

FEDERATED CITY EMPLOYEES' RETIREMENT SYSTEM

Minutes of the Board Meeting

THURSDAY

SAN JOSÉ, CALIFORNIA

February 11, 2010

CALL TO ORDER

The Board of Administration of the Federated City Employees' Retirement System met at 8:30 a.m., on Thursday, February 11, 2010, in regular session at the Department of Retirement Services, 1737 N. First St., Suite 600 - San José, California.

ROLL CALL

Present:

Matt Loesch

David Busse

Jeffrey Perkins

Ed Overton

Ash Kalra

Pete Constant

Arn Andrews

Chair/Trustee

Vice Chair/Trustee

Trustee

Trustee

Trustee – arrived 8:50 a.m.

Trustee

Trustee

ALSO PRESENT:

Russell U. Crosby -Secretary/Director

Mollie Dent -City Attorney

Russell Richeda -Conflicts Attorney

Debbi Warkentin -Staff

Steve McCourt -Meketa Inv. Group

Veronica Niebla -Staff

Carol Bermillo -Staff

Jesselle Holcomb -Staff

Ron Kumar -Staff

Tom Reilly -OE3

Aracely Rodriguez -OER

Melanie Kirmse -CEO

Carmen Racy-Choy -Staff

Donna Busse -Staff

Diane Hunt -GRS

Yolanda Cruz -AFSCME-MEF

Laura Wirick -Meketa Inv. Group

Rhonda Snyder -Staff

Gerry Chappuis -MEF

Ceara O'Fallon -Staff

Linda Dittes -AFSCME

Toni Johnson -Staff

Allison Suggs -OER

REGULAR SESSION

Chair Loesch called the meeting to order at 8:30 a.m.

ORDERS OF THE DAY

Chair Loesch stated the following changes needed to be made:

Item 1a – Joseph Carrillo's disability application has been deferred to March by request of applicant.

Items 16 & 17 – Meketa Investment Group issues will be heard first.

Item 19 – John Siudzinski's request for effective date change should be new date of July 26, 1997.

NEW BUSINESS

- 16. Discussion and approval of Asset Allocation Option C as recommended by Investment Committee and by Meketa Investment Group in this Asset Allocation Study (Out of Order)**

Ms. Racy-Choy introduced *Laura Wirick* and *Stephen McCourt* from Meketa Investment Group. She indicated that the Investment Committee and Meketa have been working on reviewing the Plan's asset allocation. Today, there is a recommendation from the Investment Committee, and Meketa is here to brief the full Board on this recommendation.

Ms. Wirick stated that Meketa had performed an asset liability study at the request of staff and the Investment

Committee. The purpose of the asset study was to analyze the system's assets and liabilities and analyze how they might behave under various economic scenarios. Meketa worked with GRS, the system's actuary, and staff as well. More than any other decision made by trustees, the asset allocation has the most influence over the investment results for the next 20 years. The first step was to develop economic and capital market scenarios. They worked with their in-house research department and looked at actual historical situations over the past 100 years to develop various economic scenarios. They looked at many and then narrowed it down to three which they called pessimistic, moderate and optimistic. From there they developed various assumptions for how different asset classes and the economy would perform over the next 20 years. The next step was to develop asset allocation policies. They reviewed many different investments, including both the current asset allocation and new asset classes such as hedge funds, real assets, commodities and other asset classes that the system has not historically been invested in. They reviewed many different asset allocations and narrowed down to three which they labeled as Options A, B and C. Next they looked at how the economic scenarios they developed would affect these asset allocation policies over the next 20 years in pessimistic, moderate and optimistic environments. The four steps involved working with the actuary to analyze the liabilities of the system and how they would react to various economic scenarios and the various asset allocations they developed. Finally, they worked with GRS to develop outputs, and under these predefined economic conditions and asset allocation policies they gained insight into how the system's assets and liabilities would likely perform over the next 20 years. The following chart is on page 3 of their memo:

	Current Target	Option A	Option B	Option C
Equities	53%	39%	45%	49%
Fixed Income	36	38	28	20
Alternatives	11	23	27	31
Expected Return (MVA)	7.4	7.4	7.7	7.9
Standard Deviation (MVA)	10.6	9.2	10.1	10.8

The chart above shows the various asset allocation policies developed with staff. The first column is the current allocation, followed by Options A, B and C. The bottom row shows the expected return with the standard deviation using a mean-variance analysis method.

