, it reduces the loss.

>> So you're saying the loss is there for future payments.

>> Being deferred.

>> Russell Crosby: If the old corridor had remained in place last year, it would have caused a huge increase in the city's contribution rate in one year. What's happening is, it's being phased in over five years and by widening the corridor last year, you didn't take in the additional loss beyond 20% all at one time. The board debated that, talked about it for, what, three, four months, on end last year Before finally revising the corridor, opening it up from the 80-20 that had been in place to a 70-30. And that still, I don't know, that was $50 million, there was a substantial chunk that was still recognized last year but then we're still phasing in all the rest of the losses over the normal five-year phase-in.

>> It's also changing back to the 80-120 corridor in June. And I guess my question is now, how is that going to affect future liabilities? With the markets swinging in the other direction will it change that?

>> Fundamentally --

>> Conrad Taylor: Carmen, do you want to go?

>> Sure, I want to tie the discussion in first of all to why the whole issue about the retro is happening. It happened much later in March. The reason Segal requested, very simply the fact that the Municipal Code requires that the SRBR calculation be done based on the valuation, the actuarial valuation assumptions. So that's really kind of the full context. And I'll let Paul --

>> Conrad Taylor: Paul.

>> Just one comment on as we've been talking about the effect of the corridor and the smoothing decision on the employer contribution rate which was the main focus of last year's discussion. It's probably also worth noting as far as today's action and you have these two numbers in front of you, the $300,000 number and the $720,000 number. If the corridor had not been widened. If you had stayed with the 120 many there would have not been any excess earnings to transfer into the SRBR. 30% corridor last year, that's where the 296 comes from. But if we're consistent, though, if we had not widened the corridor, what would happen is last year you hit the 20% corridor. You would have hit it fairly hard. That's why there would have been no -- the 300,000 would drop to zero. This year because of the recent market gains, you are now back within not only the 30% corridor but the 20% corridor. You do not hit the corridor. And if you go from one year where you hit the corridor which means the assets have basically been held down to a year where you don't hit the corridor there is a big gain. Which means that the $720,000 number would actually be in the millions of dollars this year. So if you are consistent and you do a 20% corridor and then consistently go to not hitting the corridor this year, sure, the 300,000 goes away but the 700,000 becomes much larger. The numbers here, are consistent, which means you had a much smaller gain, that's why staff is making this recommendation. It's a consistent application of the decision.

>> Russell Crosby: And if I could, staff has been criticized a fair amount for this recommendation in this environment. But if we didn't do the 300,000 call it backward credit you're looking at something in the range of 12 to 14 million. So we would recommend do the 300,000, avoid the 12 to 14 million, and let's go forward that way. And that's why that recommendation was done. Why we're fairly strong in saying, give on the

300,000. Because if you don't do that, then there's a very good argument for, well, then the real number for this year is 12 to 14 million. And we'd rather give the 300,000 for last year that be the 14 million for this year.

>> I appreciate the explanation. Thank you very much.

>> I have a question being new to the board, has there been a question he about say high water mark, in regard to, 90% fully funded before, there would be any contributions to a part like this?

>> Russell Crosby: I think our problem is that we have to operate under the Municipal Code and what's been spelled out in the Municipal Code and is really not up to this board to redefine, renegotiate, implement new benefits. We have the City's director of employee relations here. He negotiates with the unions and I think he has an opinion on the subject.

>> Good morning. Alex Gurza City Manager's office. Welcome to the new trustees. I just wanted to mention briefly that the city council in passing the ordinance, where it included no payouts until at least June 30th. Part of that recommendation was to review the SRBR and look at options. And the board absolutely can make recommendations that you would like the city to consider while we review the SRBR. That could be the issue. Mr. Bill you are raising what is the trigger for what does excess earnings really mean or how should payouts be. We welcome any recommendations the bhord should make. Also, we'll be discussing with the bargaining units, the retiree associations and other stakeholders.

>> I think it would be for long term viability it would be necessary to consider that. Not that the fund would be 100% funded there or perhaps 90% of the way there before a fund like this receives funds from the pension plan.

>> What's also interesting is it looks to me like this was created in 2001 and this pension fund was nearly 120% funded. Where now we are in a deficit situation. So I think this would be a topic that we'd want to address at some point at the board level.

>> Yeah, something that's known to me as well, these matters since 2001.

>> Conrad Taylor: Sean.

>> Sean Kaldor: As part of the board we have to follow the rules, set between the bargaining group and the city. We are bound to follow those. I'm interested in Mr. Gurza's comments, what recommendations the city council looking for from us. Because as I understand, we can affect the payout formula, that's a recommendation we make but the rest of the agreement is the city council also -- was there direction to us to give them comments on how we'd like to see the SRBR change or is it just the payout changes, they're looking for a revised formula before the payout could be executed?

>> I think, Mollie correct me, that, simply on the payout or the structure itself, I think the city would welcome the board 's input and recommendation on it.

>> Mollie Dent: So because what's on the agenda today is the excess earnings declaration for this year, what, if the board wants to have a more inclusive discussion of the SRBR, it would be appropriate to agendize that for a future agenda item so there can be just more information brought forward on it. There are two options for the board. The board can come forward with its own recommendation to the city council. But even if the board doesn't come forward with a recommendation to the council on the SRBR, if there were any amendments to the code, that were proposed by the council, to restructure it, those amendments do come back to you automatically for review. So one where, no matter what, if this benefit gets changed, you're going to get to see it when it gets changed.

>> Conrad Taylor: Sean.

>> Sean Kaldor: Thank you. Just to finish then, I think it's said negotiated benefit for the 719,000, the ordinance is that we shall make that transfer within the 90 days. For the other $296,000, I think it is the academic integrity of if we're doing a wider corridor for some benefits, it affects other benefits, we need to do it, skiing not to do it in one

part might change levers in other areas. For the consistency I would second the chair's motion that both of those be transferred into the SRBR.

>> Conrad Taylor: Any further discussion, Mr. Wentley.

>> I think one of the main issues that's not being discussed here and very valuable as far as background, in 2001 the City of San José and the Police Officers Association and local 230 from the fire department, signed an disagreement giving this board sole authority, to handle all aspects of the retirement fund. That agreement, we had reviewed by our attorneys. The buck stops here. He is of the agreement and this is Moscone and Embrage letter you have before you. You have the he sow discretion to distribute the SRBR, not the city council. What we have here, it boils down to a fact that you have three parties who have agreed to a contract that was in effect for nine years, being changed by one of the three parties. With no consultation with the other parties involved. So I think you have to keep that in mind, that three parties signed into this, three parties used it. Now one party says, wait a minute, we want to change the rules here.

>> Conrad Taylor: Thank you.

>> I have a question, too.

>> Conrad Taylor: Russ, did you have a question?

>> Those are very important items to keep in mind, they may be going to the next agenda item, not this agenda item and not to the motion.

>> A question Mr. Crosby, if the corridor wasn't changed, the payment would be $796,000, significantly larger. Why would the council vote against this, then? I don't understand that. Why would they just not --

>> Mollie Dent: The council didn't -- the council hasn't taken any action at all on the excess earnings. They took an action on distributing the money to the individuals.

>> Correct.

>> Mollie Dent: So the council has not taken any action on the corridor or the excess earnings, at all.

>> I guess that was more specific than my question. Why would they not approve the movement of the funds?

>> Mollie Dent: They -- it's not their role to approve the movement of the funds. It's your role and he shz rethey haven't tried to take that role away if you.

>> Russell Crosby: They approved the distribution, out the door, that's where they closed it.

>> Okay.

>> I wanted to acknowledge that the issue of consistency is an important issue. I didn't appreciate it originally. And I think that tips the balance in favor of you voting for this. At the same time, I do want to go on the record as saying that although I understand the necessity and exigency of moving the smoothing corridor up to 130%, I'm not criticizing, I'm making a statement of fact, it is somewhat of a deal with the devil. And to have that factor embedded in this, you know, is -- makes it a difficult and somewhat troubling reality. Because what that corridor means when you open up 130% is you're just telling yourself that something has a market -- has a value that's different than the market says its value is. So I'm willing to accept the necessity of that decision having been made in the past but make sure we don't lose sight of what it meant.

>> Conrad Taylor: Sharon.

>> Sharon Erickson: Sharon Erickson City Auditor. I was listening to you upstairs. I just want to add one piece of the back story, which is the City Auditor's office has recommended to the city council that they consider eliminating or the distribution, I'm getting my words mixed up ever since I went on break! The distribution and the transfers into the fund, as well. And that the city council took its action to limit distribution or recommend against distribution, after receiving our audit report.

>> Conrad Taylor: Thank you, Sharon. Any first questions?

>> Do I understand correctly, this motion is to put the money into that fund but not affect the distribution of the funds?

>> Conrad Taylor: Correct. Mr. Crosby would you like to reads the motion?

>> Russell Crosby: Motion was played by chairman Bacigalupi, to follow the staff recommendation and to make the two transfers that were outlined in the staff memorandum.

>> Conrad Taylor: Okay. And it was seconded by myself. Those in favor of the motion, say aye, those opposed, motion passes. Under old business and continued deferred items, 19 B, adoption of resolution 3683 --

>> Mollie Dent: That's what you just adopted. That was the staff's recommendation. That is the excess earnings declaration, you've already acted on it.

>> Second, the second possible motion related is the payout from the SRBR.

>> Mollie Dent: Actually there isn't anything related to payment on the subject.

>> Sean Kaldor: Not related to the Supplemental Retirement Benefit Reserve, doesn't say funding or payment out?

>> Mollie Dent: The resolution is just for the excess earnings. So --

>> Sean Kaldor: 19 doesn't open up a new motion?

>> Mollie Dent: If you wanted to do something more generally on the motion, that would be 19 A not 19 B.

>> Sean Kaldor: Still on 19 A we've entertained one motion.

>> Not for the transfer.

>> Mollie Dent: You did 19 B. You adopted the excess earnings. If you look at the resolution in your packet it is the excess earnings resolution. You've adopted that one. So if you want to go back to 19A to have more of a discussion on the excess earns --

>> Isn't 19A related to the Segal plus the supplemental letter?

>> Mollie Dent: Yes it is.

>> I don't think it allows further discussion on SRBR.

>> 19 C should involve --

>> Mollie Dent: I don't have an amended agenda. So this is the letter from -- okay.

>> 19 A and B --

>> Mollie Dent: Let's do 19 C then.

>> Conrad Taylor: Under old business continued deferred items, letter from Moscone, et al. regardings the board's administration of the supplemental retiree benefit reserve.

>> Sean Kaldor: Would it also be appropriate to consider item 35D at the same time, which is the San José Police Officers Association, regarding the SRBR and its consideration of it as a negotiate benefit? Let me lump that in with the same -- they're also seeking payment from the SRBR.

>> David Bacigalupi: Mr. Vice chair.

>> Conrad Taylor: Yes, Dave.

>> David Bacigalupi: One note on 35D, I was going to include the same thing this part of the agenda, joint agreements under San José POA under PAO letterhead.

>> Conrad Taylor: Thank you for that clarification.

>> I don't have 19C, it wasn't on my agenda nor do I have any information on 19C.

>> Conrad Taylor: Dawn, do we have a copy? Anybody else need a copy of the letter? For 19C.

>> Mollie Dent: I have to ask, I'm sorry because 19C isn't on my agenda, when was an amended agenda posted?

>> I think it came in the e-mail a couple of days ago, few days ago.

>> Mollie Dent: When was an amended agenda posted? It has to be posted three days in advance.

>> Monday. It would have been Monday.

