

SDCERS BOARD MEETING August 19, 2005 by *Patricia Karnes*

FINANCE AND INVESTMENTS meeting lacked a quorum on Aug 12th and met August 19th at 9:30a.m. with Lopez, Sullivan, Flynn, Meyer, Preovolos, Torres, Thomson, Sheffler, Grissom and Chapin.

Completion of the Fiscal Year 2004 Comprehensive Annual Financial Report (CAFR) is delayed by the necessity to include subsequent events after June 30, 2005 that impact SDCERS this next year. Grissom must include the dollar value of lawsuits (that keep being filed), including the lawsuits of SDCERS' actuary (Roeder) and financial advisors (Callan). Grissom thinks the SDCERS' June 30, 2004 audit will be out by October.

Over a million dollars was refunded, last year, due to the work of SDCERS' two staff that litigate on bad investments.

Doug McCalla's presented the status of SDCERS' asset allocations, etc. Preovolos asked what, if any, plan there was against a downturn in real estate? Offices tend to be more volatile than residences and industrial properties. Real estate fundamentals are moving up to counter a rise in interest rates. The Board approved, 8-0, SDCERS' real estate strategic plan with Townsend Group to diversity holdings by joining a larger investment group, and giving up immediate capacity to sell properties.

Regarding selection of SDCERS' 2005 target asset allocation and investment strategy: Preovolos postponed a vote, until September, to give the Board time to give greater review to Callan Associates' choices of strategy levels for various returns and their associated increasing risk. The Board would need to accept more risk to earn the same returns June 30, 2005-June 30, 2006. McCalla presented the question of how to meet the challenge of the return dropping below 8%. He said perhaps by adding equity exposure. There are limited options, because SDCERS is already diversified which has protected SDCERS' assets from deep losses in the past. Meyer wants to compare figures with past years' allocations and assumptions.

The Board asked how are investment consultants selected and measured? An outside expert gave three factors: 1) Performance. 2) Provide the information you request. 3) Independence and free of conflict. Look at a company's standards to meet SEC guidelines. Steve Meyer said, "That I don't get surprised!"

BACKGROUND ON RISK for the next meeting: The previous Board had asked themselves questions about money managers, consultant fees, level of risk, and who is fiscally responsible--whether it is the Board or the Consultant/Money Manager. In the past year, Mercer mumbled, in the various SDCERS audits, about SDCERS being more risky than conservative in order to push SDCERS out of underfunding. Mercer didn't seem comfortable with the situation. In 2004, funds were in 53% equity, 37% bonds, 10% real estate. SDCERS' Board is managing risk by using 13 difference investment managers. Most, if not all managers, are recommended by Callan. In December 2004, some previous Board members wanted to make Consultant/Money Managers sign that they had fiduciary responsibility as part of the new conflict of interest policy. The old Board preferred the view that the Board is only to be administrators and not \$\$\$ responsible. SDCERS Board said if the Board "took actions", and not the money managers, the Board would bear fiduciary responsibility. The City Attorney has noted Treasury bonds are the usual pension fund investment for safety reasons. If the fund were to have losses, the funding level would fall and the City would have a bigger problem.

OPERATIONS meeting at 1:30p.m. included Sullivan, Flynn, Meyer, Preovolos, Torres, Thomson, Sheffler, Grissom and Chapin.

New retirees: Ralph Inzunza at 15.25 years and Michael Zucchet at 8.85 years.

DROP rule changes were not discussed again this month. In the legal report section of the Board packet, available at the SDCERS reception area: "V. Minimum Distribution Rules- 'IRS' Final Regulations issued June 14, 2004, effective Jan. 1, 2006. The recommendation to amend Board Rule 12.20 (regarding payment of DROP benefits) to comply will go before the Board in September." DROP has 898 active members with \$106,227,884.95 and 562 retired DROP have \$121,808,807.08 left on account at SDCERS.

(There was no Closed Session following the meeting. There was a Closed Session on Monday, Aug. 15, 2005, at which time a decision was made for SDCERS to start the hiring process for a special consultant/auditor to "review allegations of wrongdoing". On Sept. 6th, the City Council will be reviewing SDCERS' Board failure to waive attorney-client privilege and possible firing of Board President Peter Preovolos and/or asking for three remaining Mayor Murphy appointees to resign so a whole new Board can be appointed. Four Board slots are currently empty. Some members of the City Council had hoped SDCERS would accept the necessity of waiving after Kroll's serious presentation at the City Council on August 9th.)

Re: Non-position of the SDCREA on legal vs. illegal benefits: I spoke regarding the City of San Diego Retired Employee Association Board's vote not to split membership by endorsing one benefit group, to the detriment of another group, rather SDCREA is focusing on asking where the money is to pay benefits. To that point, my question to the SDCERS' Board was: What impact would the City's bankruptcy have on SDCERS' ability to pay future benefits?

Dick Vortmann, former Board member presented his Pension Reform Committee minority report. Vortmann advised the Board to make sure to have issues publicly aired. He said the City is not paying benefits when they are accrued and the cost is ballooning out in the future. He recommended the Board tell the City, each year, what the cost is to fund benefits. SDCERS has not been doing this, it has been using an alternative procedure to determine funding since 1997. Vortmann said the Board should look at all the numbers. Grissom apologized if he had led the Board to believe that dropping the 8% assumed return had not been debated by previous boards. On the subject of "rich benefits", Flynn pointed out over 475 retirees are receiving under \$300 a month. Torres added that new employees have no DROP and their health eligibility has been changed. Grissom said he wanted to work on three issues before he leaves in December: 1) the 50/50 split of employee/employer contributions, 2) "waterfall", and 3) general overall funding policy. Grissom said complexity has caused lack of clarity. Regarding health costs: Is SDCERS out of the health insurance business? Grissom said that the City is evaluating it with their actuary now.

Is the pension board out of health insurance business? Grissom said that the City has materials, prepared by SDCERS, to establish a separate health trust. The City is currently paying SDCERS monthly for healthcare instead of annually, said Chapin.

The Port's second amended plan and agreement was passed by the Board. The Port's greatest concerns were: 1) inclusion of the Jan. 1, 2005 domestic partners' act, and 2) Board holds the Port's assets are only for Port district employees. Other issues require City Charter or Muni Code changes.

Industrial disability was "streamlined by a 7-1 vote, due to an escalation of automatic hearings which increasingly slowed the disability process and cost \$10,000 to \$15,000 each. Staff maintained that only a few appeals have been reversed in the past few years since the process has been in effect. Previously some Board members had been argumentative about rejections. When Mr. Clem said DROP participants were being turned down for industrial disability, staff asked why active DROP employees were applying for disability, up to their last day of work? Earlier, there had been a discussion on whether Fire Prevention Inspectors were required to work fires, or were they free to refuse. Lopez said police are required to be able to arrest people, even when they have desk jobs, and therefore they are given industrial disability if they are only able to work on a desk. Grissom said that City job duties vs. physical job descriptions vs. the descriptions that are used to determine industrial disability by SDCERS, are changes in benefits and therefore up to the City Council to clarify. Apparently there is also a conflict between work comp. definitions and SDCERS' definitions.

Under comments, Preovolos asked Sheffler to report back in the future about Gasby 25 and 43 that Sheffler has been looking into. Also, Callan has acknowledged that they have been served by Aguirre and they are prepared to defend the allegations.