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.

>> Matt Loesch: Welcome to the December meeting of the Federated city employees retirement system. We have a bit of shuffling around, moving things and waiving sunshine on other things. Under orders of the day, I have six items that we are requesting to waive sunshine, mostly because they were delivered late to meet the deadline. Here we go. Most of these should be sitting in front of you waiting for you with baitbreath. Revised minutes of November 15th, 2012. Item 4.1 F received late, that's the third quarter performance report. Item 4.2 ABC received late, that's Cheiron's pension valuation and the ordinance. 29174. Regarding the SRBR. Item 4.1d, the flash report, that was received late. An the health care side, open that one as well, apologize for not doing that initially. 1.1, health care minutes of November 15th, 2012. And item 1.2, the flash report was received past the deadline. Other than that we're going to take the agenda in order. I'll entertain a motion on the orders of the day.

>> Motion to accept changes to the agenda.

>> Donna Busse: Waive sunshine.

>> Matt Loesch: Waive sunshine on those.

>> Arn Andrews: On 4.1 D and F and 4.2, AB and C.

>> Second.

>> Matt Loesch: All those in favor, opposed. Okay. On the consent calendar I'll entertain a motion.

>> Edward Overton: Move approval.

>> Second.

>> Matt Loesch: I'd like to request a moment of silence for those who have served the city and have passed. [Moment of silence] thank you. On the matters of closed session, two brief reports I would like to make out of the

closed sessions that are not in order. We had in closed session, 3.1, 3.2, 4.1A and 4.9. The only reports-out from closed session. One on item 3.2 and that is one of the cases that was new to the slate here and that's the San José retired employees association versus the City of San José, Santa Clara County superior court, case number 1-2-CV, we directed council Reed Smith to respond. And then item 4.9, the closed session on the retirement director, Roberto Pena was appointed with the board's advice and consent on Tuesday. At city council meeting. So starting in February, date yet to be determined, middle of February or so, he will take on his new position as director of retirement services. And then we will go to item 3.3. I think that's the next one on the docket. Hope you keep me honest, there's a lot. Update on pension system RFP.

>> Donna Busse: The update on RFP, we had staff go visit onsite of people we are moving to recommend. I don't think we'll make January, we want to do some more revenues calls to other people that we didn't go and visit.

>> Matt Loesch: Any questions about that? Okay, an update on the retirement services organization and staffing. I suppose I could have held off on the Roberto Pena stuff, but this is an Oregon chart, the chances for staff to reach out to the board and get any guidance or help from us or give us updates on changes or updates to the staff.

>> Donna Busse: This was also created before Tuesday so Roberto is not on there. And the only thing that was additional is we hired one temporary staff member for the investment group since last month.

>> Matt Loesch: Okay. Any questions or comments from the board on that? Why did 4.1A in closed session. 4.1B. Discussion and approval of modifications to the Federated city employees' retirement system's investment policy statement. Someone is here from Meketa.

>> Good morning. In your packet you'll find four items waiting for this presentation. One a revised memo modifying two changes that were previously approved in investment committee last week, two, an original memo that went to the investment committee last week, 3, an IPS that incorporates changes and 4 a current board

approved IPS. As you might remember, Cortex language on tactical rebalancing and leverage usage. The board's delegated trustees, the board trustees to review IPS and bring it back at later point. Staff worked with Alborne Cortex and Reed Smith to incorporate the requested changes, and we brought the IPS back to the investment committee last week. I plan to highlight the major modifications made and I'll be referencing two documents so please follow along. I'll be referencing the revised memo and the many investment committee 12-12, 2012. Turning to page 3. We made two changes to paragraph 16. First, we added an extra line to spell out how transaction cost and liquidity should be taken into consideration when rebalancing. We also added an extra line to tactical rebalancing. Currently reads as follows the retirement system will be rebalanced through tactical rather than long term target allocations and circumstances where the Board of Trustees have approved a tactical allocation. Staying on page 3, paragraph 19, we revised this paragraph to incorporate Meketa's standard language in regards to proxy voting. This new language is a lot more specific in regards to proxy voting on the site and annual basis and how written explanations a proxy vote should be provided should the board request from the vendor. Going to page 5, paragraph 32 regarding investment costs has been revised to incorporate Meketa's standard language. It provides more clarity on the different types of investment cost and how they should be monitored and controlled for. Going to pages 7 and 8 the hedge fund appendix. We had originally included definitions of leverage Net and growth and how they're calculated. Upon examining the definitions further trustee Odell, Meketa Alborne oops of if they are applicable to all, investment strategies out there nor do they represent a true risk. We added an extra sentence on how staff and Alborne will monitor the leverage level of the total fund and manager level. Going to page 9. We revised the second TIFs benchmark from zero to five years benchmark does not exist. In conclusion, staff investment committee and Meketa seek adoption from the full board regarding the modifications made to the IPS.

>> Matt Loesch: Okay, questions or comments from the board? I have more a procedural question.

>> Yes.

>> Matt Loesch: In the future when we get changes to the IPS if we could get just a red line or strike-out version of it when we get the thing to review because of not only the length of this document and the technicality of it just

to be clear for us and then maybe we could ask for just an e-mail be sent out with the accepted changes in there later on so then we have that electronic copy. That would just be easier for me. Then we wouldn't be looking between old and new versions. That's optimal for me. I don't know if anybody else had any --

>> This one was a complete rewrite from Cortex but in the future we'll note the changes.

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

>> Lara Druyan: Move to approve the investment policy statement.

>> Second.

>> Matt Loesch: All those in favor, opposed. Thank you. This is item C. Authorization for the secretary and the City Attorney to negotiate and execute the second amendment to the agreement with Hanson-Bridgett LLP to increase the compensation for the remaining term of the agreement to end June 30, 2014 by $250,000 for a total contract amount not to exceed $500,000. Mr. Kumar.

>> Good morning. Hanson-Bridgett contract is currently active, however, funds maximum -- we reached the maximum funds allocated to the contract. We have a number of contracts that are in the pipeline and we expect a lot more in the next six months or so. The investment committee discussed and stated that it's best practice to have a number of firms to choose from based on their expertise and capacity as well as to obtain competitive pricing. So staff recommendation is to add the funds so we are able to use Hanson-Bridgett as a backup to Reed Smith.

>> Matt Loesch: Okay, questions, comments?

>> Edward Overton: Is the $250,000 Federated share or is that split between Federated and Police and Fire?

>> That's Federated's share.

>> Matt Loesch: Okay, other comments or questions? I'll entertain a motion.

>> Edward Overton: Move approval.

>> Second.

>> Matt Loesch: All those in favor, opposed. Okay. Thank you. This is item 4.1D, the presentation of the trust fund flash performance report as of November 2012. Why don't we open up all reports so you can speak of them in their leisure. Presentation of the pension trust private markets report as of June 2012. Presentation of the pension third quarter performance report as of September 2012. Good luck keeping those straight. Ann, welcome back.

>> I'm here with Brad Regere from Meketa investment group. Thank you for opening up all the items, because we thought it made sense to go through the quarterly reports before we went through November performance. To start off Brad's going to give brief economic updates then we'll talk about the public markets third quarter report, then we'll talk about the private markets second quarter, always a quarter behind then November flash report as of November 30th for the retirement system then for the health care trust and then we'll GIF a verbal update of performance since November 30th. A lot of items, we know you had a long meeting already this morning, we'll try to be brief, feel free to jump in at any time with questions.

>> Matt Loesch: Before you break into the health care items, I need to introduce them, they're not introduced. Go ahead and I'll introduce them.

>> We'll take a break at that point. Mr. Mayor Mr. Reg everyre.

>> I'm going to start off with a brief third quarter economic review so we need to go back in time just a little bit. Our book, our third quarterly report has a number of section that are really there for your reference. I'm going to start on page 112 of 126. I'm looking at the bottom, the center, page number. And that just has indexed returns for the third quarter of 2012.

>> The quarterly review September 30th, 2012.

>> So just to put some context into the third quarter performance before we get to that. The markets improved in the third quarter despite mixed economic data in the United States and slow in global activity. Equities produced strong returns during the third quarter which you see here in the first column. The U.S. indices increased, between five and 6%. International indices were up between seven and 8%. Real assets were very strong. The Dow Jones UBS commodities index was up 9.7%. The optimism in the third quarter was due in large part to actions taken by the European central bank and the federal reserve. So during the third quarter, the ECB outlined plans to keep interest rates lower for struggling nations and basically, signaled that they were willing to do whatever it takes to preserve the euro. The Fed announced in September a third round of quantitative easing which was seen positively some in market performance. Now I'm going to go to -- so the rest of this section has some general third quarter returns data. That is there for your reference. I'm going to go to page 74, kind of going backwards and just wanted to point out two sections in this report. That are done on a quarterly basis by Meketa investment group. The first is a global macro-economic outlook and the second section which immediately follows this is a capital markets outlook. This covers a number of global macroeconomic issues. I will just highlight the concerns that we have right now. Which are this is been consistent with what we've reported, the past few quarters, three major concerns. The solvency of sovereign governments and banks in Europe, slow growth in the United States and slow growth in China. The fourth one that I would add is the more immediate concern, which is the fiscal cliff in the United States which is well publicized right now. The capital markets outlook is more gives some valuation data regarding more asset classes. Would be you know international versus domestic, growth versus value, core real estate versus REITs and that kind of data. So with that kind of context let's go to page 11 and we'll look at the fund. Total fund value at the end of September was $1.94 billion. Net inflows for the quarter were $73 million which includes the City's annual contribution which was done in July. In real assets, just shy of

$100 million was added during the quarter to the two real asset managers that were a part of the portfolio roster. So that means that the physical investments in real assets increased here 13.9%. Relative to the target allocations this fund continues to be overweight, global equities and public fixed income, as you are well aware, the hedge fund allocation is ramping up. And as it ramps up, those allocations will be used as a source of funding. It should -- I do want to point out and -- that as of September 30, this snapshot of the portfolio changed quite a bit following the quarter. Russell investments who is here and going to talk to you about the transition that happened in October, there were a number of asset movements during the month of October. Some managers terminated some new passive managers funded. And so the portfolio does look a little bit different in October and we'll see some of that in the November flash report when we get to that. If you turn the page, to look at the manager roster. In September, no changes to the manager roster with the exception of the only one that you see here is under -- is on page 14 in the public fixed income the Northern Trust intermediate government year, funded on the last day of the quarter with the $100 million and was part of the transition taking place in October. Moving to page 16, we'll look at performance. Performance in the third quarter was 5.2%, better than the policy benchmark 3.2%, global equities, during the quarter this fund was overweight equities which helped performance. Performance was slightly better than the custom benchmark of 5.1% and better than the median fund return of 4.8% for the quarter. In terms of you can move forward to page 19 look at a couple of managers. There's only three active managers in this fund in the global equity roster and that's artisan global value, eagle small cap growth and RS small cap value. Artisan continues to post strong performance. I'm on page 19. 8.2% versus 6.6% during the quarter, absolute and relative performance over the one-year and since inception return has been phenomenal. If you look at the 18 months since inception return of 8.9% versus negative 1.9% for the benchmark. Eagle performance page 20, strong returns for the third quarter, 6.9% versus 4.8%. They made up a little bit of ground. They had underperformed during the second quarter and so for the calendar year they are outperforming for the one-year they are slightly under-performing. RS had a very good quarter in the third quarter but is slightly underperforming on the calendar and one-year basis. We have no concerns about any of these managers. And from there we'll move on to the other two managers I wanted to comment on are page 23 the real assets Credit Suisse and first quadrant. Both of these managers came to speak to the investment committee last week. And gave updates to the investment committee. Both managers had strong absolute returns during the third quarter. Credit Suisse, outperformed the custom risk parity benchmark. And first quadrant underperformed the risk parity benchmark during the quarter. Overall since inception, the allocations have been doing pretty much what we thought they would do. And are giving the kind of exposure to the asset class that we expect. With that a couple of final notes, let's go to page 34 which is an attribution report. One month, three month and one year attribution. Which gives a total effect, allocation effect and relative to the policy perch mark that this fund has outperformed the policy perch mark for .4% for the year. Most of that has to do with the allocation effect which has been positive 1.2%. and a negative selection effect. Some of the underperforming managers during the last year Tradewinds Calamos MacKay Sykes are no longer part of the deviation from the policy benchmark because a large portion of the assets are in passively managed fund. So I wouldn't expect to see a lot of selection effect over the next year, until allocations get built out. Finally, I'll conclude this report by looking at the peer universe make 56. 5.2 per 25th percentile 5.1% and that is largely because of the international equity and real asset allocations and performance in the third quarter. You see the one-year performance that's in the bottom quartile and it is largely because of the performance in those same two asset classes, international equity and real assets. And that would conclude the third quarter pension report. I can turn it over to Laura to discuss the private markets report unless there are any questions.

