

SDCERS NAVIGANT REPORT COMMITTEE/STAKEHOLDER MEETING

August 16, 2006 - Meeting Notes by Virginia Silverman

INTRODUCTION/PRELIMINARY

Committee members in attendance: Mark Sullivan (Chair), Richard Kipperman, Thomas Hebrank, William Sheffler, and Wayne Kennedy.

The (only) stakeholder representative in attendance was Virginia Silverman, representing CSDREA.

Chairman Mark Sullivan stated that this would be the last meeting of the Navigant Report Committee, and provided some perspective on the committee. He commented that it began seven months ago with a simple objective: to take the recommendations of the Navigant Report seriously, and to implement them as expeditiously as possible. Sullivan said that some objectives have already been achieved; that (for example) activities are now more transparent,

Sullivan said that all discussion on the Navigant Report would be henceforth transferred to the Business and Governance Committee (which meets on the third Thursday at 8:30 a.m.)

PUBLIC SPEAKERS

Patti Karnes, CSDREA Board Secretary, spoke as an individual to urge the board to require that a full and complete tally of the annual required contribution be presented to the SDCERS Board by the actuary. She also stated that SDCERS should not rely on investment earnings to make up the unfunded liability (as the actuary had suggested could happen).

DISCUSSION AND DEVELOPMENT OF POLICY TO ENSURE SOUND ACTUARIAL FUNDING

This review was presented by Michael Jimenez of Marathon Communications (SDCERS consultants). Jimenez reviewed that applicable laws governing actuarial policy for municipalities (Federal laws including ERISA and the IRS Code, Sec. 401(a) and 420(e)(2) -- California constitution and laws; California court precedents -- San Diego City Charter and Municipal Code -- GASB policies, especially GASB Statement NO. 25 -- and the Actuarial Standards Board.)

Recommendations on Actuarial Policy

Jimenez also reviewed the recommendations regarding actuarial policy in the reports by Navigant, Kroll and the Pension Reform Committee, as follows:

1. Re-evaluate SDCERS Board Committee Structure:
Both Navigant and Kroll recommended changes to the SDCERS Board committee structure, to improve planning, performance assessment of staff, financial reporting and internal controls. SDCERS has already reorganized its committee structure to better meet the recommendations.
2. Actuary Should Deliver the Annual Actuarial Valuation report in open session and comment on the conclusions, and that a formal billing to the City should be presented each year.
The open session rule has already been put into effect, with the recent actuarial valuation report by Cheiron.

3. The SDCERS Actuary should provide a written report in year in conjunction with its actuarial valuation,

The report should discuss actuarial requirements under federal, state and local law. The report should provide for projected assets, liabilities and contributions, and any benefit increases granted over the five- year valuation period.

4. Develop a reasonable definition of Actuarial Soundness and an approach for periodic assessment of the definition as it applies to SDCERS

Jimenez commented on Proposition G, which was recommended by the PRC and approved by the voters in 2004. Proposition G is scheduled to become effective in FY 2008, and requires an amortization (payment) schedule no greater than 15 years and payment of past liabilities for new benefits over no more than five years. He said that the California Constitution vests authority in the SDCERS Board to decide the amortization schedule, confirmed by the Attorney General's letter, and that it is not mandatory to follow Proposition G.

5. Actuarial independence: SDCERS should insure that actuary shall be free from influence.

The question was raised if this requirement can be monitored? The Kroll Report recommended that the actuary contract be rebid every five years, with a maximum of two five-year terms Annual certification was suggested. William Sheffler also suggested that the actuary contract go out to bid every five years. (The Cheiron contract is for a three year period, with one five-year extension possible.)

DISCUSSION/COMMENTS

Amortization of investment returns:

Doug McCalla (SDCERS Chief Investment Officer) spoke to the issue of amortization of investment returns. He said that if the 15 year schedule is adhered to, the schedule for amortizing surpluses should exceed that 15 year schedule, so surplus earnings won't be used to reduce employer contributions.

Compliance with Actuarial Standards:

William Sheffler said that actuarial standards have a lot of wiggle room, such as 'normal cost' (which for SDCERS excludes the Corbett Settlement). He said that much narrower definitions are needed. He also said that there should be a policy that says "No negative amortization." Wayne Kennedy suggested that general policies could be approved, with more detailed guidelines approved for each policy (presumably placed into the SDCERS Board Rules).

Investment Assumptions vs. Actuarial Assumptions:

Doug McCalla said that investment assumptions need to be integrated and compared to actuarial assumptions.

Richard Kipperman said that they are two different crystal balls, with different numbers at times. How are they reconciled?

Michael Jimenez said something could be put in the actuarial policy to re-evaluate when investment and actuarial numbers differ.

William Sheffler said it is better to recalculate based on actuarial experience (wages, deaths, turnover, etc.), rather than on future assumptions.

April Boling said the policy should be positive -- what SDCERS is going to do to assure that the money for retirement is in the plan by the time an employee retires.

Sheffler commented that when extraordinary contingencies or events occur, there is a lot of publicity, which tends to justify violating own standards to meet the contingency.

Thomas Hebrank asked if there are examples of actuarial mistakes. Jimenez replied that MP1 was an example of how actuarial assumptions can be skewed. The SDCERS Board asked for some

information, but not other information, resulting in an actuarial assumption to favor a point of view. The Board ignored some things they should not have.

An additional comment was that there should be a stress test of assets and liabilities under future risk scenarios.

Actions/Events Outside the Actuarial Goal Posts

Doug McCalla listed several actions or policies that have been 'outside the goal posts' for sound actuarial policy:

- 1) Changing the amortization (payment) schedule to meet the City's cash problems.
- 2) Legal or other contribution agreements which fix contribution rates.
- 3)
- 4) The Waterfall -- the mechanism to pay benefits. The problem was (and still is) a failure to include these payments in the actuarial assumptions.
- 5) Reserve accounts used to pay some obligations. All should be ended, funds transferred to transferred to pension fund.

Setting of Contribution Rates

William Sheffler asked if employee contributions are correct (in conformance with the City Charter).

April Boling (Chair of the Pension Reform Committee) said that the flat dollar amount used to set the City contribution requirement was based on a payroll two years old. Therefore, the payroll rates used will not generate the dollar amount required (it will be either over or under). She said there should be a transparent rate-setting process (General discussion followed on setting a dollar amount versus a percentage of payroll.)

Support for Proposition G (15 Year Amortization Schedule)

Virginia Silverman spoke as an individual in support of Proposition G. She said that the CSDREA Board had discussed this issue, but had taken no position at this time, and that some board members were concerned that Prop. G would force the City into bankruptcy.

Virginia cited two reasons for supporting Proposition G: 1) The city has underfunded the pension fund for over fifteen years, and will not increase funding unless it required to do so. Meanwhile the unfunded liability of the pension fund continues to increase under current payments. Adoption of Proposition G would stop this. 2) Public confidence and trust in the City and the Retirement System (and including employees and retirees) as at an all time low, and if the will of the voters in approving Prop. G is ignored by the SDCERS Board, the cynicism will increase. It is important to keep faith with the voters.

APPROVAL OF ACTIONS/ADJOURNMENT

1. Policy for Sound Actuarial Funding

This was a discussion-only item, and no action was requested. The Business and Governance Committee may continue this discussion, and/or the full SDCERS Board will ultimately approve the policy.

2. Carry Over All Remaining Items from Navigant Report to Business and Governance Committee.

This action was approved unanimously. The next meeting of the Business and Governance Committee will be on September 14, 2006 at 8:30 a.m.

The meeting was adjourned at approximately 3:30 p.m.

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