

**PATTI'S NOTES from
SDCERS BOARD MEETING and Business & Governance Committee
December 14-15, 2011**

This is my impression of the meetings.

Thanks to SDCERS CEO Mark Hovey for reviewing my notes for factual errors before they go to REA retirees' web site.

See SDCERS web site for official information.

www.sdcers.org

2012 SDCERS Meetings (approximately ever 6 weeks):

Jan. 20, Mar. 2, Apr. 13, May 18, June 29, Aug. 10, Sep. 21, Nov. 2, and Dec. 14.

June 30, 2011 VALUATION with funded ratio and ARC

SDCERS' actuary Cheiron is working on the Valuation based on assets as of June 30, 2011, and it is expected to be presented at SDCERS January 20th Board meeting.

SDCERS ASSETS

EXECUTIVE SUMMARY OF STAFF REPORTS:

"The value of the reconciled net invested assets as of October 31st, as reported by the custodial bank, was \$5,104,279,419."

DROP RATE CHANGES APPROVED. See website.

Active DROP Participation Accounts - 1.9%.

Retired Annuity rate - 4.45%.

Effective Jan. 1, 2012.

Trustee Herb Morgan noted other rate changes are set by the Board consistent with the Municipal Code requirements but that the Board has more discretion in setting DROP rates.

TRUSTEE NEWS

As Ray Ellis is running for City Council, he resigned from the Board and turned over the SDCERS Board presidency to Trustee Herb Morgan, effective January 2012.

Retiree and former Trustee Joe Flynn noted a trustee needed patience, thick-skin, and firm resolve. Flynn thanked Ellis for always making him smarter. CEO Mark Hovey and Board members recognized Ellis' for his collegial talents from October 2008 to December 2011. Hovey said Ellis had done an excellent job in leadership and mentoring. Trustee Richard Tartre noted the pension meetings don't have to be somber and he appreciated Ellis'

graciousness and respectful style in handling meetings. He added that Ellis was very effective in easily dealing with members and their families and keeping meetings moving forward. Trustee Dick Wilken concurred that Ellis' temperament was even-keeled.

Ellis thanked everyone for allowing him to be on the team: Mayor Sanders for the appointment and the approval from two City Councils, as well as SDCERS staff for their patience in explaining the complex pension system.

Ellis directed the Board to try to resolve legal issues to protect members and tax payers, to continue to recruit talented trustees and fiercely protect the pension system's independence. And he encouraged retirees Joe Flynn and Patricia Karnes to continue making helpful comments to the Board.

Hovey said that with luck, the City Council will approve a new mayorial appointee to the SDCERS Board by the January 20th meeting.

COMMENT ON CITY and OUTSIDE AUDITS

Trustee Greg Bych said it was amazing to see only minor fine tuning after the City and MGO audits of SDCERS.

BOARD RESERVED RIGHT TO CHALLENGE THE CITY COUNCIL'S ORDINANCE O-20085 RESTRICTING SDCERS RIGHT TO DO SETTLEMENTS

Under Board Resolution 2011-02, SDCERS Board documented the Board's right to challenge this restriction in the future. The Board's plenary authority covers decisions relating to settlement of claims and lawsuits.

SDCERS DEATH BENEFITS FACT SHEET (revised)

Trustee Alan Arrollado noted the new SDCERS death fact sheet is outstanding. Thanks go to Robyn Bullard for coordinating the project.

COMPREHENSIVE ANNUAL FINANCIAL STATEMENT

This CAFR will be posted on SDCERS website.

Marilyn Brown, Chair of SDCERS Audit Committee reported that SDCERS independent outside auditor MGO (Macias Gini & O'Connell) had given SDCERS an unqualified approval opinion with no reportable findings and no recommendations. There were notes on SDCERS funding level.

CITY AUDIT OF SDCERS: LEGAL COSTS, ETC.

SDCERS Internal Auditor Bob Wilson will monitor and report in the future on the status of 6 remaining City auditor recommendations out of 10

recommendations, according to Marilyn Brown, Chair of SDCERS Audit Committee, which will meet again April 11th.