>> Mollie Dent: Posted Monday? So okay. It would have had to have been posted Monday morning before 8:30. So -- well, it's a Brown Act requirement that it be posted dispoo hours before the meeting in order for the item to be discussed. -- 72 hours before the meeting in order for the item to be discussed.

>> Is this an agenda item that we can defer since I haven't had a chance to really review this?

>> Mollie Dent: I can certainly go over. You can always defer an item. I don't know whit was potioned.

>> Russell Crosby: It was sometime Monday. I don't know exactly what hour it got posted in the system.

>> Conrad Taylor: Since we don't know the timing, can we defer this? Any other discussion on that?

>> Russell Crosby: The letter actually came during the holidays when the office was closed so Monday was the earliest that it could have been posted.

>> Mollie Dent: Right, I can receive the received stamp on it, so -- no.

>> Conrad Taylor: Because of the Brown Act I would recommend just to defer it. Because we don't know the exact timing when it was posted.

>> David Bacigalupi: I would agree.

>> Conrad Taylor: Okay, so it's deferred.

>> I received the e-mail at 12:09 on Monday.

>> Conrad Taylor: All right. Then we'll make sure that everybody gets the letters, I guess.

>> Sean Kaldor: Agenda item for next month would be to discuss the distribution from the SRBR to the retirees.

>> Conrad Taylor: Yes.

>> Mollie Dent: Will it include MC 9 35 both?

>> Conrad Taylor: Yes, both. Number 20 is going to be discussion and action relating to setting the discount rate for the June 30, 2011 valuation at 7.5%. Carmen.

>> I'd like to start by apologizing that there is a significant amount of history and I believe that all the memos that provide the context and the history were omitted from your packets. So I'll try to orally give a small summary of the background. Fundamentally given the current actuarial methodology, the liability discount rate must be set equal to the expected return on the plan's investments. There are two recommendations that came to this board earlier. One from Segal which recommended that the board moves to a discount rate of 7.75 and that next year, the board considers a discount rate, or reducing the discount rate further to 7.5. This was based on their analysis, which I believe if -- all board members should have received a large binder, is item 10 in the binder. And basically, that was discussed at the prior board meeting. Their assessment of the actuarial rate assumption is 6.93, based on a model that is consistent with their model last year. The staff recommended that the liability discount rate be set, 7.75 this year, and 7.5 next year and that the decision be made now. The reason, first I'd like to make the comment that all of these numbers are net rates and not gross rates of return. For this pension plan, the difference between a net rate and a gross rate is approximately 85 basis points. This includes investment expenses, admin expenses, and a small in assessment of what the SRBR actually costs the plan. I think the fundamental rationale for difference in the recommendation is that Segal used first of all a different methodology, they built their discount rates recommendation based on an estimate of future inflation. And he they used surveys of forward-looking rates of return on the plan's assets given the current asset -- target asset allocation of the plan. The combination of that target asset allocation and the he survey results, basically prouded a net -- a real

rate of return. They combined the two, to form a discount rate assumption. Staff used a log normal model with a volatility adjustment. What that actually does is, it provides the board with various probabilities of achieving specific rates of return. And rather than use the survey of investment consultants as a source, we fundamentally developed assumptions in conjunction with the plan's investment consultant. The main reason for doing that is the survey of investment consultants usually look at what is going to happen in the next five to seven years. Basically, this assumption is more around a 30-year assumption. So staff worked with the plan's investment consultant to move, really, the numbers from a five to seven-year horizon to a 30-year horizon. So based on that analysis, the median growth rate of return is 7.5%. And the equivalent net rate of return would be around 6.6%. So given that the current net discount rate in the actuarial assumption is now set at 7.75, that's obviously significantly higher than the 6.6 median net rate of return. So if the liability discount rate is set too high, obviously, this increases the probability of potential future shortfall in assets. And that's the rationale behind the staff recommendation. So with that, I'll let --

>> Conrad Taylor: Paul any comments?

>> Segal add any comments.

>> First, I don't know where to begin. I think as broadly outlined by Carmen, this is a complicated issue, which is new to this board. Carmen's description of our report I think is a good sort of capsule outline but does actually capture our entire analysis or the basis of our recommendations. I think the main issue today is not whether 7.75 or 7.5 is the right number because no model can answer that question. In fact, part of our -- what you'll find is that we are quite humble when we get to the end, we say you cannot analyze away the discussion. Can you not choose between 7.75 or 7.5 or 7.25 or 7% based on a bright line analysis. We want to let you know this is always going to be a subjective decision. It is always going to be your decision based on your risk tolerance. Our recommendation today is to take, we are not recommending against the staff recommendation, our preference would be generally to follow well established, context of each valuation. We know of few precedents if any of a board setting the earnings assumption in advance. And so, you know, our recommendation was, and by the way we do think that if you review this assumption next year, go through the full description you will very likely see

from Segal a representation that you go lower than 7.75. You say why not do that now? And part of this is just a matter of have you actually gone through the analysis as individual trustees, you know to make this kind of decision now. So again, we kinds of know where this is going. Across the country, these earnings assumptions are being lowered. I mean we're actually, later today we're having a discussion with some state retirement association leaders and just universal, the systems that are at 8 are going to 7.75, those at 7.75 are going to 7.5. They are all going down. Follow the usual practice, you do an annual review of this assumption and base your future decision on that. If you were to make the assumption today I think that again, you may well end up in exactly the same place. We probably would want to do at least some kind of disclosure on what the impact would be probably in the plan financial statements because it would be a little bit misleading perhaps to publish your financial assumption on a 7.75 basis if you are planning on going to 7.5 next year. I think again we are -- while our preference generally would be to make each decision with each year's valuation, if you make this action today our only recommendation would be that we talk to staff about how to make sure that the impact is disclosed to the readers of your financial statement.

>> Conrad Taylor: Thank you, I have three or four on the floor that want to talk. Sean.

>> Sean Bill: I think if I read that correctly it was 3%, is that right? Or is that just because that's what is built into the contracts? Or 3.5.

>> 3.5.

>> Sean Bill: How is that derived,.

>> There is two, one is to look at historical rates of return and pretty much flip that forward. That basically is what Segal has used. Carmen can speak to whatever investment assumption you used. Market based approaches are to say that well the market basically can predict, has a de facto implicit inflation assumption, based on securities like tips. We want to emphasize, nobody knows what inflation is going to be for the next 30 years. The market

does not know what inflation will be for the next 30 years. It does have an estimate, it will change and it will be wrong as well. We have not used the yield curve for base of our assumption.

>> Sean Bill: Was it a survey of wall street firms or how did you come up with 2.5?

>> The real rafts return by asset category. That is a he survey of nine or so investment consulting firms that provide investment consulting assistance to California public retirement systems. Our particular approach, every consulting firm has their version of this. We looks at rolling 15 and 30 year assumptions going back to I think 1929.

>> If those were actual inflation published by the bureau of labor and statistics.

>> CPI. By the way this is price inflation not wage inflation.

>> Sean Bill: I would make a statement that 3.5% would be significantly above what you would encounter, maybe want to examine, 2.20, last ten years, last CPI was only.6%. We have a lot of room in that.

>> You will find that investment consultants have of lower, in the range of 2 to 3 at the top. Whereas, actuaries, partly because it is a longer term more slow moving assumption, are now starting to ratchet down. Cal PERS is at 3, so that is, you know so the top end of the investment community is the bottom end of the actuarial community, that's an actual fact.

>> Sean Bill: Could you go over, it's not your decision but moving from five to seven year versus the 30 year assumptions on the returns? What's behind that?

>> Bottom line is, the investment consultants provide their expectation of returns on the various asset classes and I believe what Segal uses, that survey as a base for determining the -- basically the real return component. What staff does is, basically, acknowledge the fact that the investment consultants have a different horizon than

basically a pension plan. A pension plan looks at the next 30 years. But for instance, an investment consultant may think that for the next five years, high yield or direct depth should do 9 to 10%. None of them will tell you that over the next 30 years a direct depth or high yield should do 9 to 10%. So there are decisions that are made when you look to the five to seven year forecast when you can kind of go well we know these are outside the norm and if we move the assumptions to a 30 year number then these should change. And that's basically what staff does in conjunction with using our internal models to recommend the rate to the board.

>> Conrad Taylor: Carmen, thank you.

>> I was going to say is there any background in terms of the fact of the city's contribution of going from 7.75 to 7.5 to given us a little context of what that would involve?

>> Paul?

>> Is that number in your packet?

>> Conrad Taylor: We had it last meeting.

>> Sorry, I believe that's in the backup material which is missing from your packets.

>> Conrad Taylor: 8 to 7.75 resulted in a city increase of 4.69% and a member increase of something like three quarters of a percent.

>> Going to Segal's number, rate of 7.75 to 7.5 for this valuation would have added about $13 million. The city contribution would go from 126 to $139 million. But this -- the talk, the change we're talking about is the valuation that will be done, in approximately a year from now.

>> Conrad Taylor: Chairman Bacigalupi.

>> David Bacigalupi: He yes, I was just going to say that I think that after reviewing all of the reports from the Segal company and not to disparage anything that Mr. Angelo said, that the board had actually thought about making a two step process in their original motion to lower to 7.75 and follow staff's recommendation but our structure I think in how we agendized that didn't allow us to do that. I still support the staff recommendation of lowering it from 7.75 to a more realistic 7.5, in the two-step process having already done one part of it. So therefore, I would make a motion to follow the staff recommendation, to lower the investment return assumption from 7.75 to 7.5%, for the June 30th, 2011 valuation.

>> Conrad Taylor: Thank you. Sean.

>> Sean Kaldor: Just couple comments. The comment you made, the reason this is a stand-alone item, we considered last month, it wasn't on the agenda to consider the following year. I was also in support at that time of going to 7.5% but one thing came up this time from Segal, saying if we make that predetermined 7.5% but then we publish all our financial reports, saying 7.75, but we know that's not the number we're going to, is there an integrity issue or disclosure issue or --

>> I again will defer both to counsel and the auditors, would your auditors say once you made the decision, you had to publish, our understanding is the auditors are comfortable doing this in a two-step process. In your consolidated annual financial reports there should be a reference to this and perhaps an attempt to quantify. I don't think that's an obstacle to this decision.

>> Veronica. That is already checked with the auditors.

>> We have already checked with our auditors. We're doing it in separate valuations, it is allowed and just to add to that. There is in the management discussion analysis, a look at the economic factors affecting the next valuation. There is always a disclosure that talks about upcoming events in the financial statements.

>> Mollie Dent: Right, I wasn't saying, it wasn't allowed. Even though it is a note in the financials, it may end up needing to be disclosed when we do our bond disclosures. That doesn't mean you shouldn't do it or need not do it.

>> Sean Kaldor: One more question, would that allow us to change it in the next fiscal year, or once it's set it's set?

>> Mollie Dent: Once your actuaries get started on that valuation, you'll you know make them do extra work if they get started on it under this assumption.

>> Sean Kaldor: When we get them started on the 7.5?

>> That valuation will automatically be done.

>> Sean Kaldor: Seeing no hindrance in our disclosures, seeing this is what I believe to be a direction we should be moving in based on the staff recommendations I support the chair's motion.

>> Conrad Taylor: Three people, Michael and then Russ and David.

>> Michael Flaherman: A question for Segal. How do you feel about what will still be a pretty significant gap between the expected earnings rate and the discount rate?