Ms. Wirick stated that Meketa developed certain conclusions as a result of this study. First, the financial position of the plan at the starting point places it as a disadvantage. The next point is that they believe the asset allocation policy, if it became more diversified, would make it more likely the plan would meet its obligations going forward. If hedge funds and real assets are included under each of the above options mentioned above, the expected returns are higher and standard deviations are lower than if they had excluded hedge funds and real assets. Their conclusion is that allocations to these asset classes would most likely place the plan in a better position going forward.

The Investment Committee, working with Meketa and staff, elected to recommend Asset Allocation Option C to the full Board. Asset Allocation Option C includes 49% equities, 20% fixed income, and 31% alternatives. The alternatives allocation is made up of 5% opportunistic, 5% real estate, 10% real assets, 5% hedge funds and 6% private equity. The reason the committee decided to recommend this option is that the expected return is higher than the current target; it's also higher than Options A and B, and, although the standard deviation is higher as well, they think the expected return is more important in helping the plan meet its future obligations. Also, the asset allocation to alternatives, the new asset classes, real assets and hedge funds, are designed to dampen the effects of inflation going forward and the hedge fund allocation is to dampen downside volatility. Hedge funds over the last economic crisis were able to protect on the downside. The expected return of Option C is 7.9% compared to the current target with an expected return of 7.4% which would be an increase of 0.5%, while the standard deviation would increase by the lesser amount of 0.2%. One fact that they wanted to note is that this expected return of 7.9% is gross of investment management and administrative fees, which they expect to be

about 90 basis points moving forward. In summary, Asset Allocation C has a higher expected return and it has allocations to new asset classes which are expected to protect against inflation moving forward and dampen downside risk.

Trustee Overton stated that he heard that the expected return is gross of fees, administrative costs. He asked if it was representative of a managed portfolio or is this indexed returns.

Ms. Wirick responded that there was no alpha in these returns. These are general asset class returns so if the Board, staff and Meketa are able to choose managers that can add alpha over time they would expect the return to be higher.

Trustee Overton asked if there were any returns by individual components available, particularly of the alternative area. What are the expected returns of hedge funds, real assets, etc?

Ms. Wirick responded that in the full asset liability study, under scenario A or the moderate case, they are showing the 20 year annualized average return for hedge fund as 6.6%; with a 20-year standard deviation of 10.1%.

(Trustee Kalra arrives – 8:50 a.m.)

Trustee Andrews added for the trustees that weren't part of the Investment Committee, when this was discussed, he was able to put a human face on the hedge fund component due to the fact that he had worked for a multi-strategy hedge fund with the exception that they only had one investor. They did not take investments from the outside. The term "hedge fund" can bring up all sorts of connotations. He stated traders over the course of their careers will discover and then focus on an anomaly in the market and then spend the rest of their careers executing a strategy to take advantage of that anomaly. Hedge funds are something he is very comfortable with and he feels exposure to hedge funds benefits the entire plan.

Trustee Overton stated that one thing he would be very interested in is how to control the risk in selecting various types of hedge funds. Hedge funds can be very risky to conservative. One of things staff need be conscious of is how to stay out of the leveraged products and very risky issues.

Chair Loesch stated that they are not selecting hedge funds to hit the super home run or hit the grand slam to change the portfolio. It's not necessarily to find the folks that are trying to swing for the fences every time. This focus is on reducing risk.

Trustee Perkins stated that when they went out to look for a consultant, one of the things that Meketa had was their expertise in not only in this area, but in coming to the Board and providing educational information. They have a lot of experience. They understand where the Board is in terms using some of these vehicles. They realize that the Board is looking for a strategy across all asset classes to minimize any more bad times and to balance this portfolio out.

There was continued discussion among the Trustees and staff as to the reasons behind investing in hedge funds and the reasons for doing so.

The Secretary added that it's staffs intention to use both Meketa and the P&F consultant, New England Pension, to look at this issue simultaneously.