>> Matt Loesch: Questions from the board on the quarterly report. Comments? Mr. Andrews are you working on something or are you -- okay. Ms. Warrick.

>> Great then I'll move on to the private markets report for the second quarter which is labeled public version. And if you recall, we also do a private -- or a closed version that we do that on an annual basis and have a closed session. That deep dive into the portfolio markets just took place over the summer. We have canal Shah meet with the investment committee and go into the report that shows all the individual holdings and underlying funds. Those are not able to be publicly you know included in this report because of nondisclosure agreements. So this is public version mainly for your reference because we can't talk too much about individual companies. So I'll just do a brief review. If you want to skip first to page 15 of 69. These again are the bottom numbers in the middle of the page. The environment for public equity in the first six admonition of 2012 was one of the most active since the global financial crisis you had stable corporate earnings, open debt markets that private companies could access. Globally however there was a lack of European deals for reasons Brad

mentioned in the well publicized European accident cries. If you look at page 69 you see total capital to private equity managers is about 136 million. The program is relatively mature. There's only been one new private equity investment since this Board of Trustees began acting as trustees for the plan and that is partners group 2011 which is not shown on this page because it just had its first capital call in the last couple of months. You can see here that total distributions to date are $111 million so that means that the majority of your funds are winding down. You haven't made many new commitments recently. During the second quarter the partnerships in aggregate called about $1 million from your plan and made about $5.1 million in distribution. And the net IRR you can see here is 4.4%. Differed slightly from 4.1% in the previous quarterly. If you look to skip to page 31 of 69 we'll move on to private real estate managers.

>> Lara Druyan: Laura how much higher would you like it fob.

>> Low double digits for a conservative private equity plan. You'd want certain managers certain funds to be higher than that. You know if they're in higher octane areas. You know we've done pacing studies and whenever the board is ready to make additional commitments, we have a lot of ideas. We have a large private equity team, we think one of the best in the country. Mainly based in Boston with a few individuals in our San Diego office. And we're happy to bring them to you whenever you're ready to make the commitment.

>> Lara Druyan: Thanks.

>> Page 31 of 69 then for private real estate. As you know, the fund made or the retirement system made most of its commitments to Real Estate at not the most opportune times. You see here vintage years 2006 and 2007. The second quarter of 2012 was positive for real estate, the fundamentals in the real estate marked improved marginally. multifamily. Retail is the only area that has held study with not improving fundamentals. That said the I.RR of the program did increase slightly, from negative mainly because of one of the underperforming funds G.E. asset management had a write-up in some value. This fund has trustees have been active that is DRA growth and income fund 7. You had been in previous DRA funds 5 and 6 which performed well for you. During the second quarter DRA called just over $3 million and you had about $3 million returned to the retirement system as well

from other funds. DRA fund 7 is showing an 18.4% IRR perform well going forward. With that I will skip to talk about private debt on page 44 of 69. Just briefly. In 2010 the retirement system as you know committed $150 million to three private debt managers. The credit markets during the first half of 2012 were strong. You did have some volatility in Europe so most of their activity was in North America and you can see here that these programs are designed to call capital more quickly than your private equity and private real estate managers so they called 94 million out of a commitment of 150 even though they were vintage year 2012 funds. And performance is not yet meaningful due to the immaturity of this program. And again we'll continue to do deep dives of our private equity group during our closed sessions. Any questions?

>> Matt Loesch: Questions?

>> Lara Druyan: What kind of recycle provisions do these guys have Laura shorter time frame?

>> It really varies by fund. They're each going to be different but that's why you'll see that some of the more mature funds have called capital in excess of what you actually committed.

>> Lara Druyan: Okay, thank you.

>> So it depends.

>> Matt Loesch: All right, thank you.

>> Pension fund November flash report. The first page has --

>> Matt Loesch: One moment, it should be sitting on our tables for you, I believe.

>> It should just say the retirement system, November 30th and at the top it says preliminary flash report.

>> Matt Loesch: Right, do you have that Mr. Armstrong? Thank you. Please.

>> The first page is just an overview of index performance as of November. What you'll see here is the best performing asset classes, the EFA index, if I'm looking in the first column 2.4% for the MSCI EFA index during November. Fiscal year to date the EFA is up 10.4%. The strong performance from foreign equity is very positive for this fund. Given the allocations to foreign equities. So that's good news. On the next page, look at the asset summary. At the end of November, value in the fund at $1.912 billion. The overweights to global equity, real assets and public fixed income remain. But what you do see is allocations to the hedge fund assets. There was one fund that was funded basically for whole month of November. And then one fund that was funded on the last day of November for December investment. So the hedge fund assets now total 3.1% of the total fund. on the next or actually one more note there is on the real assets, you'll see in the second column the percentage of the retirement system, 20.2%, as a result of the transition, the real assets, the investments and physical investments, now total 20% which is the target. And so that's great news as well, that that allocation has moved up. And so if real assets now -- the real assets now include Credit Suisse, first quadrant and then a natural resources index fund. The next page you'll look at performance. For the month of November we estimate the fund was up .6%. This is basically reverses the October performance which was down about .6% so for fiscal year, we estimate that through November, the fund was up 5.2% which is very good. That's higher than the policy benchmark for the fiscal year and equal to the custom benchmark. For the month of November global equities was up 1.5% which drove much of the performance. In real assets, both of the custom risk parity managers were both up slightly. The returns were offset by the natural resources index which was down slightly.

>> And that's a preliminary number. They haven't reported the final numbers yet.

>> Yes. And on the second page, the hedge fund was down negative 0.2%. That just reflects one fund. And obviously is very early since that was just invested for that month. So that's it for November flash report. I would add that we're estimating that the fund is up about a percent in December, month-to-date which would mean that the quarter is about a percent and the fiscal year-to-date is a little over 6%.

>> Matt Loesch: Questions from the board, comments? Thank you.

>> Would you like us to hold comments on the health care flash record?

>> Matt Loesch: I'm going to beg forgiveness of folks to jump over to that agenda and while we have them sitting here, everybody has stuff since public comment is usually not robust often our flash reports, so I will beg the forgiveness. On the Federated city employees health care trust, 1.2, presentation of the health care trust fund flash report for November 2012.

>> Page 2 of the report, end of November, $42 million. The target allocations, they were the funds, the allocations to global equity, fixed income and real assets are fairly close to the target allocations and all within range within their target ranges. On the next page you can see performance, the fund up 1.2% during the month of November which is equal to both the policy benchmark and the custom benchmark. Fiscal year to date, health care fund up 6.2% and that was driven mostly by the global equity performance which was up 8.7% fiscal year to date. December we're estimating that the fund is up about a little over 1%. And so that would mean that the quarter to date estimates about 2% and the fiscal year to date is maybe 7.5% is what we would estimate. As you know the health care trust allocation will be reviewed in the coming months, as we work with Cheiron and figure out how to evaluate and analyze the asset allocation in connection to the health care assets that are included in the pension fund.

>> Matt Loesch: Right, perfect. Questions, comments? Okay. Thank you. So we have item 4.1 G, listed as an oral update but we also have a slide deck in front of us. This is the oral update of the portfolio transitions. We have representatives from Russell here.

>> Good morning.

>> Matt Loesch: Good morning.

>> Thank you for having us. My name is Steve Kovel and we are here from Russell, I've got Travis Bagley, as well as Chris Pierce, a senior portfolio manager who managed the event on behalf of the Federated plan. It was the significant restructure. We traded nearly $625 million which at the time representalmost a third of the total plan. It was complex in that there were eight managers on the sell side. Multiple strategies encompassing both fixed income as well as equity strategies. We were winding out of some interim assignments that we had managed in-house into typically pooled funds managed by Northern Trust. So there were lots of different moving parts and this is definitely an exercise in project management probably bigger than just executing trades. Travis will take you through some of the highlights of the event. And specifically speak to the synchronization of the futures positions that we were working with on the overlay at the same time as transitioning physical securities. And Chris will give you the opportunity to go through any level of detail that you'd like to go through on the trade.

>> Matt Loesch: Thank you. Just make sure you speak into the microphone so that everybody can hear you.

>> So I assume you have the book in front of you and page 2 is where with we'd like to start and that's a high-level executive summary which works well in kind of this format. To talk about the event, generally these events post-event we look at them there's two aspects that we look at. The investment performance, and the operational management of the event. And from both of those aspects we believe this event was very successful. Given the complexity that was involved in this event, and the amount of moving parts, Chris Pierce and the team did a very good job at manage that complexity and delivering a successful performance outcome. A big reason for that performance outcome is the synchronization of the transition management. So we synchronized the trading so that you're exposed to the market the way you should be throughout the transition. There's no large cash bets. You're in the asset allocation that you want to be in equity versus fixed international right from the get-go and we coordinate the trades with the overlay in the futures market . The outcome is 16.6 basis points of implementation shortfall which is the metric used in transition event. That's at the transition level. That translates to five basis points at your overall plan level of costs associated for doing this transition, five basis points at the $19 billion your total plan value. That again, that's drink by a lot of the strategy that Chris an the team developed as far as retaining securities. So that they -- we don't have to trade, if we don't have to trade that saves cost for

the plan. He'll go through some of the specifics about how we divide some strategies to save cost for you and manage risk. As well as just the number of managers involved and the number of securities involved in this transaction. 13,000 transactions overall to move these assets from where they were to where they were going. Chris is a very modest person but he and the team did a great job of managing that complexity for you and again delivering a very good outcome. If you go to page 3 you'll see just the number of managed -- I think I counted 17 mandates across multiple asset classes. We can't go through every single item and what we did on every single mandate but I would like Chris to point out the highlights with regard to what we did on these assets.