>> Well, again in this case, the discounting that we used is an expected earnings rate. I think the gap is between two different models, two different approaches. What we have found is that the investment consultant's projection of earnings is almost always different from the consulting actuary's long term earnings expectations. Sometimes higher sometimes lower. Normally, there are differences often over the duration. Usually the investment consultant's analysis tend to be shorter term, and the actuary's longer term. Anticipating some sort of inflation bubble out there that's not built into the shorter term models. Even though it seems like it's the same topic in one

case the investment folks are setting, you know, earnings assumptions but the ultimate decision is an asset allocation. So all this discussion about earnings, from investment standpoint is just a step toward the decision you will make which is setting an asset allocation. Ton actuarial side the assumption is the decision. So I know that you would think that they would be more similar but they are always different and historically sometimes one are higher one is lower.

>> Michael Flaherman: I appreciate the fact they are not normally synced. My experience is that I haven't had them be so -- quite so far apart in my past experience.

>> I would say, in this round, Andy you can check me on this. We did I think fives of these economic assumption reviews in 2010. And in every case we recommended lowering the assumption. Not as far as the investor consultants were but defendant moving in that direction. I think we have seen wider spreads in those two numbers in 2010 than we have ever seen before.

>> Because the investment outlook is so poor?

>> That's right. But is that a 30 year assumption, exactly right.

>> Michael Flaherman: Again, I'm coming in well into the movie, which is many so postfinancial crisis, I'm wondering what has happened in the expected return stochastic process in terms of the assumed distribution of returns, is it -- is there more of a fat-tail element to it than there was formerly, and has there been any fundamental rethinking about how coordination matrices are set up?

>> Definitely, I think almost all investment consultants have adjusted their volatility assumptions upwards, which fundamentally means the expected distribution of returns has become wider. However, what we're focusing on from point of view of this analysis is the median number. And that number, there isn't a huge impact on the median from the volatility assumption. However, if you're look at the 25th or 75th percentiles, those are going to change significantly due to the higher volatility or to the fact that correlations are now stronger than in the past.

>> Michael Flaherman: And you're using a log normal distribution?

>> That's correct.

>> Conrad Taylor: Russ.

>> My comment the board may want to defer this altogether given the complexity, and the background that hasn't been given to the new board members. This is a fiduciary important decision. In moving to that point, perhaps the new board members would appreciate the time to receive more background on this, that they can actually think about prior to making a decision on it.

>> Conrad Taylor: Would concur with Russell. I think the new folks would appreciate reading the history and getting an understanding of it but David.

>> Yes and I guess to that point one of the things I would want to understand is the horizon, too. Because I'm assuming between now and the next 30 years we are going to have this discussion you know another dozen times as well. And the allocations change pretty I assume -- the allocations changed pretty substantially ownership the past couple of years, target allocation and bands around that and a tact cam component to it as well, so I think the horizon and using an actuarial assumption based on the I'm understanding a 30-year horizon, while correct, isn't the true experience of the return of the portfolio.

>> David Bacigalupi: Mr. Vice chair.

>> Conrad Taylor: Chairman Bacigalupi, yes.

>> David Bacigalupi: I would be happy too defer my motion until next month, to allow the background information be given to all the board members. And give them a chance to review the information that we've already seen.

>> Conrad Taylor: I would agree with you.

>> Sean Kaldor: Motion or are you deferring your motion?

>> David Bacigalupi: I'm not sure the exact process but I think would I move to defer my motion until next month for decision.

>> Mollie Dent: Why don't you just amend your motion and get the second to second the amendment.

>> David Bacigalupi: Okay would I amend my motion to put this off until next month until the background information is provided to all the new board members.

>> Conrad Taylor: And I accept that amendment.

>> Michael Flaherman: I appreciate that motion. I think it's important that we get more background information. I'm comfortable with you using the 30 year, when we talk about the funding we do for our retirees. What I would be interested in nothing, are we looking at this over different rolling time periods as well, over different decades. That might have an impact on the number. Specifically, what would be valuable for us as board members are the other ramifications of this decision. We make a decision to lower that actuarial assumption down to 7.5% which may be he very realistic and prudent to do in this climate. But what does that mean for other aspects of this plan. Exactly, tax liability, the additional liabilities for the city, for the taxpayers. How does this impact the SRBR.

>> How it would impact the member contributions also.

>> So that would be helpful.

>> Conrad Taylor: Do we have a motion to -- go ahead.

>> Russell Crosby: Motion to defer the matter until next month.

>> Conrad Taylor: Motion and second. All those in favor? Motion passes.

>> I assume would it have the information prior to next month.

>> David Bacigalupi: I would suggest they get it ahead of time and not just in the packet.

>> Russell Crosby: We'll go ahead and send that out early. Also David you can't see it but the other trustees up here have been given a fairly substantial document package today of everything from planned documents to these kind of backup materials are all in this notebook. We've got one for you, too, we'll accepted it to you.

>> David Bacigalupi: Thank you.

>> Russell Crosby: Okay.

>> Conrad Taylor: Number 21. Discussion and action on Segal's pension valuation for the period ending June 30, 2010. Paul.

>> I see you have the binders in front of you. We do two actuarial valuations for the system each year, one for your retiree benefits and one for your pension benefits. This is in the window here the pension only. This is the annual review of liabilities and contribution rates that are done by the consult actuary to every retirement system. This is laid out for, summary section, we have some reference points in the summary section, so what I will do is go through the summary section. I would invite your questions as we go through. In the interest of time I will not go into a whole lot of depth. There are a couple of he key points I'd like to lie light. If there is anything that the new trustees want to highlight, I will focus your attention as we go through. Section 1, numbers are in Roman

numerals, page little I. Polyer plate describes the purpose of the valuation. The one thing that is particular to this system is the next to last paragraph, it tells what your amortization policy is, and basically, you have you have in 2003, you restarted your amortization of your entire liability at that time. There is seven years remaining on that layer. And then you have -- there were benefit improvements in 1996, which have seven years remaining on that, and then actuarial gains and losses are arrangemented over 16 years on each. So instead of taking your entire unfunded liability and amortizing it over a single period some we actually identify where each component of a liability came from and amortize it over a seven year period. This is called layered amortization. Track where it came from and when it will be paid off. Next page, we get into the items for the current year. Details of each those items, this does reflect the reduction in the investment return from 8% to 7.75%. I believe you have part of your background materials. We also show that the amount of interest credits, now he here are those two numbers. There's the $719,000.

>> And then the 200, roughly $300,000 that the board has decided to transfer -- I'm sorry to be credited to the SRBR account.

>> Even though we did not know what decision you would take, we had to decide for the purpose of doing this calculation, roughly $1 million. Do we include it as what are called valuation assets which would reduce the unfunded liability and therefore reduce the employer's contribution or do we exclude it from the valuation assets, which would correspondingly make the unfunded liability $1 million higher, the employer's cost correspondingly higher. What we did was in discussion and direction from staff was exclude that from the valuation assets. Which means that these numbers actually are consistent with the action that you took today. So we don't have to go back now and revise them to back out that $1 million that you only decided today to put into the SRBR. The SRBR is let's call it a nonvaluation asset. This structure only applies in systems that have these excess earnings based benefits. Transferred into a reserve in your case the SRBR that do not count as available to fund statutory benefits, schedules in here show the details of that. Now, a lot of discussion in the last couple of years on pension plans has to do with the market losses in the year ended 2008 in particularly and year into 2009. If you look, market rate dropped about 2% in 2008, which means the 7-8 year had generally negative return. We thought boy that's a bad thing. If you are assuming 8% and the market delivers negative 5 be 7 loss, we don't assume that as

a serve point loss but a 13 point loss. negative return of about 20% and we have your actual returns in here that we'll look in for a moment. That means from a actuarial standpoint a loss of 8%. Those unprecedented losses are return threw smoothing method, five year recognition of those and that whole process of asset smoothing is a lot of what you'll see driving these numbers. We start on the third bullet, the ratio of the valuation of assets to the actuarial value of assets decreased from 86.7%, from about 87% down to about 80%. That is not because you had a loss in the is most recent year. That's because we've recognized an additional one fifths of those losses in year ended 8 and years ended 9. The recognition of those losses is what caused your ratio to decrease here. I'm going to jump ahead to the next page in the report because I know I can tell from some of the comments this idea of market value versus actuarial value is one that causes a lot of sort of cognitive dissonance among trustees. Why are we funding a plan ton basis that does not recognize the true market value. I want to you understand, we don't ignore or any way look around the actual market value. We manage the impact much those markets losses but are fully cognizant of what that impact would be. Give you an example of that, I want to go to the second bullet on page 3 where we talk about asset smoothing. What you'll see is that the -- they're the unrecognized losses, the unrecognized losses, that is, the amount of losses in market value that have been deferred, recognition had been deferred is about $350 million. Now this year we did not hit this market value corridor. I want you to notice that last year, the deferred losses were $600 million. Which means last year, you calculate the employer contribution rate, based on $600 million of assets that were not actually in the fund anymore, because you're deferring recognition much those losses through the smoothing period. Just to show you, that A deferred losses went from $6 13 million to $313 million. We'll look at the schedule on page 6 and can you seize exactly how that works. We want to illustrate, this is a mandatory bullet, in Segal reports, we want you to understand what it means to defer $350 million of losses. If you go to the third bullet on page three, first of all that is about 15% of the market value of assets. That means that for every $100 of real value, we're adding $15. The fact that 15 is less than 20 is why you're not hitting this market value corridor. The market value corridor says that you cannot defer more than 20%. You are only, in quotes, only deferring 15%. So what would happen? This is not a registers, we want to illustrate what would the funded status of the fund look like? What woo the employer contribution look like if we recognized that entire $350 million today? So the first subbullet shows if the deferred losses were immediately recognized your funded percentage would drop from about 80% to about 70%. I'm often asked, if you are at Starbucks and you say, what do you do, I'm a pension trustee, what's your funded ratio? You tell them 80%, you tell them 70%, the answer is both. If you want to know what the contribution rate is being based on you have to say 80%. What you really want to know how your current assets compare to the current liabilities then that's the 70%. So on a funded ratio basis the 70% or 69.1 is probably the more realistic term. We go to the next bullet please. As we'll discuss in detail your current aggregate recommended in this rate is 55.6%. we want to you understand if you were to take that $350 million and take that out of the sates today, that is increase the unfunded liability today by that amount and amortize it over 16 years which is your amortization period for gains and losses your contribution rate for the employer would go from 50.4 to 61 of 8. What this means is if for the next four or five years your smoothing period if the market value earns 7.75%, then those $350 million will show up as logs over the next four years. And the contribution rate will increase roughly to that 62% level. So again, we manage the impact of these investment losses through smoothing. We do not in any way obscure or hide it but we want to quantify for it.

>> Do you calculate the normal cost of contribution rate?

>> Oh, absolutely.

>> On page 14.

>> If you jump to page 14 you can see the components of your cost. And by the way, the question from the trustee really gets to the first paragraph pension 101 which is the contribution rate is always calculated in two parts. There's a part that's called the normal cost, cost associated with each new year of service based on the funding policies I've documented. That's a fairly stable number. That number is not influenced by investment returns. That number only changes really through demographics of the plan or through changes in actuarial assumptions. That is sort of your forever, permanent ongoing cost. Then in addition the employer makes a mortgage payment to pay off any unfunded liability. And the unfunded liability simply takes all of your past normal cost, that's what your liability today is, compares that to assets. What you see here, if we use the June 30, 2010, I'll use the police numbers just as an illustration, what can you see here is that the normal cost rate for police benefits is about 38% and that is split about 27.7 going to the city, and about 10.4 paid by the members. If

someone says how expensive is this plan on an ongoing basis that's where you go. And then the rest of this is what it will cost for the employer. You'll notice the members generally do not pay very much towards the unfunded liability. The fact that your members pay anything towards the unfunded liability is something of an anomaly. It has do with particular benefit improvements that were adopted historically. Generally speaking you'll find that all of the unfunded liability cost falls on the employer and that's all the cost volatility comes in. So you have a very stable normal cost which in this case shared roughly 27 parts to the -- what's that?