The Chair stated that last month and this month, they are considering some fairly large issues to try to address funding and investments, then with the assumed rate of return and now with asset allocation. These types of

investments have changed over time. Investments for these types of portfolios, ten, twenty or thirty years ago have changed. There are different opportunities available now. Some people, mainly retirees, think this plan should be invested like a personal retirement plan would be; much more conservative, much less risk. Being a more perpetual fund, it should be here for the long run. The need for the return, especially given the status of the liabilities, requires the Board to take opportunity of different investment classes.

Trustee Constant stated he was comfortable with the recommendation from the Investment Committee. He stated there should be a brief discussion reconciling how they set an asset allocation where they expect a return of 7% with the decision of the Board last month to use an assumption of higher than that for the actuarial study.

Ms. Racy-Choy responded that the two obviously need to converge. We have to give a lot of credit to the Board in that there has been a lot of convergence that has happened this year. The interest rate was moved by 50 basis points and now the asset allocation expected return has been increased by 50 basis points. In fairness, in one year expecting more would be very difficult. We want to be cautious in the changes in the asset allocation. Over time, in two, three or four years, we may find ways to increase the return farther. This year staff would like to congratulate the Board on the various decisions they've made. They feel tremendous progress has been made. Over the next few years, hopefully that progress will continue.

Member Overton pointed out that there is no alpha in these numbers. These are index returns and the plan is to go out and find managers that will add value over these returns. You can't factor in alpha in a study like this because you don't know what you're going to bring to the table in terms of expertise or different strategies.

Trustee Perkins stated part of those 90 basis points that they talk about as costs is what you pay the managers. You expect them to do better than the index for what you're paying. Some do way better, some don't; that's why you have to stay on top of them. To the extent that we're good at getting the right people and they do their job, they should cover that additional cost or high percentage of those 90 basis points.

The Secretary added that tremendous progress has been made this year. As a future goal, it is something that the trustees need to keep an eye on and keep watching to try to bring those two numbers closer over time. There really isn't much more that can be done in one year without dramatically changing the financial picture of the whole plan in ways that would be negative for both the plan sponsor and participants.

(Busse/Constant) to approve Asset Allocation C as recommended by Investment Committee and Meketa.
Motion carried 7-0.

17. Adoption of Resolution No. 6558 delegating authority to Investment Committee and staff to implement Board-approved asset allocation, including authority to select and retain transition managers and terminate investment managers under advice of Board's investment consultant. (Out of Order)

Trustee Overton requested a clarification of the resolution.

The Secretary responded that this resolution is to implement the allocation that was just approved in Item 16. This is a delegation for the Investment Committee to be able to complete the transaction and then to delegate to staff, as needed, parts of that transition from the current asset allocation to the new one.

Ms. Dent added that the way the resolution was drafted was to allow delegation to be done in the future for transition managers only.

Trustee Overton stated his concern that normally when you transition a portfolio, you transition from both a strategy and a group of managers to a new strategy and a new group of managers.

Ms. Racy-Choy stated the transition is to the new asset allocation. For instance, we need to consider how we get exposure to the new asset classes, whether it is possible to do so. The reason they want to use transition managers is there will be a lot of money moving around and it is much more efficient. The equity allocation from the current allocation is changing significantly. This is intended to allow the Investment Committee to take over the process with respect to the selection of the transition manager and the specifics of what the transition manager is going to do.

Trustee Overton added that when you are talking about firing managers, terminating investment managers under advice of investment consultant, then the Board is not involved in the decision of whether a manager should be terminated and a new manager hired.

Ms. Racy-Choy responded that if we have an allocation that requires reducing the equity allocation to 45% or 49%, some managers will have to be removed from the roster. The decision as to which one would come from the investment consultant to the Investment Committee. That is what staff is recommending, as opposed to bringing that recommendation to the Board. It is not that the Investment Committee is going to take over the decision; but, as it relates to implementing the asset allocation they would make the cuts.

Chair Loesch suggested that a better description of the transition manager be given as that is the key. This is requesting approval to hire a transition manager, singular, that would be an intermediary from the Board's current positions to the new allocation. At that point, if we are to select managers moving forward then that would be done through the typical process that they go through to hire new managers. This is a way to consolidate the process to get to the new asset allocation that was just approved. Firing a manager is not a difficult challenge as it is to select a replacement manager.

Trustee Overton stated that was not clear in this memo and resolution.