>> Thanks Travis. So again this is the transition matrix and what we refer to kind of as the road map. On the left-hand side of the matrix is the legacy manager lineup. The managers that were actually either terminated or reduced, to help on the right side of the matrix is the target allocation. You can see Northern Trust as we alluded to earlier was the recipient of the majority of the asset and the new target allocation with their passive commingled fund products. And I guess before I go into a couple of examples, but the planning phase, for a transition of this size and scope, takes place several weeks before the event itself. And it was a collaborative effort with the San José retirement system staff, Meketa, state street who is the underlying custodian for these managers as well as Northern Trust since they were an integral component of boast the legacy and the target allocation. A as a portfolio manager managing this type of structure there is three objectives and the first one is the maximize the value of the assets in the transition which takes into account minimizing the transaction cost. And one of the key points to that was, in designing the strategy was the retention of the underlying securities that were existing held in the current lineup. The second objective was, once all the manager contracts are complete, as a portfolio manager on the transition side, we need to move quickly and efficiently into the new target allocation because that's how we're measured, in determining a successful outcome. Because there's as you know markets are fluid, any time that you're outside of your target allocation, you're introducing potential risk and opportunity cost that could significantly impact performance of the plan. And thirdly, as Steve alluded to the project management. We try to remove as much of the administrative burden as possible away from the staff here. But obviously we'll need to rely heavily on their insights on the contracting and kind of ultimately balancing off the finalization of the implementation strategy. Just high level of one of the key components of the strategy again was, as there's multiple asset classes and account structures involved, Northern Trust is a commingled fund manager in that the

retirement plan holds units of a fund, and that fund invests in underlying securities. A basket of securities. As well as all these other actively managed portfolios are what we call separate accounts. So when we're designing an implementation strategy, one of the things that we're trying to determine is, how can we minimize the actual straying or the turnover of the portfolio, and what a lot of investors don't realize is whenever you are investing or redeeming out or subscribing into pooled products or commingled funds you have the option to come out in cash and/or in-kind securities. And for the majority of these redemptions as well as subscriptions we took the approach of in-kind securities. There was a significant amount of overlap. For instance, I'll take the Northern Trust, the legacy Acqi mandate. We value in in-kind securities. And that allowed us to retain a significant portion of the new target allocation and a good example is that Acqi was made up of a Russell 3000 could mingled fund as well as an MSCI commingled fund and really by introducing a transitional manager that kind of sees the big picture of all the moving parts. We worked with Northern Trust to actually do a unit exchange on the U.S. component of that Acqi fund directly into this Russell 3 new target allocation. That was done at zero cost. It was simply a bookkeeping entry where you're exchanging units essentially from the Acqi fund into this new Russell 3000 mandate. That is an example of some of the coordination and the strategy discussions we had with staff as well as the managers involved. And I think that's essentially what we wanted to do. To address on this slide. The only other thing, just to point out, as Travis mentioned was, as you can see there's a number of underlying managers involved. But one of the benefits that we're able to lean on during this transition is the asset allocation was authorized or approved several months prior to this transition. So we made the move synthetically and therefore when we're actually moving all the underlying managers in the physical securities we were essentially already in that asset allocation. We just had to coordinate internally amongst the derivative and the futures traders and the equity and the fixed income traders at Russell. So that, as you'll see later in the presentation, that actually benefited the plan greatly.

>> So again, page 4 is the project management. And as you can see there's a number of groups and entities involved that we need to coordinate with to make sure that things happen. Chris and the team did a great job with that. You can see just the vast 1800 e-mails exchanged to make these projects happen. So again, that is the burden that's taken off your staff that we can help you with as far as the project management side of the equation. The next page, page 5 is the performance. Again, chief standard implementation shortfall and there are

a lot of numbers on this page. The key number to look at is the implementation shortfall number that's in bold there which is 17 basis points. And that's at the asset level that we moved 624 million that we moved it cost you about 17 basis points to do that. The cost to do that, the transactional cost the commission cost the taxes and fees and spread and impact some of those less visible costs we estimated to be about 18 basis points. So you can see there was just a couple of basis points of opportunity cost. Again staying that concept of the overlay and how that helps in the risk managements and operational management, because we have that overlay, because we have the allocation of our target structure already, we can really keep the opportunity cost to a minimum amount. As can you see this is a great example of an event in a market that was rising from October 12th to October 17th where you were fully invested, and you participated in that up-market. You can see if you had a large cash exposure during this transition period, and you only had 50 basis points of positive performance, you know 40 basis points down the drain, because you didn't have exposure, not because the transaction costs were high. So that's the importance of the overlay and the exposure management and why it's so beneficial for your plan. On the next page just to go back to the estimate and how we look at these costs on page 6, the mean cost that we estimated was 18 basis points. Around that mean cost we expect things, one standard deviation to one side or the other, based on the risk of the portfolios from the legacy to the target. There will be some dispersion around it. As you can see our event came on actually right on estimate, expected 18 and came in about 17, 16.6 actually. So that's a very good outcome relative to expectations, to determine what we determine those mean costs are page 7 gives a detailed breakdown of the cost and this is part of the transition process. While we are work with staff to determine what the costs are of doing this transition, where we can save costs, and set the expectation of how much -- what the impact is going to be for the performance of the fund. So this is on the left here is our estimate. On the right, what dictates or show what we actually transacted. What you estimated is not actually what happens. This is very close, within a basis points, not even a basis points of expected cost in total. There are a lot of numbers on in page. I don't know if we need to go through that on detail but at the end of the day, we thought it would cost about 18.1 basis points, it cost 18.4 basis points, with 1.4 basis points of opportunity cost very good outcome we think.

>> And really the only other thing just to highlight in this matrix is the in-kind security redemption or retention. This is where you know by the strategy that was employed, we were able to retain roughly 43% of the existing underlying stocks, and bonds that were held in the legacy allocation into the new target structure.

>> Matt Loesch: Okay.

>> I think we'll stop there. Any questions --

>> Matt Loesch: Sure, comments or questions from the board? No, anything from staff on this? Does anybody want to make any comments on it? Did you want to make any comments, staff? Okay, thank you very much. Okay. Moving on to item 4.2. And we'll do let's do A and B first. So Discussion and action on Cheiron's final pension valuation. So A is, the presentation and B is the actual valuation itself.

>> Bill Hallmark: Good morning. So yeah, you should have both the -- a PowerPoint and an actual report. I'm just going to walk through the PowerPoint. And I'll take any questions you have on the report. We presented the preliminary results of the 2012 valuation at the November board meeting. And we're just coming back with the final, reflecting some of the comments made at the November board meeting. Particular, we're going oshow results both with and without the SRBR, some additional gain-loss sources, and we've got printouts of the projections we looked at and discuss some of the other measure B items. So in the November meeting, we clarified that measure B is not included in this valuation. Except tier 2. We clarified how the rates are expressed. And we're showing prepayment amounts for the city separately for tier 1 and tier 2. One of the questions that came up is our 7.5 discount assumption. We understand that Meketa worked with the investment committee to review their capital market assumptions and came back and confirmed the 7.5% discount rate so there was no change there. And then the other items we'll talk about in more detail. So here's the summary of our results with and without the SRBR. So the right column and the middle column were presented last month, the new information is the left column, without the SRBR. If we eliminate the SRBR, it reduces the actuarial liability and therefore, the unfunded actuarial liability, by the balance currently in the SRBR which is about $43 million. Does not affect the value of the assets. Because we are counting the SRBR assets as an asset of the

system. Internally, there would presumably be a transfer from the SRBR reserve fund to the general reserve fund. But both of those are included in our actuarial value of assets. Here, we summarize the effect on contribution rates. It -- eliminating, again, the right column and middle column were presented last month. If we eliminate the SRBR, it has an effect on the City's contributions. It does not affect the member contributions and would reduce the tier by about 4.5% of pay and about $9 million in contribution . So there is a significant effect. It's both due to the 20-year amortization of that reduction in the Ual of 34 million and we charge a load for the normal cost every year to the expected transfer of assets to the SRBR and that's the other component of the change. Here we provide this is a standard exhibit in our report that provides more detail and I've included it here so that you can see the change to the city normal cost rate goes from 18.93 down to 16.12, or a reduction of 2.81 if we removed the SRBR. And the UAL rate goes from 36.4 to 34.73. And that's what makes up the 4.5% reduction in city contribution rate. The gains and losses at the last meeting, we summarized and had categorized the sources of the gain and loss into significant groupings and there was a request that we go into more detail. So this slide goes into a lot more detail on where those gains and losses were. The -- we added the right-hand column to give you some perspective of the percentage of the actuarial liability that each gain or loss represents. The significant one is obviously the investment experience. But there are a variety of sources of gain and loss, all of them pretty small and leaving a total gain and loss very similar to the investment experience. These are the projections we presented in the last meeting. The total plan tier 1 and tier 2 projections, of contributions both as a percent of pay and as a dollar amount, the dollar amounts shown are middle-of-year dollar amounts, so they don't reflect the prepayment reduction that the city uses. We showed tier 1 only amount. And rates. And again, the rates go up significantly as the tier 1 members leave the system and the total payroll of tier 1 gets small. So that's what's driving that significant increase in the top graph. The lower graph shows that the dollar amounts don't spike as much. Tier 2, again this was a projection shown in the last month. We're projecting the rate to remain constant. All of these projections assume all assumptions are met. But as tier 2 grows, the dollar amounts contributed to tier 2 will grow. And then, finally, this is a new graph showing what happens if the SRBR is eliminated. And shows the projections on that basis. And here, the dollar amounts you can see are less than the projection from the 27 valuation. Which is the red line. There was a request for some specific dollar amounts from the projections. We -- these are middle of year dollar amounts, again, and rates for the city. When the valuation's finalized we'll come back and in conjunction with the OPEB valuation we provide a projection that then goes to the city and we'll need to know whether that projection should be with the SRBR or without the SRBR. Going forward. Then finally, just there was a request to review the other measure B items that are not included in the report. And could affect future costs. There were changes to the current plan in measure B that would require employees to pay up to 50% of the UAL cost with limits each year as a percent of pay. There were disability changes. The SRBR elimination and there was the voluntary election plan. We have not included any of these items in our projections or the valuation at this point. There were a few other provisions also to look at, the potential suspension of colas probably could have the most significant effect on the pension valuation. If retiree health care split affects the OPEB valuation not the requirements that we have not addressed. So with that, take any questions you have on this or the report. I also have the model, if you need to -- if you'd like to look at any other projections.

>> Matt Loesch: Okay. Questions from the board? Mr. Overton.

>> Edward Overton: Yes. I don't know if this is a question for you or for the attorneys. But the way I read the ordinance relating to SRBR, it deals with the crediting of income only. It doesn't say anything about transferring those assets from the SRBR to the general reserve. Does your analysis require that type of action or is it simply based on the fact that SRBR will no longer receive any excess earnings?

>> Bill Hallmark: We assumed that with the elimination of the SRBR that both there would be no additional earnings which is the adjustment to the normal cost and that the current liability we are holding for future SRBR payments would no longer exist.

>> I think issue here is that the ordinance eliminates the SRBR as a reserve. There used to be a reference in the code to the various reserves, there used to be a reference to the SRBR which is no longer going to be there. So that money has to go somewhere, eventually, not speaking to what has to happen today but I think that's the issue.

>> Edward Overton: So does this get into a type of plan termination issue or is it just dealing with the SRBR no longer being there? Because there is a provision in the plan document for eliminating plan benefits. And what happens to the funds.

>> I think right now we're just talking about the SRBR and please, you know staff or the actuary jump in if you think I'm getting any of this wrong. But as I understand it there's no longer going to be contributions to the SRBR and then there's no longer going to be an SRBR account in the way that the funds are accounted for.

>> Right. And our understanding is that the funds that are currently in the SRBR account would not be distributed as benefits.

>> Yeah, and that's the main point, is the big issue here is that the law has been rewritten so that there will be no benefits paid out. And then the funds are already invested, they're currently invested now, they will continue to be invested. So then one of the questions I think we're going to be dealing with later, then, is how to account for all this in the valuation, and when to account for it. But in terms of just -- if there is no SRBR account, that money has to go somewhere.

>> Donna Busse: Last time when we had other reserves that we collapsed we moved the money into the general reserve. I don't think there was a specific code revision that dictated that. I think it's kind of like the way Jeff said? We eliminate the reserve, we move the money to the general reserve. We did it last time when we got rid of -- I'm not sure if it was this plan or the Police and Fire plan that we eliminated some reserve accounts.

>> Matt Loesch: Around 2007 or 2006, in that vicinity of time we did kill some reserves.

>> Arn Andrews: Just counsel when you talk about the SRBR has been eliminated and we'll have to determine at what time we do that, at our last board meeting when we were speaking to this topic I got a sense from counsel, you weren't here, when Harvey was, that there was no determining factor for us as a board, that the law

has been established and as board members we don't really have much in the way of latitude here. So could you speak to that?