>> 3 to 8.

>> 3 to 8 antitells me shared ratio of 3 to 8, I guess it's 8 to 3, but all of the unfunded liability cost and that's where that $350 million of deferred losses will eventually show up. All of that is paid by your employer.

>> Just for clarification, Paul, the number, normal cost number is heavily influenced by the liability discount rate.

>> By all the assumptions, discount rate, mortality assumptions, all of those are in there.

>> Actually that is the reason why you compare the 2009 to 2010 the normal costs have not stabilized only because of the change in the discount rate.

>> Good point. If we go back to section 1, did I want to focus ton the asset smoothing aspect. Section 2, page 6 if I make a personal observation, asset smoothing is one of my favorite topics. Andy usually has to cut me off at some point. What we're showing at five year smoothing we identify at the top of page 6 each year what was the total return on a market value basis. We then show what was the expected return based on your then 8% assumption. We compare those two and so the investment gain loss now again that's not whether you made or lost money. Whether you beat or did not beat your 8% assumption. And can you see the history here again 5 and 6 were good years. As I mentioned in the year ended 2008, you had a certain amount of loss that's the 377 but the most significant impact was really in the 2008 year. Now this is where the corridor accommodation in and there's actually about $44 million. If you subtract those two, you take the 481 which is a loss, and compare it to

the expected loss of 205, you add those together, that's about 686 million. So you actually fell short of your assumed earnings in year ended 2009 by about $680 million. However, the gain-loss that the smoothed is only $500,000, that is effect of the corridor. So instead of deferring the entire 600,000, you are only allowed to defer up to the market value of assets. That's why the double-asterisk there, that's the effect of the market value corridor. Now if you look at the fair right column this shows the remaining amount of deferral. We include the 2005 line since that was five years ago, none of that is deferred. All of that is now fully recognized. For the year ended 2007 you had a gain of $262 million. We have now recognized 80% of that so we are deferring 20% of it. You see he the pattern, 2007 the same idea. Go to the last line, we did have a gain in year ended 2010. About $154 million. We are he very symmetrical in asset-smoothing we treat gains and losses exactly the same. So instead of recognizing that entire $154 million we only recognize 20% of it by deferring 80%. So that's where we get this total deferred return of the $353 million. You basically subtract that -- I'm sorry add that to the market value. Again if you are deferring losses you adds that back in and that's why even though market value is 2.3 million the actuarial value is about 2.7 million -- I'm sorry about the. It's helpful for planning that 350 million deferred losses when is that going to hit us? We show at the bottom of the page a schedule that shows the rollout of those deferred losses. As you can see, it's not really level because it depends on when you know each of these 20%s makes those in for each of the four years but we're going to see 118 million, 170 million, 95 million and then a gain in the fourth year. This means if the fund earns 7.75% on a market value basis I can tell you today what your losses will be for the next three years. 118, 170 and 95. When you add all this together that is what leads to increase in contribution rate of about 60%.

>> Hi a question. Just to point out my understanding is, the numbers on this page 6 are the combined pension and health assets?

>> Yes.

>> So once you get down here you split out a pension so part of that deferred is belonging to OPEB health benefits?

>> That's correct.

>> But the significant amount is for pension?

>> That's correct. Because the funds are even though you have two different benefits that are funded by your assets because they are invested together we do the asset smoothing on a combined basis and as Mr. Maley suggested, we do that on the asset basis.

>> How is that selected?

>> A lot of discussion on that. The five years historic first of all going all the way back to ERISA, mid 70s, five years has just always been sort of the industry standard for asset smoothing. If you ask for rationales there are several that are put forward. Some say it is basically trying to capture a business cycle. Five years is enough to let the gains and losses offset each other or maybe it is an investment if that's different from a business cycle. Those are externally based reasons. More results based you want the smooght period to be long enough that you get some volatility control but not too long that you have too much risk of an intergenerational shift to cost or savings to future taxpayers. I think it's somewhat subjective but one thing we know is it's very definitely industry standard. We did find in 2010 we had three I think of the systems that we serve in California extend their smoothing period from five years to seven years. Relatively modest increase.

>> I would add that the CFA institute uses five years on their pension smoothing.

>> The reason I asked that is since 2000 I can argue that we've been in a structural bear market. We have had these chunks of time rolling at you roughly five years ago where the market has been declining over a rolling five year period and increasing. Which is exacerbating the numbers you're giving. 05 to 06, 06 to 07, roughly those numbers are positive in excess returns and anonymous we're on the other side of that handle. And it will likely continue for a period of time as you're showing by your assumed deficits. This is --

>> Just a correction, the numbers are not positive if you are looking at the investment gain or loss which is the --

>> Actually 07 was the beginning of the downturn in the market so that might be -- if we took it to an 01 to 06 period of time and looked at that rolling period it would likely be positive.

>> Could be but I want to point to the fact that this is the fifth column investment gain is comparative to the 8% benchmark not the market return.

>> Correct. So but if your returns are skiing that 8% benchmark that's where you're getting your surplus.

>> And that might not be positive.

>> Along that same lining it might be helpful if you turn to page 10, page 10 and level in section 2, we only have about five years, that's the period of time we have been in service to this fund. We should other patterns, if you like numbers you can look on page 10 and it's really the market value compared to the valuation value of return. Or alternative, turn to page 11, you will see this in graphic am form. That gray line, the gray, you have color copies, the gray squares are -- these are the rates of return on market value basis. And if you went back ten years, you would see the runup in the 1990s. The steep in 2000 to 2002, the crash in 2008-2009 and you have this sort of roller coaster market value number but the smooth value number again it follows the pattern of the plarkt, simply does it with the volatility reduced. That all makes perfectly good sense if you do not have an excess earnings machinery in place. If you do you get to the trustee's comment you have to look carefully between the relationship of recognizing these gains and losses for excess earnings basis on a smoothed value basis when you actually look what the future looks like on a market value basis. That is certainly a consideration that basically only comes to the table because you have an excess earnings base benefit structure.

>> Is it fairly easy to run assumptions using different smoothing periods taking it from a five year to a seven year to see what it would look like?

>> Yep, yep. Again we had about 14 discussions last year with systems on whether to do longer smoothing periods. There are a number of considerations, they sort of fall in three categories. One is if you're dealing with future volatility and there you know the question is, is the market going to be more volatile? You would need a longer smoothing period just to deliver the same value. Or maybe your employer can is more volume tilt sensitive. You'd need a longer smoothing period just to provide a more consistent pattern of contributions. We had a whole different chapter on this contribution, what do you do with a big market loss? Five years or seven years. We have yet a third consideration, that is, if you have an excess earnings based benefit structure, which means again, that gains will be pulled off into a nonvaluation asset, whereas losses as Mr. Malley observed, that could also be an argument for a longer smoothing period because you now have an additional cost associated with volatility namely the SRBR. That is a good valuation.

>> Has there been any discussion in termination of having a rainy day fund for the plan, something like SRBR, that says we want to have a little reserve for those down years?

>> Interesting that -- the whole -- we work on county systems have that reserve based systems and he they actually have contingent reserves that serve exactly what you describe. They tends to be in the period of 1 to 2%. Fixed income exclusively, in which case a 3% reserve was a big reserve. These days, 3% reserve is tissue paper. We could blow through that in a month. What you find is the idea of a rainy day fund or reserve is another version of volatility control. While asset smoothing is actually your rainy day fund. That is when you had good years, by the way we talked about deferred losses of $350 million, when we had gains we had large amounts of deferred gains. That's your rainy day fund.

>> Okay that makes sense.

>> Could you very well have a reserve based rainy day fund and it would be, I'm not saying it is bad but some ways redundant to, but some way belt and suspenders type.

>> My understanding is they're good ideas but when there's a lot of money available the employer generally finds a place to spend it. There are many needs for moneys. I know it's a good idea but it typically doesn't actually come to fruition when it happens.

>> Are you seeing any type of claw-back structures that are coming into place given excess returns that might create these over-fundings that take place yet all of a sudden you run into large deficits for a period of time?

>> Couple points there. One you have to distinguish between excess earnings which is a year by year phenomenon versus surplus which is a cumulative phenomenon. The last time we had surplus was the late 1990s and because of a whole collection of policies, those leads to reductions in employer contributions, either full or partial contribution holidays. By the way, contribution holiday doesn't mean a contribution of zero. Any time your cost is less than -- remember the normal cost? Neil Young fans, rust never sleeps. The thing that is always there. The thing that happened in the 1990s because of surplus levels, we had contributions that were less than normal cost, which made the plan appear less than it really was. Which led to employer relief and led to discussions of increasing member benefits. Whether that's sort of the reverse claw-back. If we ever have, Cal PERS in 1995, adopted new funding policies, it will be amortizized over 30 years, surplus as actuarial heroin. It is an apt metaphor. It is temporary, it makes you feel better than you should and when your supply disappears you have to sell the TV. What happened was, we had very short amortization periods, and uncut heroin, led to these reductions. Cal PERS we strongly endorse, if you have to, step on it as much as you can, spread out the surplus as much as you can. Whether that answers your question about claw backs I'm not sure.

>> It does. Thank you.

>> Is there preventions in the 2000s and 2010s, that can reduce the normal cost contribution?

>> Again, if -- one thing that some of our systems have done is comprehensive review of their funding policies. In every comprehensive review of funding policies we recommend at a you have an overright which says you have a

minimum contribution equal to normal cost minus 30 or amortization of any surplus. I believe in San José's current policies I don't know if you have that overflied there.

>> No.

>> You don't. What would happen is if you start having a whole lot of gains, would you amortize those gains over a 15, 16 year period. 16 years is you know pretty short. You know again going back to the metaphor, that's fairly well diluted. But what would you see if you had a lot of gains you would in effect be amortizing your surplus once you got there over more or less a 15 year period. I think the board would have ample time would see that coming and discuss with your consulting actuary whether you want to have a special feature in your funding policy to deal with surplus. But currently you do not have that in the system. This is a lot more fun than going through the results of the report. I invite these discussions. We would probably talk about the recommendation rates, then that might close off our formal remarks. Go back to section 1. So we're now on page I I, we're back to page double I. And I'm looking at the fourth bullet where it says page 15, about 39 and a half to 50 and a half. That is the -- that's before applying the charge of the SRBR. The rate after the SRBR is 49.95, plan year only. The employer rate increase for pretty much the same reasons listed above which he we didn't really go through but let's go to page -- if we go to page 15, in section 2, we'll show you a reconciliation of that employer rate, and then we'll also look at a reconciliation of the unfunded liability.

>> Just to be clear real quick on that page 15 point, the charge, the SRBR resulted in a decrease in the city's contribution rate?

>> That's right.

>> But it's only a one-year decrease in the City's rate.

>> Sean Kaldor: Understood, thank you.