Ms. Dent requested clarification as to exactly what the Board's concerns and desires are. It sounds like there is an understanding of the transition manager selection process and having the Investment Committee select the transition manager or work with staff to select the transition manager. It sounds like there is confusion about the termination of managers. If the desire is to have the Investment Committee alone be able to make the decision on termination of managers, then the resolution should be redrafted. The way it reads now is that function could be delegated to staff also. If that's where the confusion is, with the authority to terminate managers, it certainly could be made clearer.

Trustee Overton stated that the explanation he has gotten has been very helpful. It doesn't come through in this memo and the resolution should reflect what has been said. He restated his understanding of what has been said was that this gives the committee the authority to hire a transition manager and implement the new asset allocation plan. It does not include hiring other managers without Board involvement.

Chair Loesch added that it also authorizes the committee to potentially terminate existing managers.

Ms. Dent stated that it does not include hiring new investment managers. The current resolution does say what has been said, but it does also include the ability for the committee to terminate managers and the ability to delegate authority to staff to select a transition manager or to do terminations.

Chair Loesch stated that presently there is no intention on the part of the Investment Committee to do that.

The Secretary added that the reason this portion got put in was because staff did a similar transition in December for Police & Fire and ran into some issues of how P&F's delegation of authority worked from their board to their committee and then to what they could delegate onto the staff. Once the transition begins there are a series of decisions that need to be made very quickly. It's all done real time over a series of days and you don't want boards and committees having to meet in the middle of that process. Once this process starts, there are certain things that the committee will likely delegate to the staff just to make the transactions complete. Staff wanted to try to address the problems that were faced during the other transition by having those capabilities to delegate built in this initial resolution document. They may be used, they may not be; it depends on what the Investment Committee decides when they have their meeting later in the month.

Mr. Richeda stated that after hearing the explanations given, he did not feel that resolution as drafted clarifies what has been said. The resolution as drafted talked about delegation to the committee and to the department; whereas, at the bottom of the first page it delegates to the committee and staff. That could be read as giving it authority to the committee and staff without any indication that includes the committee's ability to delegate certain decisions solely to staff. The more clarity in this resolution, the better it is.

Ms. Dent added that if that is the intent of the Board, that the Investment Committee on a case-by-case basis delegate the authority to staff, it could be more clearly stated that way.

The Secretary stated that it is necessary to get this issue off the ground and try to move as quickly as possible.

Ms. Dent stated the Board could adopt the issue, then the resolution could come back in March on the consent calendar. The motion could be effective today, and the resolution merely memorializes what was decided.

(Constant/Busse) to adopt an amended Resolution No. 6558 and delegation of said authority. Motion carried 7-0

Back on Agenda

RETIREMENTS - None

CONSENT CALENDAR (Items 2 thru 10)

(M.S.C. Busse/Constant) to approve Consent Calendar. Motion carried 7-0

Service retirements approved:

James A. Adduci, January 23, 2010
Michael C. Capri, February 23, 2010
Eugene C. Casarez, February 23, 2010
Rudy A. Teneyuca, February 6 2010
Chuck Hagenmaier, February 20, 2010
Joan V. Huntley, February 20, 2010
Mathias E. Palmen, February 20, 2010
Yakov Parievsky, February 6, 2010
Corazon Z. Pascua, February 20, 2010
Olga P. Sanchez, February 6, 2010
Dorr K. Shimamoto, February 6, 2010
Kathleen A. Stagi, February 6, 2010

Deferred vested retirements approved:

Billie Fitzsimons, February 16, 2010

DEATH NOTIFICATIONS (Moment of Silence)

The Chair stated there would be a moment of silence for the death notifications.

OLD BUSINESS/Deferred-Continued Items

12. Travel Audit compliance update.

Mrs. Niebla reported that this Board has only three remaining travel audit recommendations which will be handled at the next meeting of the Policy Committee, scheduled for February 16th.

13. Discussion and possible action on update of outside counsel for tax qualification review of the system.

Ms. Dent explained that the tax counsel RFQ has been sent out. They are expecting to receive responses in the next week. Once received, the qualifications will be reviewed immediately by the Secretary, Mr. Richeda, herself and possibly another attorney from her office. They are hoping to have a recommendation for tax counsel before the Board in March.