>> Jeffrey Rieger: Sure. Let me break this into two parts because I think there are two parts to this. The first part is that the board has to follow the law as written. Even if there may be constitutional challenges to that law. Even if the board itself thought there were legitimate constitutional challenges to that law, the board still has to follow the law as written. And I think the best example I can give of that is the gay marriage case issue. Particularly back in the mid 2000s Gavin newsom started issuing same sex marriage licenses because he believed that the prohibition of doing that was unconstitutional. The California Supreme Court ultimately said he was not allowed to do that. As a local official he had to follow the law as written even if he reasonably thought it was unconstitutional. The very -- the interesting historical development in that case was that a few years later the California Supreme Court agreed with him on the constitutional question. So a few years later they actually said he was right. In his constitutional analysts. But he didn't change the fact that the court had to say that. Not Gavin newsom wasn't able to unilaterally able to make that action here we have changes to the plan document which there may be constitutional challenges to them but until a court orders this board, until a court decides that the plan changes are unconstitutional the board has an obligation under the law to implement the plan as written.

>> Arn Andrews: And so the law as it stands today is that the SRBR is eliminated and you're saying unless there's any future or pending legal action as a board, the only determination we can make is that it's been eliminated, and that the moneys currently associated with it that are in the reserve account I mean no longer have to be held in reserve because it no longer even exists according to law today.

>> Jeffrey Rieger: The second question I mentioned the question of how you value the assets, when do you recognize the assets and when does that hit the employer contribution rate. Now that's very much a matter that's within the board's discretion and for that purpose I would then cite another case called Bant V. board of retirement, 2006 court of appeal case where mid stream, mid-year, the system received hundreds of millions of new assets and the city, the employer asked for an interim valuation to recognize the receipt of those new assets so as to lower employer contribution rates at an earlier time than would normally occur in the actuarial valuation

cycle. In that case, that's very much a discretionary act of the board. In terms of when to recognize the assets, and when it hits the employer's contribution rate. This board has, under article 16, section 17 E of the constitution, sole and plenary authority over the actuarial services. And that kind of decision falls under that very broad grant of authority. So again, to summarize, you got two steps to this. The first step is, and I think the main issue, that you're just not paying the benefits. I think the accounting just naturally flows from that. You're being ordered not to pay the benefits anymore. You have the assets. I mean, you know, as your actuary just told you, the assets are invested. They're on the books. They're being valued. Really all that's happening is the employer last eliminated a liability. And then, now, and they've changed the structure of the reserves. So that part ultimately is going ohave to fall into place to follow the plan document. Then the question before you today, or potentially even at future meetings would be, when do you recognize those assets? And I believe you have a letter from the city asking you to do that now. And that's within this board's discretion. It certainly doesn't have to. It can take account of all the -- I do note this is a valuation as of June 30, 2012, and there was an SRBR at that time. So essentially, I'm sorry?

>> I was just going osay the financial statement as of 6-30 still reflect the SRBR as a balance reserve.

>> Jeffrey Rieger: It's very much like the Bant case that I just told you about. You're sort of in an interim situation here. There's been subsequent developments since June 30 that you know about and the question is do you want to in your discretionary authority want to account for that now or do you want to wait for the next cycle? Either way is fine for from a legal perspective. It's a board-discretion issue.

>> So as I read this, though, the city is look at in 2014 a $9 million difference in contribution. So if the city says, we want to contribute at a 50.85% rate, are we obligated to accept that? Or can we say no, you have to pay at 55.33?

>> Jeffrey Rieger: You're talking about the difference with and without the SRBR?

>> Correct.

>> Jeffrey Rieger: That's within the board's discretionary authority, as to whether to recognize the assets now or later. Or recognize the changed liabilities is probably a better way to phrase it, to recognize them now or later. Your actuary will tell you, you have an -- please correct me if I'm not properly speaking for you. But your actuary will tell you that you have an unfunded liability in this system. So over time, that unfunded liability is going to have to be paid off. It's either now or later. So if you recognize the reduced liability from the SRBR now, that's good to slightly reduce employer contributions sooner but it's not going to reduce the long term liabilities of the plan. Because you would be reducing them next year anyway.

>> Bill Hallmark: Yes, so if the choice was whether you recognized it this year or next year, the difference is just, you'd be collecting $9 million additional contributions for that one -- for the June 30th, 2014 fiscal year end. And that would get reflected in future valuations. So it really affects mostly the timing of the contribution he.

>> Jeffrey Rieger: So if you recognize the change in liability now, the city will pay less earlier but more later. Because that means they will have paid $9 million less on the early side and that's going to have to be made up later because you still have an unfunded liability to the system.

>> Arn Andrews: I don't think it gets made up later. Because the earlier slide showed what the red line would be, when you reduced it throughout permit perpituity.

>> You are reducing liabilities into perpituity absolutely, agreed. But the question is when you recognize that riced liability. If you recognize it earlier it's going to reduction your correction at an earlier stage but you're going to have to make those up later. Because you're going to ultimately if you don't recognize it in this cycle you'll be recognizing it in the next cycle.

>> Bill Hallmark: Right. If you are comparing our projection charts, you have to keep in mind the SRBR there for eternity. And the projection without the SRBR has it eliminated today. And I think what we're talking about here is, whether you reduce, recognize the elimination a year from now, versus today. And so the long term proposition is going to be very similar to our recognition without the SRBR. But the only difference being, whether there's an

additional $9 million contributed in the 2014 fiscal year, which goes to paying off the unfunded liability and therefore, affect the cost down the road for that unfunded liability.

>> Matt Loesch: Okay, let me try ocorral this just a moment here, Councilmember Constant has been very patient. We're treading almost into 4.2 C, which I got no issue with, I want to corral the conversation so mr. Gurza and others want to speak as well. Councilmember Constant.

>> Pete Constant: Couple of comments. One, I understand what you're saying about paying the $9 million less now. But still, accounting for it next year. But elimination of it in this valuation does reduce the unfunded liability. There's no doubt about that. And the comment that, you know, as of 6-30 which is the valuation date, SRBR was in effect. I would say that the board knew at that point that the voters had already voted to eliminate it and Measure B, was passed and was law in the charter, and that's something that needs to be considered at that point too. Made the implementation ordinance was trailing but the vote was clear and the intent was clear. And also wand to remind you that while you pointed out the responsibilities of the board under the state constitution there's also a responsibility to minimize employer contribution he. And that wasn't discussed at all and that's a responsibility that this board has. And by following the will of the voters, that was known before this date, and honoring the request of the city in their letter, which SRBR make no mistake has been eliminated, it doesn't exist, it's gone, you would be able to fulfill your constitutionally mandated requirement to minimize employer contributions as well. And I think that's a responsibility that you need to have a discussion about.

>> Matt Loesch: Okay. Let me ask this, is it directly about whether we're moving SRBR or not? Let that conversation keep flowing because there are other issues about this valuation that have been brought up that are equally weighty and equally important. I want to make sure we're not following along then Mr. Seville you can follow Mr. Gurza.

>> Alex Gurza: Thank you, Alex Gurza deputy City Manager. I did have other comments later on on valuation. A lot has already been said. We do request that the board transfer the SRBR into the main trust fund. As has already been said measureb calls for elimination of SRBR. Since we go into the technical municipal code and

eliminates the references to SRBR it's really the steps that need to be taken. But I think it's very clear that it is a significant impact on the City's contribution of almost $9 million in next fiscal year 13-14. So you know, clearly if we -- we have to plan our budget around it? And $9 million difference is a significant swing. Our last projected shortfall for next fiscal year is $22 million. And that would help significantly if we didn't have too pay a contribution that we knew was simply simply not going to have to be paid the following year. So we do ask the board to transfer the SRBR balance into the main trust fund and to incorporate that into the rates.

>> Matt Loesch: If you want, you can stay there if you want other questions and Mr. Seville if you want to use the stand-up mic that's fine. Make sure that's on.

>> Thank you for the opportunity to speak to you today. My name is Michael Seville. I'm the senior representative of IFPTE local 21. It's a very interesting discussion that's going on here and I just have a couple of points to make beyond what I stated in my letter to the board dated December 7th. We are urging the board to withhold liquidating the SRBR at this time. As you all know the discussion that has transgressed here today, measure B and specifically the SRBR whether or not it's a vested right is being challenged in a court of law right now. And should the judge rule that the SRBR is a vested right and we fully expect the judge to do that, we believe the law is in our side with this regard, the ordinance that was passed which changed the Municipal Code would then be void and the SRBR if it was eliminated those funds would have to be transferred back. And what the discussion here is talking about is you know basing a budget next year on these dollars being moved out of the SRBR and put into the general reserve. The accounting nightmare that would then occur should that step be taken would be monumental, and to the city budget and to this board. And to go to the council's point around Gavin newsom and the legality of that, the difference between that case and the instance he sited and this, is you all are fiduciaries the mayor when he made that decision was not a fiduciary. He was making a moral and political statement by doing that. But as fiduciaries, not only do you have a duty to prudently invest and protect the investments and the accounts that you are charged with. We have a duty to the beneficiaries as well and to ensure that their rights and the investments they have invested in are protected with that said, if the board is going to move forward, with liquidating the SRBR I would urge you to do so in such a way that the accounting and upon a final decision made

by the court that those funds would be easily identified and be able to be transferred back to the SRBR because that is a main point of a major part of that litigation.

>> Matt Loesch: Thank you.

>> Jeffrey Rieger: If I could speak to that last point, I absolutely agree with that last point. Whatever happens, whatever this board does I think it's important that the accounting is done in such a way that whatever happens in the courts can be implemented. It might be a nightmare for the City's accounting but we don't want it to be a nightmare for this board's accounting. So whatever we can do to prevent that, we want to do that. And I think thankfully maybe staff can speak to this, I think thankfully that's doable. This is all invested assets that are part of the system. We're really just talking about book entries. It's just bookkeeping.

>> Donna Busse: Right and it's invested together so it's just whatever the assets earned or lost would be figured out.

>> And again I want to be very clear to highlight the distinction between the two parts of this my comments about Gavin newsom, you can't pay benefits right now out of the SRBR. And nobody's asking you to do that. The second part of this is the actuarial side of it. And that's the part that I'm saying is discretionary. And that you've heard from both sides now and I think both sides have legitimate arguments. I'm not discounting either of their arguments. It's up to this board to take account of those and make a decision.

>> Pete Constant: Could you just talk about the dates and the knowledge of the charter on 6-6 versus 6-30 and the board's fiduciary obligation to minimize employer contribution. S.

>> Certainly. certainly the board does have a fiduciary obligation to minimize employer contributions but I think that mostly refers to the prudent investment of assets and the efficient administration of the retirement system. I mean ultimately the liabilities are the liabilities. As defined by the law. So you're either going to pay now or you're going to pay later. So I don't think that the duty to minimize employer contributions does not require you to take

specific actuarial action he in a given year. And on this particular issue, assuming right now that the law stays as it's written, that there is no SRBR, that changes your liabilities from here out to eternity. And if no change is made to that that is what will happen. But then the question is when do you recognize that change in liabilities and when does it hit the employer's contribution rate? That part is within your discretionary authority and I don't think that's inconsistent with the obligation to minimize employer contributions. Because that obligation is a long term obligation, it's not just one fiscal year. But as far as the timing of it, obviously this is a very complicated issue, we had elections, we had knowledge that the election was coming. But I think from the actuarial standpoint I view this as being very similar to that bant case that I described actually. Because you have a snapshot in time on June 30, 2012, where you did have this liability on the books technically and you did have the account technically. So the question is now since that time you have further information, just like the board did in the bant case. And so the yes is are you going to account for that new information, in this cycle, or are you going to wait till the next cycle when you have a June 30, 2013 valuation. And that's really the question that's before this board. And again I'm not saying the board can't do what the City's asking. I think it's within the board's discretionary authority.