High costs on page 3 of the Sept. 2011 Performance Audit: “Expenses are higher than peers largely due to litigation and efforts to correct prior, well-publicized problems that enabled the City to underfund the pension for years. SDCERS’ trustees also adopted more conservative actuarial assumptions in the past five years to be more in line with peers, after previously using methods that were not in line with industry standards.”

Page 4: “...ensuring independence and transparency has been critical for SDCERS in order to address prior issues and to restore the public’s faith in the system.”

Funding ratio on page 5: “...the City’s retirement plan has the lowest funding ratio of any of its peers and that its fiscal year 2010 ratio was below what many experts consider to be adequate.”

“The City now has one of the highest employee and employer contribution rates compared to other systems.”

“While less conservative assumptions and methodologies may result in lower payments today, it essentially shifts funding the retirement plan to future generations of employees and taxpayers.”

On page 58, “In addition, a June 2011 study by the National Institute on Retirement Security found that the funding ratios of systems that were not well-funded prior to 2008 only further deteriorated as a result of 2009 economic downturn.”

Page 60: “The normal cost is essentially the annual payment amount that, when combined with the members’ contributions, will accumulate to the amount necessary to fund retirement benefits. The majority of the City’s ARC payment is related to the UAL- \$168 million (72 percent) versus \$63 million (28 percent) for the normal cost....the UAL comprised more of the City’s ARC payment than any other system.”

Benefit level on page 7-8: “In fiscal year 2010, retirees received an average annual benefit of \$40,029.”

City budget on page 8: “...the City’s costs for retirement benefits comprised 20 percent of the City’s fiscal year 2011 General Fund - 16 percent for the ARC payment and 4 percent for retiree health care.”

Fiduciary definition on page 10: “Fiduciary responsibility requires that the Board act, first and foremost, in the members’ interests, rather than in their own self-interest or the interests of the plan sponsors or the taxpayers at large.”

Legal costs on page 24: “...outside legal costs are one of the largest expenses for SDCERS, comprising 20 percent (\$2.94 million) of their fiscal 2010 expenses....Costs related specifically to litigation accounted for close to 60 percent of SDCERS’ total outside legal costs.”

Rent on page 31: “...SDCERS does not own its building....San Diego’s real estate market is generally more expensive....” and the location “affords convenient access for its members and for staff who need to frequent City Hall.”

I.T. costs on page 33: “...SDCERS largely maintains independent IT operations from its plan sponsors...”

“Specifically, we found that SDCERS maintains one of the most user-friendly websites of any of its peer systems. SDCERS also televises its full board meetings and makes video recordings available on its website to ensure decisions are fully transparent.”

On page 35: Five positions are expected to be eliminated with the new software (being installed in 2011- January 2014 for San Diego’s complex pension design), based on operational issues that were identified in 2009 by SDCERS’ consultant.

Actuarial costs on pages 33-34: Actuarial work for litigation accounted for \$170,000 of fiscal year’s \$565,000 actuarial fees.

Hovey noted in his follow up letter to the auditor that a RFP seeking new bids is in progress. CFO Bob Buscher wrote that a second RFP will be issued by the end of December.

Footnote on page 53 notes “SDCERS issued a RFP for actuarial audit services in 2010; however, they were unable to identify a firm.”

(Patti remembers that SDCERS’ previous actuary was sued and this, as well as on-going litigation by the City vs. SDCERS, did not result in enthusiastic responses.)

FIDUCIARY INSURANCE and AUDIT

In his letter responding to City Auditor Eduardo Luna’s audit findings of SDCERS, SDCERS CEO Mark Hovey pointed out there is no current legal way for SDCERS to self-insure and the “...City Attorney recommended to the

City Council at its March 9, 2011 council meeting not to afford any additional fiduciary protection to SDCERS Trustees other than that already provided by California Government Code 995.”