14. Discussion and possible action on Board's agreement to move monthly meetings to City Hall.

The Secretary reported that at the last meeting the Board directed the Chair to send a letter to the Mayor and City Council; this action was done. It was previously on the agenda for the Rules Committee for February 10th; however there has been no update given by the Administration.

Trustee Constant stated that there was no quorum for yesterday's Rules Committee so the matter was probably deferred to the 17th.

Chair Loesch summarized the staff memo by saying it indicated that it would cost between \$25,000 to \$30,000 a year per plan in just staff time; about \$1,800 to get the staff there and back for the meetings. There is no clarification as to exactly what is going on over at City Hall as to set up and scheduling. If the decision is to move the meeting location, what is the status of these issues?

The Secretary responded that the information given was that the Chairs' letters were coming forward to the Rules Committee.

Trustee Constant stated that when he returned to City Hall he would check to see if Rules did discuss the issue yesterday and then he will update the Secretary.

Chair Loesch inquired about Granicus and the software and the fact that we would still not be able to stream live with this purchase. He stated that previously the Board had approved the purchase of Granicus and he wondered what that would provide.

Ms. Busse responded that with that purchase you would be able to put it on the website so that people would be able to access the meeting. It would not be live, but there would be audio recording available. Even at City Hall, if someone is streaming from the Council Chambers, no other meeting can be streamed live. The meetings could be audio recorded no matter which location.

Chair Loesch stated that at this time, his thought is that in initial discussion on Granicus it was that the Board

wanted to have a tape recording be posted after the fact. The question now is does that have to be pursued or is it okay just to post it on line?

Trustee Constant stated he thought the discussion was to have it posted online, not necessarily live streaming. Secondly, given the dates and times of the Board meetings, there are no other regularly scheduled meetings that are streamed at that time. The only meetings that are currently streamed are Council meetings on Tuesday, the Rules Committees and all the other Council committees which are in the afternoon hours and the Planning Commissions which occurs in the evening. Unless there is a special Council meeting set for a Thursday morning, which is unusual, odds are slim that two meetings would have a stream request at the same time.

Chair Loesch responded that if it is not the intent to stream live then that is not important whether it is streamed or not. The request now is that we discuss this in March and come to some decision. At this time, it is his recommendation to continue this issue until March by which time they should hear back from Council.

Trustee Kalra agreed that the Board should make the decision in March. He did have a couple of questions on this topic. If there is capacity to live streaming, what if anything does that do in terms of having so many staff members present if they could listen online? Is there any way this could benefit staff? There are a number of staff members who attend for all or at least part of the meetings.

The Secretary responded that the staff members present are not just listening, they are participating. The staff you see in the audience are available to answer questions, to make presentations or to provide any help to the Board in their decision making.

Trustee Kalra asked in terms of the cost, the cost is just for staff commuting to City Hall and back.

Ms. Dent stated that if there was streaming from this location, there would be the advantage of staff coming upstairs quickly. That way they could stay at their desks and then come upstairs if needed. That's how employees do it at City Hall.

Trustee Kalra stated he was just trying to understand if there was any benefit to streaming live, but it sounds like there is not due to the fact that they have to physically be here.

NEW BUSINESS

- 15. Approval to amendment to the Agreement with Saltzman & Johnson Law Corporation, Board's conflicts counsel, to include professional services provided by Brandie M. Barrows, Attorney, effective August 1, 2009 and to allow for addition of personnel subject to approval of City Attorney's Office and Board Secretary**

The Secretary explained that the original agreement was written to include Mr. Richeda and specifically named people inside the firm. We need to expand that to include new hires and to make it broad enough so other people in the firm can work on projects without having to come back to the Board.

Chair Loesch requested clarification in that in the memo itself it mentions \$200 per hour and then it mentions \$190 per hour both referring to a current billing rate.

Mr. Richeda responded that it should show \$190 per hour.

Ms. Dent clarified that a draft of the amendment had been attached before the current billing rates were supplied. She does have these rates and those will be listed in the amendment.

(M.S.C. Busse/Overton) to approve amendment to Agreement with Saltzman & Johnson. Motion carried 7-0.