>> Pete Constant: Isn't the Bant case clearly mid valuation cycles distinctive difference. Especially given the 6-6 date versus the 6-30 date. So the knowledge on that date, the knowledge that the board has the knowledge that the actuary has at the close of that year on that date is that it's being eliminated. And it's not like we're halfway in between, we're at a point where there's a step through -- we can go back and forth on that but I think it's something the board has to weigh fairly heavily.about the intend was clear. The law on the date of the valuation, the charter is the supreme law of the city, not the municipal code. The municipal code as Alex pointed out are the implementation technicalities and we have an opportunity to make the difference.

>> Matt Loesch: Mr. Andrews.

>> Arn Andrews: Going into the mechanics a little bit more, we have married legally, that's fairly clear. The only latitude is around the mechanics, it seems like. First from staff and I'd like to ask the city also, the money in the account is no estates are leaving the system from an accounting system something reserved to an SRBR sub-

account or in the general account. And so doing the initial transfer if that were to happen moving it back is that problematic?

>> Since we actually track it on the books it's not problematic to move it january 4th, 2014. That was the effective date of the transaction that I was planning on using actually if we were to move the money out of the reserve would be that date there.

>> Arn Andrews: Okay but --

>> To move it back to answer your question it wouldn't be difficult. It would be just if all the SRBR was left intact and we do the interest crediting, all the amounts that go on with the SRBR we would be able to track that and carry on administratively.

>> Arn Andrews: So administratively it's not that onerous?

>> Yes.

>> Arn Andrews: I would ask the city, that provides you you a $9 million benefit. If the board were able to do that, the plan being able to unwind its position what would occur from an actuarial standpoint? Because then the city would have unfunded their contribution if that gets done. What would happen if something happens legally to unwind it what would the city do and what would ham from an actuarial standpoint?

>> Alex Gurza: I think the question is really how would the city instruct its actuary, would you it or wait until the next fiscal year to increase that back. I'm not quite certain how the actuary would approach that.

>> Bill Hallmark: Let me clarify acouple of things first. First, from an actuarial viewpoint, we're looking at a reduction, around has nothing to do with where the assets are. The assets are in the fund and whether you transfer them or not of does not really mean that much to us. We have an assumption that the amount in the

SRBR reserve will ultimately be paid in additional benefits. And so we put a liability, we attach $43 billion -- $43 million in additional liability because of those assets there. So the first question is, should we recognize that $43 million in liability, assuming that those SRBR assets will be used to pay additional benefits at some date in the future. It doesn't have to be next year. Then the second piece of the cost from an actuarial standpoint is the expected annual transfer to the SRBR reserve which is the 2.8% of payroll. So that again is an actuarial assumption in the valuation. And so given the status should we be expecting additional transfers to the SRBR? And so those are the two pieces.

>> Arn Andrews: And I guess what I'm asking though is what happens to the contribution amount?

>> Bill Hallmark: So what happens if -- well, so if we recognize the elimination immediately on both points, what we have put in is, right now, is eliminating that 2,8% of payroll charge for the expected transfer and amortizing that gain over 20 years so we're not recognizing all of that immediately. So if the court overturned the elimination in two years, and we had followed this approach, presumably we would have to go back and calculate what moneys were in the SRBR would would include additional transfers presumably, and then we would adjust the liability, and we'd have to discuss how we amortized that. You could look at the credits that the city had received for the transfers and if amortization of the $43 million and do something to reverse those credits.

>> Arn Andrews: And I guess that's my question --

>> Bill Hallmark: But that would be a board decision at that time.

>> Arn Andrews: I guess that's my question to the city. Are you willing to assume that potential liability in the future?

>> Alex Gurza: I think clearly if the court did overturn the elimination we would have to deal with those consequences. Be.

>> If I could add a little bit to this. We heard reference to the lawsuit from the gentleman who presented. And a couple of things I want to say on that. First of all we don't know exactly how this would all play out and when in the lawsuits because frankly we don't have -- no party has complete control of litigation. So we don't know exactly when the court would order what anything it might order. And we don't know exactly what that order would look like. We could have an order in a couple of months, we could have an order in a couple of years and that order might just be, undo what you did. Or it might have more specific directions to this board about what it has to charge the employer. And if the direction is simply undo what you did, then this board is going to have a very difficult task before it, figuring out how does it undo it? Does it just fold id of it into the UAL or does it make a determination as a board that now we have these liabilities that should be accounted for we need to recoup it right away. I'm sure the city would not like that. If two years from now all of a sudden --

>> Arn Andrews: That is part of my question, do they owe us a lump sum?

>> Jeffrey Rieger: We don't know that, we don't know what the court order would be or what this board's process would be in dealing with the court order that was ambiguous on that point. The third point I did want to make is we did hear reference to the lawsuit that relief is being sought. I also would just remind everyone that in lawsuits, there are avenues available for obtaining admonish speedy relief. -- more speedy relief, temporary restraining orders, preliminary injunctions that this board would have to follow. But to my understanding we don't have anything like that now. Just the fact there's a lawsuit doesn't end this inquiry now. It's not that simple you have to look at the whole circumstance, what's prudent under all the circumstances, understanding what the various outcomes might be and recognizing that the parts of the litigation have remedies to them if they want more specific direct and quick relief.

>> Matt Loesch: Just hold on Mr. Constant if that's okay. Mr. Seville.

>> Thank you. Just one more opportunity. I'm glad you brought that up. That goes to the point that I was trying to make earlier about your fiduciary responsibility, beyond prudent investments but also to the beneficiaries. I'm new here, I don't know some of you I know some of you. I'll be frank, this could be urging the board to make this

decision now and the steps that it's asking you to do could, when a judge sits down and makes a ruling and is considering the relief sought by other peat. If it becomes so untenable and the funds have been mixed and used elsewhere and it puts the city in such a dire financial situation that a ruling would adversely affect them in such a manner that the judge would take that into consideration. That is one of the reasons we're asking you to withhold liquidation and if you do to do so in a way that those funds would be properly identified and easily attained to attain a full remedy that the judge ordered.

>> Matt Loesch: Thank you. Mr. Constant and then Mr.--

>> Pete Constant: I won't comment about his comments about our strategy that he has no idea about. But we're talking about a lot about the unfunded liability. I want to point out on slide 6, they were also talking about 2.8% of payroll increase, I believe, let's see here, 2.8% of payroll, increase in normal cost attributed to a benefit that there's no normal cost to because the benefit does not capitulates. So I any that's something that you need to address too. You're charging the city a normal cost on what it would cost to provide this benefit going forward when this benefit does not exist going forward. That's a whole 'nother issue and I don't know if the two are separable for purposes of your discussion, but I just want to point that out, we have those two issues, and the two issues combined add up to a lot of money.

>> Matt Loesch: Mr. Gurza.

>> Alex Gurza: I did want to comment on what Mr. Seville was saying, the memo is from me, I can assure the board that there's nothing behind the memo other than the city to receive some relief on the extraordinary cost of our pension benefits and the retiree health care benefits, a very, very difficult task we are undertaking in terms of our pension reform efforts. 8.9 million as you all know is significant to the city's benefit after 10 years of with pension benefits and nothing behind it.

>> Matt Loesch: Comments or questions from the board? I mean since we've been kicking around the SRBR topic we can bring up the other funds. Mr. Andrews.

>> Arn Andrews: Question, since we're going ospend considerable time on SRBR, do you want to take items piecemeal or do you want to do it in aggregate?

>> Matt Loesch: Since we don't know what the other topics are on the valuation, since we've been talking about the SRBR, there are more comments questions concerns about it and then we can talk about how we want to proceed going forward and in the aggregate or otherwise, I'll tell you in a minute is what I'm saying. Other things on the valuations besides the SRBR. So nothing's been decided yet. Any other things on the actuarial questions on the actuarial in Cheiron or in general, the board? Being.

>> Well, I have a question for Cheiron. You've lumped together at the very end the sort of open item. If I can find my page, other provisions page 14. And is this to be discussed later? How do we -- how do I take that?

>> Bill Hallmark: These are items -- well, these are items that are not reflected in the valuation.

>> Lara Druyan: Understood.

>> Bill Hallmark: And some of them are items that we had questions about.

>> Lara Druyan: Yep.

>> Bill Hallmark: There's no implementing ordinances, and so we don't -- I think they're outstanding questions for the future that we don't know.

>> Lara Druyan: We just got those previously.

>> Bill Hallmark: -- how to address today.

>> Lara Druyan: Okay, just wanted to make sure that's true.

>> Matt Loesch: Mr. Gurza you had comments.

>> Alex Gurza: Could you put up slide number 4. I wanted to take a brief period of time what we consider the most important thing that the board does every year and that's its valuation. at least from our perspective when we look at this chart we see that as we look at the change whether you look at it with SRBR or without, we look at the funding ratio and again, if you look at the actuarial value of assets, that it's still unfortunately going south. So you're at 65% last year, and then either 61 or 62. So that's clearly an element of concern. If you look at the market value of assets you know you're either at 57 or 58%, we are so that's clearly something that concerns us. Looking again at the actuarial value of assets in terms of the unfunded liability, we go from slightly under a billion now to over a billion dollars of unfunded liability. So that's clearly something that we look at significantly. So associated with that, clearly, the issue of risk has been you know on the City's mind you know, related to our pension plans. I know that Cheiron, some months ago, did a presentation about taking risk off the table. And as we go forward, in our pension plan and even our tier 2, risk is number 1 on our minds. You know, how -- what is the risk going to be in our pension and retiree health care plans as we move forward. And one of the thinks that I noted and I know you have an item later but it's connected here, it seems like the board has decided to maintain the 7.5% earnings assumption. Part of the question that we would like to understand and I guess it tests the limits of my expertise in the area of investments and all that, you may know after I came to this board last month the Police and Fire board which I understand is a separate board voted to lower its assumption to 7.25. And I know you have different investment consultants. I don't know if that's what the reason is or if your investment allocation strategies are fundamentally different that lead to those different decisions. But it is a question that we would like to further understand. Because I know when we look back, obviously we know that you make decisions on the long term and not on the short term on a year or two or not. And I know that often we go back and look at the past. If you look at any perspectives they tell you past returns are not the indicator of any future returns. If we look at the two funds any time affirm you look at except for one whether it's one year three year five year or ten year the Federated fund was below Police and Fire. So I guess a long way to ask for a better understanding of why the risk decision that this board has taken ask to maintain that, compared to the decision the other board made and help

us understand that maybe the differences that lead to your confidence level that we're at the right earnings assumption.

>> Arn Andrews: I can speak to that a little if you want. Because what happened at the last board meeting was we did not receive a recommendation and the actuary and others assume that because we had done it previously through our ALM that we were going to maintain that so when the investment committee met to talk about this topic we decided going forward it will be an annual review and it will be an annual review that will happen before the actuaries come to us. So it will actually be one of the initial conversations that happen. In the past it has always been one of the the final conversations that happen. We are going to do this on an annual base. In the investment committee, when Meketa presented to us I believe it's 7.7 and so based on the asset allocation that we're currently implementing we thought it was okay to maintain 7.5 for this cycle. But we're going to do this on an annual base, and as oan initial conversation going forward as a part of the entire process leading up to the actuarial report.

>> Alex Gurza: We appreciate nap we had actually anticipated that is what was going to happen this anticipated that that was going ton part of the front end discussion and we're somewhat surprised that it wasn't. So we definitely look forward to the board's contemplation of that issue. But is there any -- I know it's a different board but is it a different investment allocation that leads to the different decision on both boards?

>> Donna Busse: Actually the Police and Fire's consultant came back to their assets allocation as around 8. Meketa scale back to the Federated plan as about 7.7. It is the action of the board to 8% market assumption.