>> What we showed on page 15, we showed -- again this is the aggregate rate, Police and Fire combined. It is the average rate across all members. Last year's rate about 39.5%. Here we see effective investment losses, that is an increase of 5% of pay. Smoothed basis, even though you had a gain and loss base, you had a loss on the smoothed basis, that's a loss before 5%. Any time the contribution rate goes up, valuation rate assumes that the contribution rates go into effect immediately. In fact there is a one year lag in terms of you adopting the report. When you have a pattern of increasing contributions the fact that you're missing the increase for a year compounds that slightly. That's the 1.78 there. We did have a gain due to lower than expected salary increases, about 1.2% of pay. We also had your amortizing, we assume that payroll will grow at 4.7% per year. Payroll grows less slowly. You spread it over a smaller number of dollars. Let me comment on that for a moment. We talked about the Councilmember Oliverio two components of the contribution, normal cost, unfunded liability. We're sometimes asked what happens if payroll shrinks? Reduction in workforce, what does that cause? The normal cost is really a per capita cost. So if your payroll goes down your normal cost percent remains the same so your normal cost dollars go down. They're pretty much in proportion to payroll but your unfunded liability works in the opposite way. Your unfunded liability is a dollar amount of liability. And those payments are dollars amounts of payments. We divide them by payroll to express them as a percent. What happens if your payroll goes down going forwards? Your liabilities don't care. Your liabilities are relatively fixed. The dollars are constant so payroll goes down. The cost as a percentage of payroll will go up. So normal cost, percentage constant, dollars go down. Unfunded liability, dollars constant, percentage goes up, that's what we see here.

>> Paul just a clarification on the normal cost. As you know, for the City of San José layoffs happen, with the least service fundamentally means the average age after the layoff will increase sometimes significantly. Clearly that statement assumes that the demographic assumptions underlying the plan don't change. However, in our situation, demographic assumptions would change, and the distribution of membership very specifically the age would change. Can you address that point, and how that impacts your statement?

>> Yes, the good news is that will have relatively little impact on the normal cost. Entry age method which means the cost depends not so much on the member's age today but rather on the member's age at hire. There is another method out there which corporate plans use which the normal cost is more of how much to buy the

annuity based on your attained age. In that case if you were using that projected unit of credit method then layoffs have this extra danger because if your average age increases your normal costs will increase however under the entry age normal method unless the layoffs not only are different current age but a different entry age that you won't have that effect so the good news is that under entry age normal you're relatively protected for a increase in age due to layoffs.

>> Another comment is because we have the Police and Fire plan our members tent to join us same age after they came out of the academy or school or whatever that case maybe. For the Police and Fire plan the impact is smaller where for the Federated plan it could be a factor.

>> Leer is the key point. The attained age is a relatively low impact demographic parameter. It is entry age that really drives your normal cost. Okay? The other -- there is another reconciliation page which is section 3 on page 36.

>> 26.

>> I'm sorry, 26. Page 26. Again, I skipped over this before. This is where we get from the unfund id actuarial accrued liability, last year to this year, increased 400 million to 650 million. It is pretty much the same reasons. At the top what we show is first you accrue the normal cost so your cost of the next year service under the entry age of service, here are the total contributions member and employer contribution about 72 million and then there's interest of he 33 so that goes up to 443. The reason that that is an increase, I'm trying to see why they would have negative amortization.

>> In this case, footnote number 1, there is a gap, 12 month delay. There is a $53 million shortfall because of the one-year delay. And I think it's reasonable to expect that when you look at this report next year because there's again the one-year delay and because the contribution rate is going up in this valuation you will see some kind of an increase in the unfunded liability because of that one-year delay.

>> Then the other elements out of number 6 again we already saw the cost impact. This is sort of an increasing effect, in dollars, $150 million loss due to investments, you had a gain, you had a little bit of mortality gain because your members in pay status died a little ahead of the schedule. You did have more service retirements, and the second largest one here, the 104 million that's the effect on your liability of the reduction of the assumed earnings rate from 8% to 7.75%, earlier page reconciliation ever cost, this is really a logically prior step swy a recognition of your unfunded liability.

>> The difference between the 88 million and the 72 million is largely because of the delay in the adoption of the contribution rates?

>> Yes.

>> Is there something the other systems have gone to stay ahead of that curve? Sometimes it will help you sometimes it will hurt you.

>> You can build that in. That is, we could do a calculation where we anticipate the loss that will be caused by the 12-month delay and build that into the contribution rate. We have one system, Orange County retirement system actually builds that in. You're right. When it goes down it's a slight savings. We've discussed it with many systems and really, it is supposed to average out over time. One thing about asset smoothing if you have a big loss you know what the next five years are going to look like and that's why you he see this number over and over again. That's what makes you think maybe we should build that in. One out of our 15 systems, we have one system that actually has that built in and that can be done.

>> I think Cal PERS does that part of their process. Cal PERS does that.

>> One comments is loss really is not just the difference between the 88.6 million and the 72.4 million. The real loss is if you look at footnote number 1, is 53.4 million. That's the difference due to basically that delay. And I guess the next item on the agenda, item 22 which is a discussion regarding the funding policy, attempts to deal

with that 53 million shortfall. It doesn't deal with the entire amount. It deals with a portion of it. But the idea from that discussion is to actually try and avoid having this type of shortfall or shortfalls of this magnitude again.

>> Sean Kaldor: Not only protects against changing in payroll levels but -- okay we can discuss it at that point, thank you.

>> It may be the other way around. Two things operating here. One thing, your payroll went down you're not collecting the unfunded liability item. The fact that your rates are going up because of deferred losses under asset smoothing that I think would not necessarily be captured in this. So the thing that Orange County did I think is more comprehensive. What you have later in the agenda is pick at least one element of that and that is the point I made about how your unfunded liability's in dollars. When payroll goes down you don't get those dollars. That item specifically is what is addressed in the later agenda item.

>> Sean Kaldor: That is not really addressed --

>> The two components of the 53 million is really, one in fact a difference in methodology. The fact that it's really a dollar amount that's estimated and the actuary converts it to a percentage of pay. And I believe that's more than half of the total between 50 and 60%. The other bit of it is the fact that there's a lag between evaluation and setting the rate of one year. So you can eliminate that lag if you chose to do so. But this would mean that whenever a valuation is done say in November, December, January, this valuation would actually set the rate for the next year, so that would be -- that would give the plan sponsor a lag of five to six months to come up with the money.

>> One aspect of that lag component, once you know it, becomes the question of how do you deal with it. Do you amortize it over 16 years or pay for it up front immediately.

>> Sean Kaldor: I wondered so we don't have a million dollar --

>> There are many ways to deal with it.

>> Again that is something you could consider. Again I was somewhat prized that we haven't had more systems look at that or more systems adopt that but as I say we have -- to Mr. maley's point, it could add to volatility which is not something you want to deliver to your employers. Okay? Let's see, I think that we've really covered the principal elements here. I think we have the contribution reconciliation, asset smoothing and other issues that have come up. Mr. Chairman, this covers our prepared remarks.

>> Conrad Taylor: Sean.

>> Sean Kaldor: On page 37, the final compensation for benefits termination. That is something you kinds of chaperoned through the process, the city council resolution November 2nd, I think that was changed slightly, I don't know if that should be reflected in this or in the following valuation.

>> Mollie Dent: Yes, that has changed slightly.

>> When did that change?

>> Sean Kaldor: November 2nd the ordinance was adopted.

>> Mollie Dent: It wooing in the fall, the ordinance was adopted. I'll give you the language change for that. It is the 12 months -- not the 12 months immediately -- I can't --

>> Sean Kaldor: It says, during 12 months -- you basically exclude from the calculation the -- if your last year is your final year.

>> Mollie Dent: Yes, yes.

>> Sean Kaldor: 108% only applies if it's your last year.

>> Mollie Dent: 108% only applies if the last year is your highest year. I'll pull the language from the code and we'll get it in here.

>> We'll just change impact evaluation.

>> We have to look at the ordinance.

>> In general, if salaries are generally increasing over time, I don't think there would be an impact. The issue is if you have a dip in salaries. (inaudible).

>> Currently we have one person that we are going to have to calculate a new way. That's it. So far.

>> But at least in the valuation we assume salary will continue to go up so that may not be a problem.

>> Mainly in a declining salary situation.

>> Conrad Taylor: Any further questions?

>> Conrad I just wanted to point out as Carmen did item 22. Typically the board --

>> Russell Crosby: We're e-not there yet.

>> On 21, are you still assuming we had the salary increases in there, is there any thought of moderating those? Is that still a 30-year view?

>> Very much long term view.

>> Okay, thank you.

>> If you get into the business of modifying the long term view then you may have to do it for other things, than the salary increase assumption and that becomes very misleading to a certain point.

>> Conrad Taylor: Thank you Paul, thank you everyone. I'll make a motion or do we have a motion on the floor for approval of action of Segal's or approval of Segal's valuation for a period of 2010?

>> Second.

>> Conrad Taylor: All those in favor, say aye, motion passes. Number 22. Discussion and action regarding a funding policy for employer annual required contributions being set as the greater of two dollar amounts, the contribution amount reported in the valuation or the employer contribution rate times the emerging payroll for the year.

>> Yes, would I like to address that item. What's hatched in prior years, is when the board approves the actuary's valuation, staff would come back with a board resolution to adopt the rates that are reflected in the report. And we're a bit concerned with continuing that methodology, because payroll has been declining, as Paul mentioned. And we're concerned, when payroll does decline, that the correct unfunded dollars specifically are not coming in to fund the unfunded. So we're looking to change what the board adopts so that really is board is adopting the dollar amount in the report, or if it -- a little bit of background. The city in the past has taken the rates and applied them to payroll as it comes through during the year. What we'd like to have is, where the contribution requirement for city is the dollar amount in the report, but if it turns out that applying the rates to payroll is a larger number, that would become the required contribution. So it is whatever is larger of those two amounts. And the idea is to make sure the unfunded payments do come in.

>> Why do it as the larger of the two amounts? Isn't the more precise one simply the larger dollar amounts?

>> Russell Crosby: Except in the circumstance where payroll is increasing.

>> Okay.

>> Russell Crosby: What we will do is set up a process to serve whether the city is increasing Drs.Ing going in another direction. Long term policy is what we're trying to put in place.

>> Sean Kaldor: Decreasing payroll, does that decrease normal cost?

>> It doesn't decrease normal cost. It only ensures that whatever cost the actuary has calculated is actually paid.

>> Russell Crosby: Unfunded is the real driver. Go ahead Paul.

>> If I may, strictly speaking, you would want to apply this policy only to the unfunded liability payment. Because if payroll goes down, the normal cost as we pointed out earlier, really does go down. The percentage would live but the unfunded liability might well be collected as a dollar amount.

>> Sean Kaldor: Again that's what I was seeing, but when you see at the greater of the two, some part of that is when it goes down you have a normal cost issue and when it goes up, or when it goes down you have an unfunded liability, and when it goes up you have --

>> Even on the unfunded liability if payroll is going up then if you're not careful you could actually over-collect. If you did the greater of the two then in years when payroll goes down on the unfunded liability you'd be collecting exactly the dollars that you want but when payroll goes up you would actually be overcollecting. Normally, people don't mind, the unfunded liability isn't considered a bad thing but there is asymmetry there.

>> In the typical situation, this wouldn't matter as much. But the unfunded liability has almost doubled from the prior year. The fact is that the unfunded liability may not be coming in it becomes a significant issue.

>> Russell Crosby: For the foreseeable issue, until the day comes when the city grows again, the current system creates continuing unfunded liability structurally. And this will address that constant creation of further unfunded liabilities particularly in the scenario of decreasing payroll or flat head counts.

>> This will address about roughly 50% of the total loss, however, the board can decide to deal with the remaining component as Paul has suggested. So this helps deal with about half of the problem. The other half can be dealt with through other means.

>> And the other half being the lag when the rates are going up. Mollie.