(Items 16 and 17 were previously heard at the beginning of the agenda)

18. Discussion and possible approval of Health Experience Study for Other Post Employment Benefits (OPEB) Valuation as of 30 June 2009.

Ms. Hunt stated that she was present to discuss the retiree healthcare plan. GRS performed an experience study similar to the one done for the pension plan. She summarized that the population is the same for both plans, retirement and health, so a lot of the assumptions such as mortality and retirement are the same. There are some unique assumptions related to retire health valuations and that's the focus of the study. They relied upon GASB Standards 43/45 that addresses valuing liabilities for healthcare and that have standards of practice that assist them to set economic and noneconomic assumptions. The assumptions that were reviewed were: economic assumption which includes investment return, healthcare cost trend rates and dental costs; demographic assumptions including election percentage and medical coverage and deferral ages and, funding policy and methods including amortization methodology, actuarial funding, asset valuation and phase-in approach.

Healthcare cost trends are important assumptions in determining the Plan's liabilities and costs. GRS starts with an assumption that's closer to the valuation date where the trend is higher and that trends downward to inflation over time. This is a very standard approach with the assumption being that there will be more efficiencies coming in healthcare. Costs cannot keep increasing over time exponentially. The trend includes medical price inflation, utilization changes, policy, new technology and different treatments. GRS looked at the premium increases for the plan as a starting point.

In summary, the average increase for the pre-65 is 10.7% and for post-65 it is 7.1% which tracks with a national survey that was recently done. GRS noted that currently the Plan has one trend line for both pre- and post-65 retirees and now they feel there is enough difference to recommend two separate assumptions for pre-65 and for post-65 and to adjust the trend line to reflect the current experience. The current assumption for both pre and post goes from 8.0% to 4.5% trending down over seven years. Their proposal is to increase the pre-65 that starts at 10.0% trending down to 4.5% over a longer period of time. This proposal will increase liabilities and also increase the ARC. The proposed post-65 assumption is slightly lower for the first three years and then a bit higher and then trends down to the same long term rate. Those two changes increase the contribution requirement, but they more closely match actual experience. Dental and healthcare premiums were reviewed separately. For dental, there was no clear trend; it went up 8% one year, down 6% another year and then fluctuating widely. They did remain relatively flat for the past five years. Surveys show that dental rates aren't increasing quite as quickly as expected. GRS is recommending tweaking the current assumption which starts at 6% and trends down to 4%. The proposal is shortening the trend downward to only four years where it will hit the 4% and starting it lower at 5%. This assumption decreases the liabilities.

Ms. Hunt continued that for the investment return assumption, this assumption has guidance from GASB, in that you look at the overall plan and determine if it's a funded plan, an unfunded plan or a partially funded plan. Depending on where a plan fits, that determines what kind of long-term investment return you can expect for your plan. To be a funded plan there are three things necessary: a trust, a commitment to make the ARC payments over time and the plan assets of the trust must be the sole source of payments. If you are an unfunded plan, it's simply pay as you go and you expect a lower return, closer to fixed income. If the plan is funded with the benefits being paid out of the trust, you can look at the trust's investment return. If you are partially funded, the plan is half way between the other two. There is a trust but the ARC is not being paid. When the OPEB

valuation was done two years ago, this plan was treated as partially funded with an investment return assumption half way between the assumed rate of 8.25% and a risk-free rate of 4.5%. GRS picked 6.6%. That's how GASB recommends you select the investment return. Now that the Board has adopted a funding policy to pay the ARC over time after this initial phase-in period, the plan can now be treated as a funded plan with the 7.75% investment return assumption. In other words, GRS is recommending changing the 6.6% to an investment return assumption of 7.75%. Obviously that will lower the contribution rate requirement.

Actuarial value of assets is currently determined using market value, and GASB allows smoothing to be used. GRS is recommending a five-year smoothing approach similar to what is used in the retirement plan, but doing it on a prospective basis. This year the market value would be set on a go-forward basis; every time there is a gain or loss that gain/loss would be smoothed over 5 years prospectively. In this valuation there would be no impact; next year there would be a one year gain/loss which would be smoothed over five years. Regarding the amortization methodology, the plan currently has a 30 year open amortization policy. Apparently the City and the bargaining groups have negotiated using a 30 year closed approach starting this year. For consistency, GRS recommends the Board adopt this change. There will be no immediate impact from this change and there will only be one as this gets implemented. GRS made no recommendations to change assumptions for: number of individuals electing of medical/dental percentage, funding policy to ARC, entry-age normal funding method, 100% Medicare coverage; deferral age of 58 for deferred vested and the phase-in from old policy to GASB compliant.