>> Arn Andrews: And so you asked a question. Part of the question is usually what drives this first is the asset liability study because the asset liability study starts to explain to us what are we going to need and what does it take to get there so that then starts to drive the conversation of what is an appropriate asset allocation clearly taking risk into consideration and then that starts to drive the conversation around the actuarial valuation and what is the appropriate rate of return and what is the expected median rate of return you know which gets talked about

a lot. And so we are going to make sure that going forward procedurally that's embedded in the investment committee as part of the ongoing process.

>> Alex Gurza: Thank you very much. Appreciate it. We do understand the impact changing the assumption has on rates. But in the overall on the long term indicated in the memo I send you previously especially in tier 2 where employees are responsible for 50%, we want to minimize that risk going forward are.

>> Arn Andrews: I think this board just in general has shown an inclination to derestrict the plan. We are currently down to 7.knife%. The asset allocation that we're currently implementing is constructed to decrease volatility of the plan and yet maintain risk adjusted returns. And so I think in general whether it's the actions of the asset allocation plan or whatever they are they are all geared towards making sure we get the appropriate rate of return but at a lower volatility level.

>> Alex Gurza: Thank you very much.

>> Lara Druyan: And I think the other thing we are going to potentially look at is, this is not typically done in public plans but is done in the private sector is you know working with both our investment consultant and our actuary to figure out if we should be divorcing our discount rate from the assumed rate of return. That is not a casual conversation. It's not something we're going to do in a month. So that's going to be something we explore for next year's cycle.

>> Arn Andrews: Because if you look at page 10 of the report even with a 7.5% assumed and I'm looking at the varying return scenario because I think the varying return scenario is more appropriate because you're not just going to earn 7.5% static. We are looking at a plan that is 62.5% funded and if 74% funded so your comments are well taken. I mean the board is aware that even under this scenario at 7.5% it would take 20 years to get us to 74% funding.

>> Matt Loesch: About Mr. Constant.

>> Pete Constant: Thanks, I'm glad we're having this discussion. And my quick question is, where does the 7.5 selection put us on the probability of achieving? I know with the Police and Fire plan, again, sorry to make comparisons but it's easy to do since we go through the same discussion with them. They moved to 7.25 to ensure that they broke the 50-50 chance level. They felt that at 7.5 it would not be at that 50-50 probability of achieving so they moved to 7.25. Where does this rank?

>> Donna Busse: The 7.7 and 8 on the Police and Fire was median.

>> Pete Constant: Not according to -- remember when the investment consultant came in they said they had adjusted their-that might have been the year before.

>> Pete Constant: No that was just two weeks ago.

>> Bill Hallmark: Time the investment concerns put together their valuations in January and they just said at a high level if they applied their new capital market assumptions that had not been released yet, coming out in January, that the expected rate of return, I think he said, would be at least 25 basis points lower.

>> Councilmember Constant: Right. That was discussion from two weeks ago that I was referring to.

>> Donna Busse: Okay but lower than the 8 that they put out this year.

>> Bill Hallmark: That was from the 8.

>> Matt Loesch: One problem I had, I didn't participate on anything to Police and Fire side and privy to any of the discussions around their stuff. Some our investment committee stuff is joint but a lot of it is not. What is driving their risk profile, I have enough trouble keeping one all the fun we have here let alone to know why they made their decisions.

>> Pete Constant: I understand why they made theirs. I'm trying to figure out where is the probability, where are we at on this one 7.5?

>> Arn Andrews: The Meketa report --

>> Sounds like we're staying close tore our consultant's recommendation than they are.

>> Arn Andrews: Especially with the admin cost and the SRBR being a function of contribution as opposed to additional. The only item that is currently not encompassed in that are fees, transaction fees.

>> Pete Constant: Okay.

>> Matt Loesch: So the one thing I've been hoping for in this whole thing is to let the math do this and program these discussion he so that they're more systematic and that's why we push it to the investment committee so look talk to the consultant come back with what the math tells us the numbers ought to be and if the math drives us to lower our assumed rate of return then we should follow the math. If the math tells us at the picture we're taking now but get this in the cycle so we can do this -- so we can tell the actuary when do you need the number? So in the August time frame August I see meeting come to the board this is the assumed rate of return feed these to the actuary so they can make these things -- whatever that right time frame is so we can have good logical cycles so there's the talk there's political pull here and there there's talk about this thing in the ether, let the math do the work make good prudent decision but put in the procedures so it takes a little bit of opinion about what it ought to be. You say good logic and let the math work.

>> Alex Gurza: Mr. Chair if I could point, on slide 10 of the PowerPoint presentation I just want to make sure that I'm correct about this. Again as we look at tier 2 employees, that would be sharing the unfunded liability, my understanding correct that the top chart that has the member rate absolutely steady, all the way across the line at 6.7, 6.7%, is predicated on the 7.5 assumption met each and every year?

>> Bill Hallmark: That's correct.

>> Alex Gurza: Right? And to the extent it's not met, that -- and we create an unfunded liabilities are created that -- the cost for the members --

>> Bill Hallmark: The costs will vary both for the members and the city. However, with tier 2 being a young and growing plan, the variability is very small even with significant investment performance until we get out beyond this period. The -- as you may recall in some of our risk discussions, we use the ratio of assets to payroll to talk about the sensitivity to investment returns. Because if you have a ratio of 10 to 1, a 10% deviation from your expectation is 100% of payroll loss or gain. For tier 2, that ratio is right now, zero. And grows very, very slowly during this period. So it doesn't even reach 1. Whereas for the plan as a whole as I recall it's around 8 and for Police and Fire it's around 12 to 14. So there are very different risk profiles for different groups. And also between tier 1 and tier 2.

>> Alex Gurza: We certainly, we certainly would like to see the stability in the rates return too because as we move forward there's going to be greater and greater percentage of our workforce in that tier. And to be able to have that stability and not the risk and volatility that we have seen in the past is really something that we would encourage the board to work towards that to the extent possible, again, particularly I can't emphasize this enough, now the tier 2 employees are going to be actually responsible for that risk side.

>> Arn Andrews: And I will note just kind of speaking about the variability, because you're right this is basically normal cost. Until we have history this is normal cost. If you go to page 8 of the board summary I thought there was just an interesting comment there. Where it says the small actuarial gain of 2012 indicates that the demographic assumptions adopted for the June 30th valuation would accurately reflect current demographic experience. It would seem over time the board is starting to align component is the investment component which we just discussed. But we are working diligently to align both variables to that actual performance is more in line with projected performance.

>> Matt Loesch: Okay. Other comments or questions on the valuation? Rolled out of my mouth. Okay, so what do we need today? We need to accept the valuation and the valuation has for the most part except for one portion of it fairly standard straightforward stuff of accepting stuff that we discussed last month what do we do around the SRBR.

>> Bill Hallmark: Right.

>> Matt Loesch: So the question is do we accept the thing as Mr. Andrews says, or do we accept the valuation as-is minus that portion or include -- or include that or include both, and with a point to, is one of my struggles here is to find some point of middle ground between cause and effect, if we can account for it, account for moving the funds, liquidated funds, that's the word that has been used, conscious of the fact that things can happen after now, what the city needs for budget purposes, rates, dollar amounts, they need to know how much money they need to come up next fiscal year, two numbers SRBR or not, are we assuming that there's going to be no SRBR next year that's the result, that's the rate and so we're prepared and staff's prepared so if there is something coming through from the courts at least we have both numbers available and ready. We need to know so if there is something try to find -- push out our date a little bit as far as here's the final rate number. Because usually we come through with a resolution, right? That says these are the rates for next year. And what does that look like? And when will that come into play? So that not to buy us time, so that just -- so we're in a situation so that should something happen between now and then the city knows exactly what the two rates are. I think we should say that you know as of right now the book says the law says as of June, July, January 4th that there is no SRBR therefore these are the rates. But we need to be prepared for if something happens between now and then, next fiscal year, that the rates could be this. If something changes. Really it's those two alternatives right, with the SRBR and without the SRBR. That's kind of what I'm thinking, be prepared for plan for the accounting plan for possible change ever anything, what are your thoughts? I mean I want to be prepared but I also don't want to say, do we say this and not be prepared for an alternative action. What are your thoughts?

>> Edward Overton: My issue was, the lack of clarity in the ordinance regarding the transfer of SRBR funds to the general reserve.

>> Matt Loesch: Okay.

>> Edward Overton: Not the fact that we were not going to reduce the liability until there are further instructions from a court. So I would suggest that we go ahead and approve the rates without SRBR. That we establish an off-balance-sheet memo fund with the value of the SRBR notated and tracked and that we track and approve the rates of contributions without SRBR.

>> Arn Andrews: I'm inclined to go the same way. I mean we have a body of law right now, we have both staff from the plan side, and it appears as if staff from the city side, who are saying that they understand mechanically, what is responsible here. And that at least on the plan side it's not that hard to reverse from an accounting standpoint. The city appears as if they're willing to accept the potential liability in the future. They have been an entity that has always paid the full funding so I take them at their word that if a court does unwind this, they will make sure that they meet whatever the required contribution would have been in however methodology we determine to do that. So I'm inclined to make a motion to accept the report using contribution rates without the SRBR also.

>> Matt Loesch: Following --

>> Is that a motion?

>> Arn Andrews: That is a motion.

>> Matt Loesch: First of all is there a second?

>> Second.

>> Matt Loesch: For clarification he's talking about doing off-balance-sheet track is that your --

>> Arn Andrews: My sense is froms an account being standpoint, they're going to know where those moneys are anyway.

>> I think the question of the actuarial valuation is the more important question that has real world impact. So we're going to say we're either going to do it with or without the SRBR, and that is going to change the employer rates. And as I've explained earlier, Harvey and I believe that's an issue for board discretion. You could go either way, okay? So I think that's the decision that needs to be made today. As far as the accounting, unless the actuary tells me something else or unless staff tells me something else I don't even think you have to make that decision today. I know we just got a letter last night on this issue or a couple days ago, from Mr. Gurza, so I mean if the board wants to revisit the accounting aspect of this at the next meeting, I don't think there's any urgency today and then the board can decide whether it wants to transfer the funds on its book, whether it doesn't want to transfer them but track it as if they had, transfer and track it as if they hadn't. As staff will tell you, it's really book entries, not affecting anything in the real world. But it doesn't have to happen today.

>> Veronica Niebla: In either case, accounting isn't effective date of the ordinance which is January 4, 2013. What the board decides to include or not include in the valuation, definitely we in an accounting basis can track the differences. Again most of the entries that we make to the SRBR on annual basis at year end.

>> Jeffrey Rieger: And realistically the first meeting after the 4th will be your January meeting. You've had a change in the law. That will be your first meeting after the change in the law. At that time you could seek input from staff and counsel and make a final decision on the accounting side of in. But I think today --

>> Matt Loesch: You are saying, accept the valuation for the next fiscal year it would be this one or that one and moving the accounting portion of it is possibly a discussion we could have in January but --

>> Jeffrey Rieger: Unless somebodies this we have to do it today. I don't think we have to.

>> Matt Loesch: Councilmember Constant had a comment you wanted to make.

>> Pete Constant: I did but I was so listening some I forgot.

>> Matt Loesch: We'll do that more. Let the train roll.

>> Arn Andrews: I'll make the motion again. So motion to accept the actuarial valuation result utilizing without SRBR for establishing contribution rates.

>> Lara Druyan: Second.

>> Matt Loesch: Comments or questions. Okay. All those in favor? Opposed? Okay. That was that. Okay. That was A and B. Technically I didn't open C. Item C was Discussion and action on ordinance 29174 regarding Supplemental Retirement Benefit Reserve. We had the letter, I, letter from Michael R. Seville, IFPTE local 21, acting II, ordinance 29174. Is there discussion from Mr. Seville or the ordinance itself? We kicked it quite a bit so note and file. Okay. What I'd like to do is if we could go through item 4.3, it's at noon. I'm presuming we're going to be very efficient with our time and then we'll take a quick break so we could grab something to eat and use the restroom and then we'll plow on and go to the rest of it, since it's already ready. 4.3. Discussion and action on Cheiron's preliminary OPEB valuation.