>> Mollie Dent: So just to make it clear for everyone, this will require an amendment of the Municipal Code. Because all of these -- the way these costs are paid are set out in the plan documents. So again, the board can have the policy, but in order for the policy to be implemented, the council will have to amendment the Municipal Code. So that -- and all of the issues with surrounding whether or not you do this on the unfunded liability, or only on the normal cost and the various -- we have various funds that we're going to have to do it within. It will take some time to put it together. So I just -- everyone needs to understand that the contribution rates are very specifically set out in the municipal code to be done in a certain way. So this will require changes to a variety of code sections.

>> Russell Crosby: What we're recommending is this be implemented for the next fiscal year. So the next true up will occur at the next fiscal year so the city has time to plan for this. Additionally, for whatever it's worth, the Federated board is about a month ahead of you, so they have already approved of this. Mollie is referencing the fact when the Municipal Code legislation has to be rewritten, if indeed this board approves as the Federated did, we can move the two pieces together.

>> Mollie Dent: In order for it to be in place and effective as of July 1, which is the intention, the council will have to adopt an ordinance sometime in May to realign the code with this method of requiring the contributions to be made. It's obviously the contributions can be calculated that way. It's a question of whether they can be required to be made that way and so the code does need to be amended and the board can definitely make that recommendation to council.

>> Molly Mollie, if the board were to consider or looking at the impact of the contribution lag, the one-year lag, is that something that can be discussed today?

>> Mollie Dent: No, that probably needs to be separately agendized because it is not on the agenda today as a discussion item. But if you want to have it on in February, and we took a look at the code it could probably still kind of move forward at the same time. But I wouldn't put it off much more than February. Otherwise, they're not going to be able -- this one is not going to be able to move forward.

>> Russell Crosby: This needs to move forward separately. Whether the board does the lag question or not, that is a whole separate transaction. Let's get this much fixed at quickly as we can.

>> To make sure everyone is clear as to what the is the suggested methodology change, if you go to page 14 of the Segal report, under the heading of June 30, 2010, actuarial valuation, if you go to the bottom two rows, fundamentally for Police and Fire combined there is a rate of 50.44. This rate used under the old methodology to apply to the emerging payroll, under the new methodology that's being the proposed, that rate will continue to be applied to the emerging payroll. But there's also a dollar contribution that's required and that dollar contribution is the 126.6 next to it. So that's fundamentally the proposed change.

>> Right now, doesn't the city generally prepay their liability for the year to get the interest benefit?

>> That's correct.

>> Mollie Dent: That's correct but the true-up he at the end of the area takes into account the actual payroll. I mean that's why it's going to take some code drafting to get this accomplished because it is going to mean that the true-up goes the other way at the end of the year where --

>> Although in practical terms I believe that the $126 million will be the governing number in this situation.

>> Mollie Dent: And that's assuming that you want -- the 126 million is assuming that you want both the normal cost and the UAAL cost to be a dollar value. If you only want the UAAL cost to be a component, that's a discussion that needs to be clear and I think staff's recommendation is that it be the 126 million total number.

>> And an additional clarification. This does not apply to the member contribution. It is applied to the City's contribution. At least we are proposing that it not apply to the member attraction. It is fundamentally difficult to go back and collect from employees.

>> Sean Kaldor: My interest is getting the plan exactly the dollar amount that it needs not a penny more not a penny less. I can see the challenge is in the delay in the collection and the payroll increasing or decreasing and generating what we get.

>> Dogs this create a disparity between the City's contribution and the employee's contribution because of this?

>> Since right now the unfunded liability is the driving force and the unfunded liability is the responsibility of the city, I would say that not really.

>> Russell Crosby: What it does is just ensure that the board actually collects what your actuary has said you need to collect on an annual basis. I mean at the very bottom line that's what we're trying to do here is create a system that will always lead to the correct answer as determined in dollars out of the valuation. Because the payroll is variable, and as head count decreases and salaries are cut back and those kinds of things you're not going to collect enough to make that $126.6 million that you need and that's why we're saying we need to do this

true-up with the city at the end based on what actually got contributed during the year to bring us back to what was contributed in the year which is the 126.six.

>> That makes perfect sense to me. A 26 million number for the employees, does that now carry over to a future year that's not made up?

>> Russell Crosby: Well, that's the problem you have now too is that is the nature of the system, that any time an unfunded liability is created, boom, it becomes the City's obligation. This becomes to narrow the amount of unfunded liability that's being created each year structurally in years where you have declining head count, declining payroll.

>> So I'm clear it decreases that but does it also shift it to the city?

>> Yes, it does shift it. So for example --

>> Russell Crosby: But that's happening now.

>> That's currently happening.

>> Russell Crosby: That's currently shifting.

>> Right now for this plan the unfunded liability is paid for completely by the city anyway. Now, there have been bargaining units in the other plan where some of the unfunded liabilities have been picked up and you have this flat dollar arc, there is a way you have to true that one up, too. But for this plan, right now, that's not an issue right anonymous. The --

>> One correction, can police members only for this current year did pay part of the unfunded.

>> Mollie Dent: They did pay one year.

>> Sean Kaldor: This is not built in construct plans, it is this year I'll pay you this much is a negotiation.

>> To address the question currently what's happening is if you look at past valuations, the dollar amount that was estimated by the actuarial valuation did not get paid in situations where payroll was declining by both the employees and the city. So currently, we're correcting the issue on the city side. I mean, obviously the board can give direction to staff to do something different. But our proposal right now is dealing just with the city component just due to the complexity of, well how do you go back and collect from employees at the end of the year and say --

>> Andy and Paul, that $126 million number that's assuming payment throughout the year.

>> I'd like to go back to the comment that Carmen made. That can be a little misleading. Because the members cost is almost all normal cost, if during the year payroll goes down and the members pay less than $126 million, they have not underpaid anything. You want to stress that. They have not underpaid anything. It is only in the issue of unfunded liability that you have this issue of underpayment or overpayment. If you adopt this policy, and payroll goes down, the 126, if you put that 126 as a fixed dollar amount, you will collect exactly the number dollars but on the employer you will overcollect. But what that does is provide an additional number to pay off the underfunded which the employer has to pay off anyway. Net net there is no additional cost to the employer. You could say you've slertd your amortization payment slightly, because you have paid more normal funds than you need. But the reason we want the members to pay as a percentage, you can't go back and collect it or give it back. But for the employer if there's any shift all that means is they're making a little extra payment on the unfunded which is their responsibility. Mike your question.

>> That 126.6 million that's assuming payment throughout the year.

>> That's correct.

>> Under this methodology that is recommended methodology the city could still prepay that at the beginning of the year and get a discount for early payment.

>> But the idea is then at the end of the year, unless salary goes up, God bless.

>> Conrad Taylor: Mr. Gerber.

>> I have one question and then to answer that, I have a follow-up question. If the board does adopt this method, going to the floor method of the dollar amount, apply to both the pension and to OPEB, retiree health care?

>> He we haven't addressed the issue on OPEB yet but we would like to apply the same method there. But that's not going to come back -- I mean the assumptions just the actuarial assumptions are another agenda item but that report won't come in until next month.

>> Understood, the reason I'm raising that, the discussion we just had normal cost and unfunded liability and the fact that opportune funded liability is almost paid 100% by the city. When you talk about OPEB and the retiree health care benefits, when we have a declining payroll we are also then not collecting as much towards the unfunded liability for the OPEB benefit as we otherwise thought. When you get to that point you have to consider that issue.

>> Conrad Taylor: Any further discussion?

>> Russell Crosby: And in fact to that point when Federated made that motion it actually included OPEB as I recall. I think that that was the --

>> They made that change at the last meeting to apply to OPEB, made in separate motions.

>> Mollie Dent: It would just be for the City's side.

>> Correct.

>> What is the cost to us? I know you don't get the money, you get money the next year when it comes under unfunded, what is the actual cost to the plan for having this not collected?

>> What you're pointing Tao to is really the lag, the fact that the rates from one valuation, basically doesn't come into effect until a year later. And that is still the case. Meaning we've made no attempt here of fixing that issue. That's when the footnote mentioned the $50 million loss this methodology changed only dealing with half the problem. The other half which is the lag is still very much there.

>> The fact that it, that we end up not collecting that amount because salaries went down for example, how much money is that? You said it's about half of the $53 million?

>> Yeah, I'll try and see if the number is exactly --

>> 25 million and our rate of return is 7.5 so it's costing us a million and a half bucks a year? Which I don't want to walk away from but when I consider the city trying to plan a number and the number changing and employees plan a contribution, I see the difficulty on that side also.

>> Just to be sure I understand the question, your question is what is the impact on the City's contribution because of the methodology change?

>> One way or another, if the city doesn't pay it this year because it goes into the UAAL and they have to pay it next year. So if they're not paying it this year and I guess there is deferment from that UAAL which we have to factor in, how much, when you apply that percentage, what is it really costing us, what is coming out of the plan?

>> Look at page 14 of the total $126 million of city contributions at the bottom of the page you can he see that if you go to look up the normal cost for the city of 43 for police group, 26 for the fire group. In total you're looking at about 60 million. That leaves us with 60, 70 million in unfunded liability payment. The assumption is that the payroll will grow at the rate of 4.25%. If it fails to do, then about 4.twiefdz of about 70 million, you are looking at two to three million a year is the amount we failed to collect. Because the payroll did not grows at 4.25.

>> Amortized basis spread over 30 years. To some extent when someone sells, how much does it cost the plan? The plan is not a cost center. The plan is passing things from taxpayers to plan members. It is a matter of how much are you delaying the times of the receipt of the correction on your employer. It would also mean you're building in cost increases which means you have that intergenerational equity thing. You're shifting cost to future taxpayers.

>> Sean Kaldor: I don't want a 20% staff reduction and building this on the liability that future taxpayers would have to pay for it. So getting it taken sooner would definitely be preferrable.

>> We're saying it's not happening right? Isn't that the point?

>> The point of the unfunded liability is to allow for assumptions where this is a potential deviation either up or down. So for example in the investment return the actuary makes an assumption let's say it's 8%. In certain years you're going to earn 15, in others you will earn minus 5. But over the long run, if you converge to the actuarial assumption then the unfunded liability is there to kind of make sure to guide you through it. Where you don't want to keep sending things to the unfunded liability that are continuing to generate either gains or losses, for example, in the situation in declining environment when you know that this will result in an underpayment if you continue to just let's defer it, the bottom line will become the -- the actuarial methodology ceases to work, and it will continue to work but it will result in a contribution that is increasing he very rapidly due to the continuous increase in the unfunded. So bottom line is, the unfunded is there to really deal with the fact that reality is different than actuarial assumptions and you typically want to use it in situations where the real number is either higher or lower than

what you have assumed, you don't want to send things to the unfunded liability where you are continuously sending gains or lows.

>> This is continuously a loss period.

>> In situations of declining payroll which we expect to be the medium term, yes.

>> But then we're talking about making a systemic change forever, right?

>> Russell Crosby: And by doing it as the greater of then you've accommodated for the period when the staff begins to grow or salaries continue to grow over time. Right now, the code doesn't contemplate that, never aimed at collecting the actual dollars.

>> Sean Kaldor: So the city's attempting to control their cost and they get a 10% salary reduction from the employees, still recognize no pension savings on that with this plan.

>> Yes.

>> Not in that first year.

>> Sean Kaldor: First year I'm sorry, correct.

>> Conrad Taylor: Anything further? No? Well, I'll entertain a motion to adopt the funding policy which sets the ark as the dollar amount setting, and for council to draft an ordinance to be presented to council. Would that be --

>> Mollie Dent: Sure, that's fine.

>> Conrad Taylor: Acceptable?