The changes from the retirement plan experience analysis that are applicable to this plan include: investment return rate change to 7.75%; inflation rate change from 4.0% to 3.67%; and payroll growth rate which changed from 4.0% to 3.83%,. These will not have an impact on the Plan's liabilities but will increase the contribution requirement. GRS is also recommending a change to the post-retirement mortality rates and a change to the active member mortality rate. Both of the last two recommended changes will affect liabilities and will increase the ARC.

Ms. Racy-Choy clarified that the employee contribution, not the OPEB contribution, was based on 8.25% with a phase-in towards full funding of the ARC moving from the policy method at 8.25% versus going towards OPEB liability method using the appropriate discount rate over five years. Theoretically, from an employee/employer contribution perspective, the plan has really moved from the policy method towards OPEB and the discount rate has moved from 8.25%. There has been mention that the discount rate has gone up from 6.6%; although that's true for the OPEB contribution, the OPEB contribution is for the City's financial statements and doesn't affect the employee/employer contribution rates. There are two separate things happening.

Chair Loesch stated that he finally understood what the intent was of GRS coming to the Board reporting what the experience was, then setting the assumptions and then coming back to the Board with the 2009 OPEB valuation results. Now it is time for the Board to tell GRS exactly what assumptions for the OPEB valuation should be used.

The Secretary added that the GRS medical inflation assumption is very consistent with the same general approach most actuaries are using. That is to say, you start with whatever the current inflation rate is and then trend down to some long-term rate. For that long-term assumption, GRS is probably a little low; most actuaries are at 5% for the long-term running rate. The two drivers are the medical inflation rate and your earnings assumption on the contributions. Those two numbers are what drive this valuation in the long run. The one criticism that staff might have of GRS, is that we're seeing the median number of other actuaries for the long-term assumption is 5%, whereas, GRS has a policy around 4.5%. The difference between that 5% and the 4.5% that GRS uses would substantially increase the liability over time. Staff is comfortable with saying that, given all the other moving parts, 4.5% for this valuation is probably reasonable. It is something that staff would like to look at again over time and maybe have, in the next valuations, further discussions on whether it should be 4.5% or 5% as the long term rate.

Ms. Hunt stated that they did trend it down for a longer period of time, ten years, where they had originally had it kicking in at seven years in the prior valuation. GRS did keep a higher percent for a longer period of time to be a bit more conservative.

Ms. Racy-Choy stated that with respect to blending the interest rate, last year a discount rate for OPEB was used at 6.6% which was a blended rate between a risk-free rate and the Plan's investment return assumption of 8.25%. She stated that when staff spoke to GASB with respect to when the Plan could stop using the blending, it was their understanding that GASB stated the Plan could not stop the blending until the Plan is paying the full ARC. What she is hearing here is that GRS is willing to certify this valuation is OPEB compliant without blending and going directly to 7.75%.

Ms. Hunt replied that she had conversation on this issue with Ms. Thompson as she had more involvement in discussion with GASB. Ms. Thompson asserted that due to the fact that there is short-term phase in, that the Board had made a commitment to consistently pay the ARC, then using 7.75% is allowable.

Chair Loesch stated that was part of the discussions on retiree healthcare during negotiations on the topic. It was stated in order to get that higher assumed rate you had to have a plan, start acting on that plan, and assets had to be in the trust. That was what was said to the employees in those discussions.

Ms. Racy-Choy indicated that GASB and Segal are saying that the blending must continue until the Plan is paying the full ARC. GASB is definitely saying that, and she believes that is what Segal has said. However, if GRS was willing to certify that that is a basis compliant with OPEB, then there are no further questions.

Chair Loesch stated that a closed amortization method was one of the topics that was discussed and agreed to with the unions. There was discussion on a layered approach as was done with the pension but this was never agreed upon. Is there a reason why the Plan would want to have two different amortization methods, one for the pension and one for retiree healthcare?