>> Bill Hallmark: Okay, we are going to go through this very quickly. It's a very short presentation. And I'll just jump right in here. The full OPEB valuation results aren't scheduled to be available and won't be available until the January board meeting. But we're aware that the bargain units are negotiating over retiree health benefits and there have been some significant changes. So we wanted to bring to you preliminary information, I have to emphasize that this is preliminary, none of these numbers are set in stone. But to inform the parties about the significant changes due to the plan changes. The funding policy for the OPEB plan has been negotiated between

the city and labor unions. The contract called for contribution rates to transition over five years to the full annual required contribution under GASB 43 and 35. The last year of the phase-in was fiscal year 12-13, and this valuation sets contribution rates for 13-14. Which means it would develop the contribution based on the full annual required contribution. That I'll give it to Mike to go through.

>> Right and in this first section we're really dealing with the funding valuation results rather than the accounting. And as we can see in this because of the changes that happened both January 1, 2012 and the new ones that are coming into effect January 2013, that the yearly actuarial liability is dropping about $200 million from 935 to 742, which given that the assets really didn't change much between the periods, the unfunded is falling about $200 million from $800 million to $604 million and the funding ratio increasing from 14% to 19%. So again, a very significant change. And then on the next page therefore we see what that does from a contribution point of view. Again, recognizing that currently for fiscal 13, the normal cost is 7.69, assuming full funding. And the amortization would be 22.5 million or 22.5%, actually dropping to 5.67% from a normal cost point of view and the 16.58 from an amortization point of view. For a total of 22.25%. So again as you remember because of the grading-in period currently for fiscal 13, the members are paying 7.26 of payroll and the city? 7.91. But the full arc was 20.22. If we go to the new 22.5 and basically split that 50-50 you're basically look at around 11% for both. A lot less 15% it would have been at the 30 but it's still a fairly big increase from 7 to 11. If we then go in kind of the key this from an accounting point of view, now we're getting into what's the discount rate that's used from an accounting point of view and again this kind of goes to the position that was adopted last meeting from the formula point of view, where we really look at how much is actually being contributed to the plan, compare that to what the full arc is and then see what the excess that you're actually contributing over the arc and weighting it over the 7.3% and 3.3% we got input from meketa on what their projection is for 30 years assets we get to a 4.8. What we're using for this which is slightly different than the example we presented last time, we're actually using 2013 valuation results to get that 21.59% arc. Because that lets us have a 4.8% discount rate. If we actually went back and used last year's valuation to redo this we'd end up with the 3.5% discount rate rather than the 4.8.

>> Bill Hallmark: This is, we're actually asking you to adopt a slight change to the blended discount rate methodology you adopted at the last meeting. And it's to get rid of that one-year lag. This conforms to the way the

Police and Fire plan calculates their blended discount rate. And it be wouldn't have been a significant issue, except for the significant plan changes that happened this year. And so with those significant plan changes, we think it would be appropriate to get rid of that one-year lag in the calculation of the discount rate.

>> Matt Loesch: And this current fiscal year was 5.1, isn't that in the vicinity of what we used?

>> Actually 6.1.

>> Matt Loesch: 6.1.

>> Yes. And so what this really does on the last chart is compare what the accounting numbers would look like. Again going from 6.1 to the 4.8, basically the same. There's about a $50 million drop. The current unfunded as of 6-30-2011 was just under $1 billion or just over $1 billion now it's going to be just under $1 billion, a fairly flat change. The impact of the changes in the benefit plan are being offset by the increase in the discount rate. And the only other thing that's really happened since then, something for your consideration if you would like to consider it on the assumption set side, is one of the things that Police and Fire asked us to do since the results are now available, is actually look at what the actual plan elections were in 2013 since we know what they were, would that cause you to change your assumption? So the only thing that's really different from that is actually you did have a bigger percentage of the retirees took that high deductible Kaiser plan that we anticipated, the assumptions were only 5% of them would. In fact 15% of them did. Therefore if you made the change in assumption it would.

>> City Attorney Doyle: Have -- the only thing it impacts is the implicit subsidy part of it. It wouldn't have a big impact on the results but it would bring the liability down slightly if you actually made that change in assumption.

>> Matt Loesch: Okay. Questions or comments? Getting up there first so I can start -- anyone else have questions or comments? Mr. Constant was first.

>> That made me forget. I think that's the trick.

>> Pete Constant: Thanks for those last comments because that was something that I brought up at the other board. Because we build these with assumptions and we had the ability between the time we set assumptions and the time we're taking action to have an actual open enrollment period to see what the behavior was and observing behavior is a lot more accurate than predicting behavior. It's interesting to see how big of a swing it was in that one category. Did any of the other categories have significant swings?

>> None of the other ones. Everything else tracked right with what our assumptions were.

>> Pete Constant: And did you see that in both? No, okay. We'll talk about that in two weeks when we have that discussion.

>> Matt Loesch: First Mr. Andrews then Mr. Gurza.

>> Arn Andrews: I just wanted to be sure I was tracking the conversation. Page 4 because of this plan the actuarial liability decreases by about $200 million and then on page 7 we're saying a lot of that effect is eroded if we move from 6.1 to 4.8?

>> Correct.

>> Bill Hallmark: Page 7 is the accounting results and page 4 is the funding results, you get the real effect on page 4.

>> Arn Andrews: Okay.

>> Matt Loesch: Mr. Gurza.

>> Alex Gurza: Thank you, a couple of questions, a couple of comments and then questions. Page 4 number one the funding ratio here unfortunately makes the pension funding ratio look a lot better but what we notice here is that we're going in the right direction you know from 14% funding ratio to 19. So you know clearly our plan is to continue headed in that direction. But we also just wanted to note, I mean the significant drop in the actuarial liability, again by difficult decisions that had to be made about the instituting a lower priced plan but dropping the unfunded liability by $200 million is just something that is very significant and definitely helps, I think, as the slide indicates, a major factor in that drop in the liability. The question part really, is the -- on the issue of the blended rate, and slide 7, or 6 or seven. We understand this is for accounting purposes. but we sort of struggling to understand the reason for dropping it from 6.1 to 4.8. Because clearly all things being equal, that significantly increases our liability that we have to book. And trying to understand why we're doing that even though the city is headed in the direction of you know funding its OPEB, and so if you could help us understand that, because on the one hand we have good news on the one side and then for the city's liability to book something that has a very significant impact.

>> Bill Hallmark: It's very much just a function of the way the GASB rules work in establishing the discount rate. And the result is, you don't get a very smooth pattern on the accounting as you phase in to full funding. Because you have these variations in the assumptions and the blending period and compared to the pay-as-you-go cost.

>> Alex Gurza: So are you indicating then that this change is required through GASB so that any actuary that did this work would arrive at the same result whether it was Cheiron or a different firm? There's no latitude on how that's arrived?

>> Bill Hallmark: There are different methods in calculating the blended rate. GASB does give some examples but the change in method was in our opinion to become more in alignment with GASB's principles.

>> Alex Gurza: Thank you, appreciate it.

>> Arn Andrews: For the most part just to expand a little it is formulaic. They take what your expected return is and discount it based on what your funding status is and then they use the City's expected rate of return on assets and then that spits out .

>> Bill Hallmark: The clear part of the formula is if you are contributing the arc we would just use the 7.5% discount rate. If you are just contributing the pay as you go cost we would use the 3.3 discount rate. If you are somewhere in between which is where you are, we need some sort of proration.

>> Matt Loesch: If the full arc is being paid the liability that is being booked would be $742 million not $958 million, because if we are paying the full there would be no reduction on the accounting method so --

>> Bill Hallmark: Right so actually here, if they go to the full arc, in fiscal year 14, we'll get an immediate change in the discount rate, and that liability will come off of the City's financial statements.

>> Matt Loesch: So it would be a reduction of another 200 and some million liability.

>> Alex Gurza: One question. That slight 5 that you're just at, we are anticipating that the arc was going to be in excess of 30 and so the good news here is that it's 22. Still very high. But much better than the 30. So is that primarily attributable to the health care changes or there other major factors involved in that reduction?

>> That reduction is the health care changes. Because it's the same 7.5% discount rate on both pieces.

>> Alex Gurza: It's all attributable to the health care changes?

>> It's that and your experiences, your actual rates went up a little less than we anticipated so you had experience gains from that as well.

>> Alex Gurza: Thank you.

>> Matt Loesch: Other comments or questions? You wanted guidance or decision from the board on which piece exactly, so we can be clear?

>> Bill Hallmark: So actually I have three questions. One of which I haven't posed yet.

>> Matt Loesch: Oh, wonderful.

>> Bill Hallmark: The first question is the blended discount rate methodology, to just approve us eliminating that one-year lag and use the method on the -- this year's valuing results.

>> Matt Loesch: Before we go on any discussion on that? Otherwise I'll entertain a motion to make it clear.

>> Arn Andrews: So the methodology used is what mediad the 4.8 correct?

>> Bill Hallmark: Yes.

>> Arn Andrews: So we're approving to use that methodology. Okay motion to approve the current methodology, utilized on page 6 for determining the blended discount rate.

>> Lara Druyan: Second.

>> Matt Loesch: Again to eliminate the one year lag on the timing so comments or questions? All those in favor? Opposed? Okay. Got guidance.

>> Bill Hallmark: The second question some do you want us to adjust the plan election percentages, to reflect the actual experience that we saw which the primary change is, we had a 5% assumption for the higher deductible HMO plan and the experience was closer to 15. So there would be offsetting --

>> Matt Loesch: We have current information that is good that indicates more realtime information and the fact that we can get on it let's do it so I'll make the motion that we accept the more current rates the ones that are actually adopted in this case and implemented in this valuation.

>> Arn Andrews: Second.

>> Matt Loesch: Comments or questions, all those in favor? Aye. Number 3.

>> Bill Hallmark: I don't know that I need a formal vote on this but the bargaining agreement has expired. And we're preparing a valuation report that will lay out contribution rates for the city and the members for fiscal year 14. And I want to confirm that we should split those according to the way they would have been split under the prior bargaining agreement for purposes of our report.

>> Matt Loesch: Well, what's the rule? Again we're kind of going at discussing the rules and laws of what's negotiated is here now until we have some difference that needs to change. We need to go with what's on the books now. Until something else is negotiated --

>> Bill Hallmark: We just wanted to confirm that.

>> Matt Loesch: All right, until we know something else. Okay.

>> Bill Hallmark: That's it, thank you.

>> Matt Loesch: Anything else? Okay, it is -- let's try to get back here as close to 12:30 as we can on that clock. We're in recess. [Recess]

>> Matt Loesch: Back I appreciate that. Hope everybody's stretched their legs a little bit and refreshed themselves. Item 4.4, discussion and action on the system expenses for October 2012. We have a memo from staff on the expenses. Any questions from the board or comments?

>> Edward Overton: Move approval.

>> Second.

>> Matt Loesch: Any comments or questions? All right, 4.5. Approval of the city of San José Federated city employees retirement system 2012 comprehensive annual financial report, and acceptance of the audited financial statements for fiscal years ended June 30, 2012 and 2011. and while we're here I'm just going to open 4.6 as well, so we can roll with the two of them. Communication to the board of administration of the of the City of San José federal city employees retirement system from Macias, Gini & O'Connell, the plans' external auditor. A independent auditor's report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with government auditing standards. B, the required communications and C, the management comments and recommendations. Ms. Niebla.