>> David Bacigalupi: I'll second.

>> Conrad Taylor: Motion and second. All those in favor? Aye? All those opposed, motion peace.

>> Let me ask a clarification. Was that only for pension?

>> Mollie Dent: Yes, that's all that was on the agenda.

>> Okay, thank you.

>> Russell Crosby: No, it's annual required contributions, period. I think and Federated certainly read that ant at that point, the Federated board made a motion that included OPEB at the same time.

>> Mollie Dent: Well, the problem is the actuarial report for OPEB is separate from this -- there are two separate actuarial reports.

>> Russell Crosby: But this doesn't refer to -- all it refers to is annual required correction.

>> Mollie Dent: The dollar arc shown in the actuarial report -- I can draft it both ways. It's going to have to come back anyway. It's not a problem but I -- I think the motion stands for what it stands for. I'll include it as an optional provision in the draft. Everybody's going to have to take a look at it anyhow. The board will get to see the ordinance when it comes back and the council is going to have to direct our office to draft the ordinance. So it's not a done-deal, until council decides they want to do it anyway.

>> Conrad Taylor: Number 23. Adoption of the June 30, 2010 OPEB valuation assumptions. Andy.

>> So every year we would, before we do the retiree health evaluations, we would approach the board, provide the assumptions for the valuations. Most of the assumptions from the pension valuations that your board has just adopted. There are certain assumptions that are pecular, how fast do we think medical premiums for retirees is going to go up and that's the purpose of this valuation, I'm sorry of this assumption is to provide for those recommendations. Now if you take a look at the attachment, it's actually on page 2 of the attachment. So if you look at our December 21st letter, second page at the bottom, you can see that this is the assumptions that we are recommending for those medical assumptions. Take for example for year 2011 going into 2012, we are register that the board adopt an expectation that the medical cost subsidy will increase at a rate of 10% a year. For the following year it is going to go down to 9.5% until it stabilize in about year 2021 and thereafter at 5%.

>> And then the rest of the report there, one of the things are the basic starting premiums, so there's a lot of data in here that is all really based pretty much directly on the information received from the fund office. I'd say the most sort of actuarial judgment that's involved is really the one that Andy just mentioned which is the medical trend.

>> The question so the rationale for scaling that down over time simply the idea that that which can't grow unsustainably won't?

>> Exactly. Otherwise in 20 years we're all done.

>> Right.

>> It's a theory.

>> Is the figure in here for the total city's contribution then calculated for medical?

>> We actually haven't done that yet.

>> This is just the assumption. We need this action in order to then proceed with the valuation.

>> Thank you.

>> I would say adoption of the assumption.

>> Second.

>> Conrad Taylor: We have a motion and second for approval of the valuation assumptions for OPEB for June 30, 2010. All in favor? Opposed, no opposed, motion passes. Number 24, this is --

>> Mr. Chair, we will excuse ourselves. Thank you very much.

>> Conrad Taylor: Thank you, Andy.

>> Very, very pleased to meet you.

>> Conrad Taylor: This is verbal report regarding disability process. Continued from the December 2nd, 2010 meeting. Mollie.

>> Mollie Dent: I'm going to be very brief with this. For the new board members you can see we had a couple of disability retirements, and there have been discussions previously among the board members, about having the disabilities heard in some forum attorney full board. Under our Municipal Code as it currently stands, the board is charged with hearing the disability retirements. And this board has traditionally heard them in full, without them going through any pre-review. Dr. Das of course writes his medical report and the staff accumulates the medical records for board. But the board itself is the trial court, and the appellate court, for the disability retirements. So to the extent there is some desire to have a different process under the code as it's currently written, the board could have a subcommittee that hears the disability retirements, the Federated board does have a subcommittee. The

Federated board subcommittee is a staff subcommittee. But the board could have either a staff subcommittee or a board subcommittee that would hear the disability retirements. And if that subcommittee recommended the disability retirement for approval, it could then be consent calendared for the board, and unless one of the board members or a member of the public wanted to pull it off, and have it heard by the board, it would go through relatively quickly. It would only be contested matters that would actually wind up before the board where the applicant or the city, for that matter, wanted to have a hearing. The other alternative, if the board feels very strongly about having some kind of independent, totally independent review and doesn't really want to hear the disabilities themselves at all, would be to recommend some different process to the city council which you know I think may have to go back to the bargaining units. I'd let them speak to that. But if the board wanted to have an outside hearing officer process where the outside hearing officer's decision was the final decision, then that would require an amendment of the Municipal Code. Right now, once the board has made its decision, the applicant's only recourse is to superior court on a writ of mandate. You are as I say the one-stop.

>> I would just offer a bit of my own experience with this, from my eight years serving on the Cal PERS board. At Cal PERS the way it works is there is a process he very similar to what was just proposed in terms of there being a staff process where a disability retirement can be approved, and where the vast majority of cases are essentially cleared. The applicant then has the opportunity if they're not satisfied, and actually I think in my years there were two people who actually were being involuntarily retired who wanted to work. It is usually the other way arounds. If somebody is dissatisfied with the answer, their disability retirement was denied and they have the opportunity to appeal to the board and the board everywhere month has a consent calendar which is approving everyone through the staff process, and then they can move -- they can move the appeals consistent with the staff recommendation, or at Cal PERS is way it works is if you don't accept the staff recommendation you can simply overturn it and then there's also a third alternative which is somewhat akin to the hearing officer but with a twist, which is that the board itself actually hold a hearing with the hearing officer presiding. The purpose of the hearing officer being really procedural, to ensure that appropriate due process standards are followed. And that was a very rare circumstance. But did occur from time to time. I thought that in the main, that system had a good set of checks and balances in terms of being able to put people through the system, without being overly burdensome but still giving people the opportunity to appeal if they thought --

>> Russell Crosby: And what you're describing is essentially what Federated does.

>> Is that right?

>> Russell Crosby: There is a staff committee that reviews. When we recommend for, it's put on the concerned, when we recommend against, it is moved to the board. And it cuts down what is to be heard by the board itself at least in full.

>> Mollie Dent: Right and the due process function, that's basically what Russ and I do. We're not hearing officers but that is one of the functions of the attorneys for the board is to kind of keep them on track in terms of the process that's followed in the meetings.

>> Is it somebody who acts effectively as the prosecutor?

>> Mollie Dent: No.

>> In that way I described there was.

>> Mollie Dent: And unour current process, if the applicant wants a hearing before the board, they are entitled to a hearing before the board. That's just it. But of course, if someone is being recommended for approval they're not going to usually ask for it.

>> David Bacigalupi: Mr. Vice chair.

>> Conrad Taylor: Dave, go ahead.

>> David Bacigalupi: We've been working on this and discussing it and in contact with the labor groups as well, of how it affects the members coming before the board. One of the things that the labor groups have expressed is a strong desire to keep board members involved, even if it's a subcommittee process. But with the additions of the current board members, we have the opportunity here to focus more on financial and investment issues, which I think, you know, this board needs to do. But at the same time, we have to address the individual outcomes to individuals' lives. So that if we had a subcommittee process, what we've been discussing so far and I'm still waiting to hear back from labor groups, is maybe leaning towards a board member combination with staff subcommittee again with the right of the individual to bypass that step, come to the entire board, if they did not get the expected result, to their next level of appeal would be hearing before the entire board. But there are just so many issues that come up that are to be quite honest and blunt embarrassing and personal, to show their case or prove their case of disability retirement, they are dealing with things that are he very uncomfortable to the individual. We are trying to look at something in that regard to handle the need of the individuals, sort of whether or not the application is valid and also, free up this board to deal with unless there is some contested issue, to deal with these financial issues, which you know are -- should be part of the forefront of what we're doing.

>> Conrad Taylor: Thanks Dave.

>> Mollie Dent: So I'm sorry.

>> I completely agree with his comments. I guess my only question is in the staff review process are there situation that are not making it to the board because of that review? Or are virtually -- most of the cases coming before the board have already been approved?

>> Russell Crosby: No, most are actually denied in Federated and they come back to the board for a hearing but there's a recommending from the staff of denial. They do move faster.

>> Conrad Taylor: Sean.

>> Sean Kaldor: I agree with the chair's comments that I think the members so far of in plan and have their interest in it, they have this board represented here, they feel there's impartiality to it, they would like the board hear their case on their disability. I think a subcommittee would be a great way to do that to get the large number of cases on the Police and Fire side, high majority get approved, a little bit different than the Federated side. So have a subset of board members to hear that. They have the right to hear that. I like the idea of a subcommittee so you get those more embarrass being or simple or more straight forbid issues dealt with directly and let the broader board focus on the more complicated issues that are facing us.

>> Mollie Dent: Do I want to add, it will, it should expedite these board meetings. That result should be accomplished by having a subcommittee. Because it will be -- if it were a standing subcommittee, it would be Brown Acted, it would be subject to all the meeting requirements. You probably would not get the same attendance that you get at this meeting but the public could attend if they wanted to.

>> Russell Crosby: And in fact the Federated meetings are recorded.

>> Sean Kaldor: You don't have auditors attending and issues on the agenda just people that care about that.

>> What about that requires public attendance?

>> Mollie Dent: Well, it's the Brown -- it's the government code.

>> Public records. Open meetings.

>> Mollie Dent: The Brown Act, open meetings law so a standing committee of a body like this has to have their meetings in public. There are exceptions for stigmatizing medical conditions where a closed session could be held. One thing I would want to look at is, if we were going to have closed sessions, those hearings might need to be held by these -- by this board. But there are situations where they can be held but it's he very narrow.

>> Chance that disability could fall under that?

>> Mollie Dent: Yes, a stigmatizing type disability can fall within that.

>> Is there any financial difference between if you take a normal service retirement versus a disability retirement other than the tax situation?

>> Depending on your age, a great one. You can go out on service connected disability after one day on the job.

>> So years of service it falls under the normal payment after how many years? 20 years. Anything after 20 years it's a tax issue. Anything under 20 years they get a guaranteed 50%, at that point it does cost more.

>> Conrad -- I'm sorry.

>> I'm not such a fan of the subcommittee having a subset of the board and the staff together. I would prefer that if it were going to be delegated that it be delegated to the staff. And then, come to the board as a whole. I think it raises tricky governance issues for the board to have some board members participating in something like that. And not others. So that's my view of that.

>> Conrad Taylor: Russ.

>> Perhaps consistent with that, I don't know Sean your recollection of that. There are a high plurality if not a majority of easy to approve. Will be approved even if it's a staff committee could appear on consent. Would not require any lengthy board consideration or deliberation. There are difficult ones on the border and would require judgment and probably would require board time but many of them could be eliminated under a restructure.

>> David Bacigalupi: That's true.

>> Conrad Taylor: Dave did you have something?

>> David Bacigalupi: That's true, many of them are quite obvious based on the package that is presented to us. But the only thing I would reiterate is, there is a very strong feeling from the individual bargaining units, to have board members involved in the process, and in fact, at one point many years ago, the city actually tried and negotiated to replace the board's decision with that of a hearing officer. And that was strongly fought against by both unions, and never implemented.

>> Conrad Taylor: If I may if we could just continue this until next month because I'd like to have the labor unions or labor parties here, local 230 and the POA discuss and provide history on what has happened in the past.

>> So could we -- would it be possible to direct staff to come up with some kind of draft proposal so then we could -- because we haven't been able to take action on this for the past couple of meetings because it is kind of discuss and hear --

>> Conrad Taylor: Mollie, this says verbal, it doesn't have an action --

>> Mollie Dent: It is really a board decision how you want to form committees. I think next month we can schedule it for action, discussion and upon action.

