

SDCERS NAVIGANT REPORT COMMITTEE/STAKEHOLDER MEETING

April 19,2006 - Meeting Notes by Virginia Silverman

INTRODUCTION/PRELIMINARY

Committee members in attendance were Mark Sullivan (Chair), Thomas Hebrank, William Sheffler, Richard Kipperman and Peter Prevolos (SDCERS Board President and ex officio member of all SDCERS Board committees). Others in attendance included Joe Flynn, Retiree Representative on the SDCERS Board and representatives from the City Attorney's Office and Council President Scott Peters' Office..

STATUS REPORT: REVIEW OF NAVIGANT REPORT RECOMMENDATIONS

A review of the Navigant Report recommendations was presented by Amanda Massucci, of Navigant Consulting, Inc.

She said that the Navigant Report identified ten recommendations, with Reish, Luftman (legal firm) recommending three more, as areas in need of review or improvement.

- 1) Responsibilities and duties of the Board.
- 2) Skills and characteristics of effective board members.
- 3) Board decision making.
- 4) Other governance matters.
- 5) Actuarial soundness, reporting and billing.
- 6) Disability benefit payments in connection with Corbett Settlement.
- 7) Executive staff reporting and oversight.
- 8) Use of reserves to fund benefits.
- 9) SDCERS' Internal Audit Function.
- 10) Retiree health care.
- 11) Fiduciary training
- 12) Definition of roles and responsibilities for SDCERS and plan sponsors.
- 13) Possible effects of a plan sponsor insolvency.

Ms. Massucci said that there are three different time-lines for three categories of recommendations: by September 2006; by December 2006; and next year. The highest priority recommendations include: Ethical tone; Tax compliance issues; Actuary; and Instituting regular Board training.

NEW BUSINESS: 2.A.1. - REINSTATEMENT OF COMMITTEE STRUCTURE WITH PROPOSED CHANGES

Board President Peter Prevolos reviewed recent changes to the SDCERS Board meeting schedule, which switched from a committee system to general board meetings for all issues. He commented that those changes gave the (many) new Board members a chance to learn all aspects of SDCERS administration.

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Mr. Prevolos now recommends returning to the committee system, with the following changes::

* Consolidate the Business & Procedures Committee and Rules Committee into a new Business and Governance Committee with expanded responsibilities (including orientation and training for new Board members; selection of non-Board candidates for audit committee, and review of :annual actuarial valuation reports.)

* Consolidate the annual Proxy Committee and Real Estate Committee into the Investment Committee.

* Consolidate the Performance Review Committee into the Executive Committee.

* Expand the Executive Committee's responsibilities to include: Development of a performance review plan for the Administrator and General Counsel; Performance evaluations of Administrator and General Counsel; Inclusion of General Counsel in meetings with Administrator.

* Discontinue with Health Care Advisory Committee (funding and benefits are exclusively the purview of the City and should be addressed by an advisory committee of the City Council.

Motion to approve the changes was approved unanimously (5-0) by the Committee.

NEW BUSINESS: 2.A.2 – DEVELOPMENT OF TRUSTEE TRAINING/EDUCATION

Eight Areas of Training

Harvey Leiderman, SDCERS fiduciary counsel, proposed ongoing training which would focus on governance of the retirement system. He said that “a fiduciary needs more than a pure heart and empty head (there is a \$4 billion trust).” He said eight areas of training are needed:

- 1) Fundamental fiduciary rules: Primary duty, Board's major responsibility. Exclusive benefits rule, provide benefits to retirees. Prudent person rule.
- 2) Legal Framework: California Constitution; Government Code (Brown Act, Municipal Retirement Systems, Public Records Act, Conflict of Interest Code, Political Reform Act and FPPC); San Diego Municipal Code, San Diego City Charter, Prudent Investor Act and common law; and – especially important – the Federal Internal Revenue Code.
- 3) Board Governance: Bylaws and rules; Open meeting requirements; conflicts of interest' ethical obligations; exercise of discretion; liability, insurance and indemnification; delegation of responsibilities.
- 4) Actuarial Soundness: Understanding pension funding; Liabilities; Assets and reserves; Actuarial assumptions and methodologies; Employer and employee contribution rates (normal cost, unfunded accrued actuarial liability/UAAL, COLA).
- 5) Prudent Investment of Assets: Capital markets; Portfolio diversification; Investment guidelines; Selection of consultants and managers; Monitoring and due diligence; Balancing long-term safety, liquidity and yield; Cash flow Management; Corporate governance activism; Shareholder litigation.
- 6) System Operations: Administrative organization and staff; Budget Process; Financial statements; Audit function; Member records; Information technology; Website.
- 7) Benefit Administration: Calculation of benefits; Delivery of benefits; Member services; Retiree health benefits.
- 8) Disability Application Process: Understanding 'permanent incapacity' and 'service connected;' Application process; Medical reviews; Hearings and appeals; and Board discretion.

Leiderman proposed several training and orientation programs, involving about 50 hours of training:

- 1) Initial Trustee Orientation: Small 3-hour sessions with 3-4 Board members each, starting in May.
- 2) Quarterly SDCERS in Focus: one-hour focused presentations to full Board
- 3) Regular Board member attendance at educational seminars and conferences (e.g. Wharton, Stanford, CALAPERS).

Motion to approve training recommendations, to include Stakeholder representatives and committee members, passed unanimously (5 - 0)..

NEW BUSINESS: 2.A.3 – DEVELOPMENT OF ANNUAL STRATEGIC PLANNING SESSION

Bob Wilson, Acting SDCERS Administrator, recommended that the SDCERS Board hold a yearly strategic planning session, to establish goals for the year. It would be the same time each year, at the end of the calendar or fiscal year.

One question was raised, asking if staff isn't responsible for planning. Wilson answered that it was a collaborative effort.

Motion to approve passed unanimously (5 – 0).

NEW BUSINESS: 2.A.4. – EXECUTIVE REPORTING STRUCTURE TO BOARD

Harvey Leiderman gave three proposals for organizational reform:

- 1) Effective administrative oversight and reporting channels (how the Board receives information is usually personality driven).
- 2) Create a compliance officer function
- 3) Establish internal audit function.

1. Effective administrative oversight and reporting channels (Independent Chief Investment Officer)

Leiderman said that the Chief Investment Officer (CIO) should report directly to the Board – not to the Chief Administrator, because MPI and MPII significantly underfunded the pension fund and therefore stripped base for long term investment earnings.

The Board has authority over investment assets, and therefore CIO should report directly and independently to Board.. The CIO is almost co-equal with administrator, and would provide a reality check on use of “Surplus Earnings.” CIO knows importance of retaining and investing funds.

Doug McCalla, Director of Investments, was asked his views. He said that the current reporting situation has worked well, and left him free to concentrate on investments.

Mark Sullivan asked who would want job of Administrator if he had no control over the biggest

function – investments. SDCERS is having an administrator as is.

Motion to approve having the CIO report directly to the Board failed 2 (yes) – 3(no).

2. Chief Legal Officer/Compliance Officer

Leiderman said the General Counsel is the legal advisor to the SDCERS Administrator, and has an ethical obligation to clients. The General Counsel should be designated the Compliance Officer. He said the Board that considered MPII had only one source of information – the Administrator.

(Note: At this point in the discussion, I commented that the SDCERS Board also had recommendations from outside fiduciary counsel, Bob Blum, on MPII. He first recommended against MPII, but later approved it.)

Motion to have general counsel be the compliance officer passed 5 - 0.

3. Internal Auditor

Leiderman recommended establishing the position of SDCERS Internal Auditor, under the supervision of the newly-constituted Audit Committee. This is consistent with corporate ‘best practices.’

Motion to approve the position of SDCERS Internal Auditor passed 5 - 0.

ADJOURNMENT:

The meeting was adjourned at approximately 4:00 p.m. Next meeting is scheduled for May 17, 2006 at 1:00 p.m. (meeting date changed from May 10, 2006).