>> Veronica Niebla: So in your packet you have the Federated CAFR or comprehensive annual financial report. The audit statements and audit opinion from MGO. Along with other information on a high level, that the plan puts out or the system puts out once a year. This also satisfies the annual report requirement of the board as per municipal code. If there's an actuarial section a statistical section, investment section and the financial statement section which contains the audited financial statements. This is just a good general overview of the activity for the fiscal years ending 2012 and 2011. Since Matt has already opened up the second item I'll also introduce Annie Louie who is the manager of this audit engagement and she will go over any communication from Macias, Gini & O'Connell. I'll take any questions on the CAFR.

>> Matt Loesch: Any comments to or from staff?

>> Edward Overton: Good job.

>> Matt Loesch: Maybe I should just -- everybody eating and that way there will be less comments or questions. Perfectly timing.

>> Veronica Niebla: One thing I did omit, one thing that was actually omitted, I apologize, did go through the CAFR as well and did recommend approval, the couple of edits.

>> I think we, I didn't want to jump into the report, I think we decided next year it would be presented to the audit committee formally, rather than the entire board correct?

>> Veronica Niebla: Correct, the one piece that wasn't presented to the audit committee is the Macias, Gini & O'Connell, investment committee, sorry audit committee, on a go-forward basis all of that information will be available and will be delivered over to the audit committee and come as a full recommendation over to the board.

>> Arn Andrews: I will just make one comment and first off congratulations, I know what a labor of love a is so to you and your staff congratulations. Now that we have a director coming on board and we're starting to think in terms of you know really shoring up operationally and staffing, you know we do still have this outstanding comment from MGO, action he taken by the board in terms of asset allocation are just making their lives more complex. So I just want to reiterate our support, to make sure you have the resources available to make sure that you address you know the staffing you need to be able to stay up to speed to what we are trying to do as the board.

>> Matt Loesch: One of the things we lean on Councilmember Constant about, making sure when it gets through the budget coming through the budget office kicking these things out, that's the rumor how these things have been bumped before, these asked for adds, you mean as Mr. Pena comes on it helps evaluate the staffing as it is what he would like to see as far as with this department that we could really look to Mr. Constant to make sure to

help carry the ball over the finish line on some of this stuff as far as staffing. So when you keep that in mind with your budget try answer these questions with your budget asks or changes. And that really communicate them here so that Mr. Constant, Councilmember Constant knows exactly what the board is asking for so as it comes through he can see it and look for that.

>> Pete Constant: And if I could just add on. If it can just be clear, for the staff that when you, when and if you get negative feedback from budget, I would encourage you to just speak with me directly and let me know so that I'm aware. Because a lot of times I don't find out until after we're a little bit deeper into the budget. So keeping me abreast of the discussions will help me be a good representative.

>> Matt Loesch: Okay. I would like to take the opportunity, I know this is a ton of work and the interaction I've had looking at the document and getting into it and asking questions and comments and the feedback and the timing from staff is very much appreciated. I appreciate it. I know it's very, very arduous. Pulling everybody's information together and hoping that they're right and on time is very difficult. I like that the audit committee is going to be front and center on this and really evaluating and providing board's first input so thanks.

>> And I also want to say as someone who looks at reports, from many, many plans, this is really quite good. Particularly given our size. This is an excellent report.

>> Matt Loesch: Okay, thank you. So Ms. Louie would you like to talk about your report there. Communication.

>> Next item. So thank you for the opportunity for me to come here and speak with you. What I would like to present today is required communications as part of our government auditing standards. What you have in front of you is our formal report and includes three main section is, listed on the agenda item. The first item is the government auditing standards report. In this report we would report to you, communicate to the board they deficiency in internal areas such as compliance matters and whatnot in this particular report. I do want to point out that while we do test controls over financial reporting, our testing procedures are not sufficient to provide assurance over the effectiveness of control. This does not give any assurance over the effectiveness of controls. I

do want to report that this year as you have noted in the report we have one comment to make which I will go over in the last section of this particular communication. If you would turn to page 3 of the report, this starts our required communications and these are standard items that are the standards us require us to communicate to the governing board. Under the first item qualitative aspects of reporting list out any significant estimates that are included in your financial statements. We listed two of the most significant ones the first of which is the bearer value of assets. This includes your publicly traded securities as well as your nonpublicly traded securities. And the second item relates to the data in your actuarial valuations. The estimates are based on the investment managers as well as the investment consultant's input and the procedures that we have performed to make sure that those estimates are reasonable, includes confirmations with the investment managers. We look at their estimates of their value as of June 30th, 2012 and we also look at their auditorred financials to make sure that the methodologies they had used to determine fair value are in accordance with accounting standards. And together the actuarial data, look at the base of your assumptions which you have gone over this morning we also engage our own independent actuary to review the valuations that have been done by Cheiron to make sure that the valuations are performed in accordance with actuarial standards as well as accounting principles. The following two pages, the required communications are pretty standard as you would see in any other communications under auditing standards so I'm going to skip over that unless anyone has questions and move on to the comments that we have on page 6. So as I mentioned earlier we do have one management comment this year for fiscal year 2012 and it relates to the real estate investment policy. The most recent investment policy that the board had approved was dated on June 10th, 2010. And there is an operating guidelines specifically for the real estate investment program. Now, this guideline we know that it has been ten years old now and relates mainly to individually owned real estate property and since the plan has moved more to commingle funds in the real estate sector we think that it is time to update the policy as appropriate so that's what the comment is. Secondly, we did review our prior year comments just to update the board on the carrying status as trustee Andrews has alluded to earlier, we did comment on the financial reporting unit as you know the department has hired additional senior accountants in the financial division to help for the employment and just the steep learning curve, there is to put together the CAFR, you know, we found that the process this year was still heavily reliant on the principal accountant so we'll continue to monitor the status of the staffing situation at the department and we report back to you next year on the progress. On the next page, on the last page, page 7, we also reported on the systems compliance with the conflicts of interest policy. So another policy which is also under the California government code, the public officials and also people who manage public investments they are required to file an annual form 700 which is called the statement of economic interest. And they're due around April of every year. And also, anyone who is joining, who is new to the board or leaving employment, they are also required to file this form within 30 days of either the admission or departure. So this year we tested seven management and staff positions who were subject to this requirement as well as all board members. And we found that everyone was in compliance with this particular policy, including the time line, except for one form which could not be located by the City Clerk's office. So for that particular one individual we could not determine compliance. And with that I'll take any questions that you may have.

>> Matt Loesch: Okay.

>> Arn Andrews: Just a question of staff. Was that board member followed up with?

>> Veronica Niebla: Yes, we have followed up.

>> Arn Andrews: Okay.

>> Matt Loesch: So it's something the audit committee could make a check once the form 700s are done, just to report that 700s are all filed and we have confirmed receipt, simple straightforward, just a memo. Any other questions for MGO? Okay. I'll move to note of -- we need to accept this or just note and file that it's been transmitted?

>> Veronica Niebla: The CAFR needs to be accepted.

>> Matt Loesch: We can note and file the MGO communication and I'll entertain a motion on the CAFR.

>> Arn Andrews: Move to annual financial report.

>> Second.

>> Matt Loesch: Comments or questions? All in favor? Aye, opposed. Okay.

>> Thank you.

>> Matt Loesch: Everybody's favorite topic. Election of the chair number 4.7.

>> Arn Andrews: Motion and second to elect Matt Loesch as chair.

>> Second.

>> Matt Loesch: His name is Matt Loesch. [Laughter]

>> Matt Loesch: So I guess there's nobody here by that name.

>> Arn Andrews: I was trying to do it so quick.

>> Matt Loesch: There's nobody here by that name.

>> Arn Andrews: I was just moving fast before you could get to the microphone.

>> It is Matt.

>> Arn Andrews: We do have a second? All in favor.

>> Matt Loesch: I'm still the chair presently, well, personally, I thank you, I guess, for the confidence. I will accept the honor, so all those in favor? And I'll abstain.

>> Donna Busse: Lucky you have enough votes.

>> Matt Loesch: Got enough votes but I think it's inappropriate that I vote for myself. Odd. And then per Reed Smith's suggestion we separate the two votes in particular because our actual policies require us to vote for a chair. There's no policy saying we vote for a vice chair but we think it's appropriate but so 4.7 is following our policy, 4.8 is something we do for insurance and probably properly so. Discussion on 4.8.

>> Arn Andrews: Motion to elect Lara Druyan as vice chair.

>> Second.

>> Matt Loesch: Comments or questions? All in favor? Opposed? I did ask her ahead of time if that was all right, just to make sure. So on 5.1, we did the 4.9, the report out on that. 51 investment committee last meeting was last week next meeting is the middle of January. Minutes are in our packet. I'll entertain a motion to accept the minutes.

>> Edward Overton: So moved.

>> Arn Andrews: Second.

>> Matt Loesch: Comments or questions? So moved. Mr. Andrews is there anything you would like to bring up as a member of the investment committee that the board should know?

>> Arn Andrews: Just very impressed by the thoughtfulness and the thoroughness of the committee and the topics that come before them. You know especially as we move to implement our hedge fund allocation what

comes before the board work behind the scenes of both staff and our outside consultant Alborne they put considerable effort into these considerations and we continue to move forward with that assess allocation. We are in the milestone 2 sector and the board will be seeing more of these recommendations coming forward.

>> Matt Loesch: Great. And the first batch of them was made public today in our consent calendar.

>> Arn Andrews: Correct.

>> Matt Loesch: What the contractor has done. C, it's a note and file, summary of the report on the discount rate, we'll note and file that. Item 5, 2, update from the audit committee chair.

>> Armstrong.

>> We met with the audit committee, met with the auditors very interesting discussion better understanding exactly what the understanding of the auditor is --

>> Matt Loesch: MGO you're talk? About.

>> Michael Armstrong: MGO, yes. I think what we're going to do with the next meeting, we'll set up a regular set of meetings, is coordinate with Police and Fire, top of mind is what we want to do with more systematically on risk, risk evaluation, stay tuned for that. Our next meeting will be late January, early February.

>> Matt Loesch: On the governance committee, chair of the governance committee. Our next meeting is tomorrow. And it will be the first report-out from Cortex, some of their study on governance recommendations going forwards. So next meeting is tomorrow. There's no other update other than that. On the personnel committee. So we do have an ad hoc personnel committee, there is no meeting settle going forward. There is some work on the CIO search, we have engaged a consultant to help us with that search. They have come forward with some names. We are hoping that once Roberto Pena comes on board he will help to preview

resumes and so forth so we're in the preliminary stages of that as well. If Mr. Pena is on board in the middle of February conceivably we could have some pretty quick action on February and March what would be going on on the CIO position. On education and training. List of opportunities there. Get your information to staff. So we can get those approvals going. Conferences and seminars. Note and file. For our record. Future agenda items. One thing I'm going to ask and this is I'm going to ask of the committees, since I've been reelected, reappointed as chair, if we keep the same committee structure which I'm presuming we probably will for now, that is get dates for like a 2013 calendar of dates of meetings, so that way it's not willy-nilly or up to -- so if we could get that kind of scheduled out I'll communicate that to Ms. Druyan of the EIC, fairly standard mr. Armstrong if you could get with roughly scheduling out it will help staff guide them what they need to do. Public retiree comments? Don't get too excited, just the pension side is adjourned. Back to the health care side. We had the approval, so this is switching gears quickly to the health care trust. Under item 1.1 the approval of federal employees health care trust minutes of November 15th, 2012. I'll entertain a motion.

>> Arn Andrews: Motion to approve.

>> Section.

>> Matt Loesch: Comments or questions, aye, opposed, none. We already did the presentation of the health care flash report. Any old business, none. Future agenda items on the health care trust? Seeing none public or retiree comments? I'm sorry.

>> Edward Overton: Did we ever resolve the 115, 401(h) status? What's new on that?

>> Matt Loesch: It is not agendized, we can agendize that so staff has the opportunity to report. Maybe we'll have a standing item of the status report of the 401(h) and issues public or retiree comments? We're adjourned.