Ms. Hunt responded that there is a little different funding approach for both plans. There is no reason why both plans need to be the same. There is a different philosophy for this plan and you're trying to reach a different funding level for it. It's easier to have the actuarial value of assets consistent for both. With amortization you can be unique in what you want to do. It might help the Board to understand if you have the same approach on both.

Ms. Racy-Choy added that both methods are good actuarial methods. However, a con against the closed method is that in 15 years it starts becoming very volatile. As you get closer to that 30-year horizon, it becomes extremely volatile. If you choose the closed, in 15 years you probably will be discussing what to do with the amortization method. The volatility will be difficult to manage. The layered approach is an approach that can be put in place and forgotten about. It is a good method to make sure over time you converge to full funding.

Chair Loesch stated it doesn't make much of a difference right now, however; then we'll have to switch it later on. He stated he saw advantages to the layered approach, due to volatility towards the end. Perhaps GRS could come back next month with what that change would look like. Perhaps showing a 30-year closed and then 20 year amortizations after that and what the layered effect, as decided for the pension, would look like.

Chair Loesch continued that one of the issues he found confusing was the chart on page 18 of the report. It should show where we are now, where we are heading and what the ongoing effects are. On the pension side, it was clarified what were the effects of each assumption. In other words, it shows that a particular item would cause a particular increase/decrease in contributions if adopted. That should be done in this report to make it understandable what the affect of any of these demographic changes is. That would make it understandable as

to which one has the most effect one way or the other. The Board can then understand the cost or benefit of making these recommended changes. In the current chart, the 2008/2009 starting point is what was agreed to by the unions. It was Year One of the ramp up, the first phase of four. Currently we are going to the second year of the ramp up towards the full funding of the ARC. What's listed in this chart is step one, not the starting point of the ramp up. The starting point was the year before that. In other words 2008/2009 was Year One of the ramp up. 2009/2010 is step two. This chart is not clear as to what is being shown.

Ms. Hunt added that the 2008/2009 number was out of the valuation report that used the policy method. That shows as the initial starting point because that was using the old funding policy.

Chair Loesch stated he would like GRS to come back with a very clear explanation of this issue. Perhaps also including discussion about what's happened over the last couple of years because negotiations affected things and helped set rates.

Ms. Racy-Choy indicated what would make it more simplified is if the Board requests GRS to do a contribution phase-in schedule as they provided last year. This way the Board would have an idea of what would be the impact on contributions.

Chair Loesch added that at last month's meeting, the Secretary had indicated that the rates for next year are essentially set, because they have already been agreed to through negotiations. Also the next report should show this is what was agreed to and this is what the valuation tells us the rates should be. It will be two columns side by side.

Ms. Racy-Choy stated that in the report, GRS should keep the ARC out of the picture because the ARC is simply for disclosure by the City in its financial statements. Although this Board must approve that report, it doesn't tie into the employer/employee contributions in a direct way. That should be kept in a separate discussion if at all possible.

Ms. Hunt summarized for next month, the Board wants projections to show the different amortization methodologies, breakdown of any assumption changes, the phase-in update and an update using 2009 census data.

This issue will be continued to next month to clarify all outstanding issues.

19. Approval to change the effective date of the nonservice-connected disability application of John Siudzinski from July 25, 1997 to July 26, 1998.

(M.S.C. Overton/Busse) to approve. Motion carried 7-0

20. Discussion on establishment of health/disability committee

The Chair deferred this matter to the March meeting.

STANDING COMMITTEES / REPORTS / RECOMMENDATIONS
Committee of the Whole

21. Summary of quarterly COW held 14 December 2009

(M.S.C. Overton/Busse) to approve summary. Motion carried 7-0

EDUCATION AND TRAINING

22. Notification of Pension Bridge Annual Conference to be held in San Francisco, April 6 through 8, 2010.

This item is note and file.

FUTURE AGENDA ITEMS - None

PUBLIC/RETIREE COMMENTS - None

ADJOURNMENT

There being no further business, **Chair Loesch** adjourned the meeting at 10:05 a.m.



MATTHEW LOESCH, P.E., CHAIR
BOARD OF ADMINISTRATION

ATTEST:



RUSSELL U. CROSBY, DIRECTOR
BOARD OF ADMINISTRATION