>> I could still see after that having to have something drafted out, a direction we want to go, we'll still need a staff policy draft. Which is fine.

>> Russell Crosby: We could give you a model that looks like Federated, already marmsed, it exists, policy is created. What I'm hearing is local 230 and POA are not at all in favor of that kind of structure. So rather than have-d.

>> Should we give them a draft or let them come to us and say here are things we like and hears are things we don't like? What would be --

>> A draft. I think a subcommittee by staff or subcommittee by board members are still allowed by the code as long as the final decision still comes to the board.

>> Mollie Dent: I think those would both satisfy the code. I think Russ and I both want to take a quick look at I think the issue, board member Flaherman sort of raised, whether or not you had a due process concern if you had a board member on the subcommittee and then the board member was also then again sort of rehearing the matter. We don't really view it that way. We views the board as always making the decision. It is really only a recommendation from the subcommittee. Even the ones recommended for approval are put on the board agenda the board can pull those off of the agenda or a member of the public could pull that off and make a comment. Even those consent calendar items could wind up being heard by the board in a full hearing.

>> I wasn't focused on the legal issue but really, just I guess a substantive in appearance issue. Which is my experience has been that board members playing this role of deciding on disability retirements tend to, over time, show that they -- you know there are some people who are just kind of intrinsically hard-nosed and other people who are intrinsically eager to show the benefit of the doubt in a contested case. And that if you took one or two people from a small board, like this, and put them in that role, they he would inevitably have a disproportionate influence because of their hierarchical role over the staff that they will be participating in it with. And the outcomes just are in danger of being tilted very heavily based on who those one or two people. And so that's my concern. That's why I would rather have, you know, all or none.

>> Russell Crosby: This is just discussion.

>> Conrad Taylor: Okay, any further? Number 25. Adoption of resolution 3685 authorizing submission of the following applications to the internal revenue service upon council approval of an ordinance containing the required plan tax compliance language. A, application for a tax determination letter with a payment by the plan of

the $1,000 determination letter filing fee. B, application to the voluntary compliance program for correction of failures to adopt timely amendments to the retirement plan as required under federal tax law and to define the establishment date of the plan's IRC 401 (h) account, with payment by the plan of the $15,000 VCP fee. Continued from the December 2nd, 2010, meeting.

>> Mollie Dent: I'll try to be he very brief on this one, too. this is the end -- this is the end of phase one of a long process. Governmental plans have a very good opportunity to file for a tax determination letter by the end of January 2011, this month. The board undertook a review of this plan starting nine months to a year ago with the goal of filing the application in this cycle. This plan has never had a tax determination letter. That doesn't mean the plan isn't tax qualified, it means it has not been blessed by the IRS. We went through the plan document, the municipal code, and tax counsel made a presentation to this board and to the Federated board jointly in October on tax issues and identified the areas in which our code needed to be amended. Most of it was technical lapping language, really, not a lot substantive. This board in December moved the tax ordinance forward to council. It will be agendized for the council on the 26th of January, just in time for us to make it to the internal revenue service by the end of January, assuming they approve it. So the only issues that came up with this resolution last month, this is the resolution that would authorizes the plan. To apply for determination letter and to go into the voluntary compliance program, is a way to get the IRS to agree that you've corrected past failures. And the only issues that came up at the last meeting, the city management and the two unions wanted more time to look at the tax ordinance. So since that time, we've met with them. We heard their concerns. We've gotten back to them I think about their concerns. We've gotten comments from them about a couple of very minor issues that may result in some changes in the tax ordinance. And also, we may as a result of the comments by the union attorneys, there are some amendments that their outside tax counsel thought should have been done earlier. And so we may open up the voluntary compliance filing a little bit to get those in there. But by and large, we're pretty well ready to go with the tax ordinance, and we do need your approval in order to meet the January 31st deadline.

>> Conrad Taylor: Okay, if there's no -- Russ.

>> Maybe there's no questions but a little bit of background. We don't need to file for this. But the IRS really, really really wants us to file for this.

>> For us lay people who aren't familiar with the IRS code, the fund is tax exempt?

>> Mollie Dent: Tax qualified.

>> Particular lingo.

>> Mollie Dent: Allows contributions to be maids by employees on a pretax basis and perhaps more significantly allows the fund to accumulate without paying taxes.

>> Traditionally many plans in California have not applied and do not have determination letters and of those that do, many of them have letters that are 50 years old. So there's not been a practice of going to the service and for example, Cal PERS if I'm not mistaken doesn't have one. You don't have to apply for one. But it is going to be he very much in our interest to obtain one. And it certainly looks as far as we can tell now that the process will be probably only moderately feignful and without any real difficulty as far as we can tell now, famous last words and don't put that in the minutes.

>> Mollie Dent: I will add and Russell you can chime in. We anticipate seeing more requests for a determination letter from some of our investment -- some investment vehicles want them. So if the IRS doesn't require them there are some investment vehicles that want them.

>> Russell Crosby: No, it's because it's never been done and the IRS has opened up a window for public plans in the West to come in and make yourselves tax compliant and submit to the VCP program and fix whatever problems they anticipate. Every time you change a plan document you send it in for a compliance review. They give you a determination letter, yes you are compliant, you are home free.

>> Were there any benefit structure issues that were out of compliance? 100% ever final --

>> Mollie Dent: Yes there were. That's not a problem. There were some -- there were some rollover issues, there were some issues with rollover of assets with mandatory distributions. And with optional forms of benefit to non-spouses that had to be minor corrections but not major benefit issues.

>> Russell Crosby: There's a whole list.

>> But very small issues?

>> Mollie Dent: Very small issues.

>> In terms of Cal PERS, my experience was eight years dated. But experience over time continuously that if the IRS want foad have a fight with the million and a half Californians we would see how that ended up.

>> That argument's still a good one.

>> I find it ironic my experience with corporate pension plans, they almost always file. So to find that we haven't done that yet really makes me a little nervous. I feel much more comfortable as a trustee doing it.

>> I don't fault you for never having done it. In the sense I view it as there are issues of federalism in play in these kinds of things. And I don't view it as just thumbing your nose at the federal government. I view it as issues of shared sovereignty.

>> The senior officials of the IRS at different conferences including conferences of public pension attorneys for governmental defined benefit plans have in a jovial way indicated we are underserved and they want to rectify this failure of service to us. They have hinted that a much more vigorous audit program and obviously it is going to be beneficial to us to have the letter in hands if we are the ones that are selected for audit.

>> David Bacigalupi: I think it also should include the fact that it's the proper thing to do.

>> Mollie Dent: Well, yeah. I mean, we've -- the city has always understood and the members have always understood that this is supposed to be a qualified plan. And so that's just been under the plan at least since 19 -- it's been there forever, ever since we've had retirement plans. The understanding has been that they've been tax qualified plans. So if we had have found substantial problems then we found it relatively manageable.

>> Conrad, one little fact. Once we're part of the system of filing with the service we are in a merry go round and have to do it every five years as all other plans have to do. The subsequent filing should be much, much simpler but it is still something we have to do.

>> Conrad Taylor: Sean.

>> Sean Kaldor: So the issues raised by the bargain groups they are not an issue with this resolution, is that correct?

>> Mollie Dent: They are not an issue with the resolution. There may have to be a couple more changes made to the ordinance itself.

>> Sean Kaldor: Which you describe as pretty minor and ininconsequential with us?

>> Mollie Dent: If we open up the filing to go beyond the establishment date of the 401 (h) account, I would ask you to give us the discretion to open up the voluntary compliance.

>> I think that is good. Failures to adopt timely amendments which at least are a couple of the minor comments advanced by the bargaining parties.

>> I'll make the motion to approve the resolution 3685 with the changes that were mentioned. Can you quantify the changes?

>> It is to add to those items that are being submitted under the voluntary compliance program.

>> Mollie Dent: I would say of failures, of plan failures under federal tax laws, including failure to timely adopt and or define. If we need to open it up, we can. I'll make that resolution so we'll have the chair sign it.

>> I'll move what she said.

>> Conrad Taylor: Motion and second. All those in favor, motion passes. Under standing committee reports and recommendations, number 26. Investment committee. Summary of the August 19, 2010 investment committee meeting. $will be a note and file. And 27A, Real estate committee. Summary of the September 16, 2010 Real Estate committee meeting. Note and file. 27B. Summary of the September 16, 2010, 1737 North First Street corporation board of directors meeting. Note and file. 27C. Summary of the September 16, 2010, Dodd road corporation board of directors meeting. Note and file. 27 D. $ Summary of the September 16, 2010, 3201 C Street LLC board of directors meeting. Note and file. E. Summary of the September 16, 20103301 C street LLC board of directors meeting. Note and file. E, summary of the September 16, 20103301 C street LLC board of directors meeting. Note and file. F, summary of the September 16, 2010 SJ progress report LLC board of directors meeting. Note and file. Consent calendar, items 28 through 35. Unless anybody would want something pulled out.

>> I would ask that the previous board of directors meeting minutes be pulled out since I was not a member of the board at the time.

>> Mollie Dent: We're not going to be able to adopt the previous minutes, they're going to have to stand.

>> David Bacigalupi: Motion to approve the remaining items.

>> Second.

>> Conrad Taylor: Motion to approve? Motion to not plooive, motion passes. Education and training. 36. 36. Notification of Cal APRS trustees round table. A, trustees round table double Tree hotel, 2050 gateway place, San José, California Friday January 28, 2011. B, general assembly, Mont Reyes California. Thursday, March 3, 2011 through Tuesday, March 8, 2011. C, principles of pension management Stanford law school. Crown quadrangle, 559 Nathan Abbott way, Stanford, California March 22-25, 2011. note and file.

>> Russell Crosby: If I could make a comment on 36C, if anyone is interested in going to the Stanford program sponsored by Cal PERS, each board can only send two trustees. There's a hard, fast rule limitation on that, so we can only send two people from each board. Let me know if you're interested in that one. It's a very good program.

>> I'll express my interest.

>> As well, I think that would be interesting.

>> Conrad Taylor: Number 37, notification of IFEBP training. 37A. Investments institute Las Vegas Nevada Monday April 11, 2011 through Wednesday, April 13, 2011. B, Wharton portfolio concepts management, Philadelphia, Pennsylvania, Monday, May 23, 2011 through Thursday, May 26, 2011. C, trustee and administrators institutes, new trustees, Hilton, San Francisco, California, Monday, June 13, 2011 through Wednesday, June 15, 2011. And I think if we could just add there's one in San Francisco for Wharton for the international and emerging markets. That's also available sometime in July.

>> In July, he yes.

>> Conrad Taylor: So this could be a note in the file. Under proposed agenda items. I think we're going to have SRBR discussion, we need to add that.

>> Sean Kaldor: Discussion and possible action regarding SRBR payout.

>> Distribution rate.

>> Sean Kaldor: Distribution from the SRBR, as well the disability discussion and possible action on board handling of disability applications.

>> Conrad Taylor: Yes. (inaudible).

>> Conrad Taylor: So we have that for discussion of the action regarding the payout for the SRBR and the subcommittee for disability. Okay.

>> How about the item 22 on the agenda where we weren't clear on the OPEB. That there's going to be a draft that is coming to us will that be a subsequent agenda item then?

>> Mollie Dent: That will probably be -- that probably will not be in February but it will be a subsequent agenda item because the ordinance itself will have to come back to you anyway.

>> And the consideration of the systems discount rate, did you want that?

>> Conrad Taylor: Okay, any further proposed items? None, okay, any public comments? None? Call for the adjournment of this meeting.