Conflicts: Also in his letter, Hovey pointed out the conflicts of the City determining when and what coverages it would provide. Hovey noted. “A process using an independent third party to value the City’s determination...would provide no greater comfort to a Trustee than what is currently present unless the third party determination was quick and binding on the City, but not the Trustee.”

Page 28 of the audit: “...if the City brings a civil action against the board members, a conflict of interest may exist and the City would not be required to provide legal defense and indemnity...SDCERS ...has a contentious history with the City Attorney’s Office and City Officials, and trustees fear that the City will not defend and indemnify them. Moreover, in the recent past, the City has brought civil action against individual board members and refused to pay their attorney fees.”

As a result, SDCERS will pay out \$595,000 for annual insurance.

(Patti notes that this is money that will not be available for investing.)

CITY AUDIT and Income Related Monthly Adjustment Amount (IRMAA) for Medicare Part B

Page 43: “Retirees earning less than \$85,000 annually (or \$170,000 if taxes are filed jointly) only pay the standard Medicare Part B premium...” reimbursed by the City.

The auditor questions if the City should reimburse retirees charged the higher Medicare Part B under the federal Income Related Monthly Adjustment that was started in 1997.

On page 5 of the audit report: “...this benefit is not explicitly defined in the Municipal Code.”

In his written response, wearing his City Risk Management hat, Gregory Bych, who received guidance from the City Attorney’s office when the IRMAA premium first went into effect, noted that the income-related-monthly-adjustment-Medicare Part B was created after the City Charter was written and it has been paid as any other City Medicare Part B benefit.

Page 44-45: The audit report recommends “...the City Attorney’s Office analyze whether the City was legally obligated under the Municipal Code to

reimburse IRMAA in addition to the Part B standard premium. If it finds that the City was never obligated to pay the benefit, the City Attorney's Office should determine whether the City can legally discontinue reimbursing current retirees' IRMAA premiums on a go-forward basis, or if it would now be considered a vested benefit pursuant to the City Attorney's January 2010 opinion on pension and OPEB benefits." (Footnote 26 notes that Opinion Number 2010-1 in January 2011 says retiree healthcare is a vested benefit.)

Trustee Dick Wilken is following this issue.

CITY AUDIT and outside income for Disability retirees.

The City Auditor is also asking the City Attorney to review the possibility of off-setting the City's disability pensions if there is outside income. Mr. Bych noted that the City negotiated off-sets away in the past.

NEW RETIREMENTS BY APRIL 1st?

Seven retirement seminars have been held for an expected 250 possible retirements that would need to be processed and approved before the City's new healthcare changes go into effect on April 1st. More seminars are being planned. While SDCERS is still offering individual counseling sessions, the seminars improve speed and efficiency in follow-up one-on-one retirement appointments, according to Salam Hasenin at the Business & Governance Committee.

SDCERS General Counsel Elaine Reagan announced the City and SDCERS are working together to send letters out to age-eligible deferred vested members regarding the deadline and their choices.

PSC CORRECTION

Also at the Business & Governance Committee, Chief Financial Officer Robert Buscher reported SDCERS was down to working out complex problems and coordinating payments.

SDCERS COMPUTER UPDATE PROJECT

Projects are going well. Chief Information Officer David Bond is doing an exemplary job, even with competing efforts by SDCERS staff to complete the PSC corrections. SDCERS completed migration off the City's mainframe early.

Trustee Patrick Lane noted that 2% of City payroll information is not automated and that keeps members from being able to automatically do calculations on SDCERS web site.

Bond continues to work with the City on the impact on SDCERS of possible outsourcing of SDDP, and coordination of employer reporting numbers to SDCERS, especially implementing processes for the new healthcare choices.

LEGAL CASES- PSC Court dates

Abitria v. SDCERS (Ann Smith) 1-31-12 Hearing on Demurrers.

Baidya v. SDCERS (Michael Conger) 1-27-12 Hearing on Demurrers.

Lenhart v. SDCERS (Michael Conger) 2-3-12 Hearing on Demurrers. City Safety members.

INVESTMENTS

Chief Investment Officer Liza Crisafi noted that SDCERS may be re-balancing international equities soon.