MEETING

STATE OF CALIFORNIA

PUBLIC EMPLOYEES' RETIREMENT SYSTEM

BOARD OF ADMINISTRATION

FINANCE & ADMINISTRATION COMMITTEE

ROBERT F. CARLSON AUDITORIUM

LINCOLN PLAZA NORTH

400 P STREET

SACRAMENTO, CALIFORNIA

TUESDAY, AUGUST 18, 2015

9:27 A.M.

JAMES F. PETERS, CSR
CERTIFIED SHORTHAND REPORTER
LICENSE NUMBER 10063

APPEARANCES

COMMITTEE MEMBERS:

Mr. Richard Costigan, Chairperson

Ms. Dana Hollinger, Vice Chairperson

Mr. Richard Gillihan, also represented by Ms. Katie Hagen

Mr. J.J. Jelincic

Mr. Henry Jones

Mr. Bill Slaton

Ms. Betty Yee, represented by Mr. Terrence McGuire

BOARD MEMBERS:

Mr. Rob Feckner, President

Mr. John Chiang, represented by Ms. Christina Elliott

STAFF:

Ms. Anne Stausboll, Chief Executive Officer

Ms. Donna Lum, Deputy Executive Officer

Ms. Cheryl Eason, Chief Financial Officer

Mr. Matthew Jacobs, General Counsel

Ms. Carrie Lewis, Committee Secretary

Mr. Anthony Suine, Chief, Benefit Services Division

Mr. Wylie Tollette, Chief Operating Investment Officer

ALSO PRESENT:

Mr. John Jensen

I N D E X

P R O C E E D I N G S

CHAIRPERSON COSTIGAN: I'll call to order the August meeting of the Finance and Administration. Could we start first with the roll.

COMMITTEE SECRETARY LEWIS: Richard Costigan?

CHAIRPERSON COSTIGAN: Here.

COMMITTEE SECRETARY LEWIS: Dana Hollinger?

VICE CHAIRPERSON HOLLINGER: Here.

COMMITTEE SECRETARY LEWIS: Richard Gillihan?

CHAIRPERSON COSTIGAN: Oh, he's here.

COMMITTEE SECRETARY LEWIS: J.J. Jelincic?

COMMITTEE MEMBER JELINCIC: Here.

COMMITTEE SECRETARY LEWIS: Henry Jones?

COMMITTEE MEMBER JONES: Here.

COMMITTEE SECRETARY LEWIS: Bill Slaton?

COMMITTEE MEMBER SLATON: Here.

COMMITTEE SECRETARY LEWIS: Terry McGuire for Betty Yee?

ACTING COMMITTEE MEMBER McGUIRE: Here.

CHAIRPERSON COSTIGAN: All right. Okay. Ms. Ease, I think we are going to jump to the item that we had noticed for 9:00 a.m. and then come back to your Executive Report, if that is okay.

CHIEF FINANCIAL OFFICER EASON: That's fine. Thank you.

CHAIRPERSON COSTIGAN: Thank you.

All right. Good morning, everyone. I'm going to read a little statement, so I apologize for looking down instead of looking up at the audience, but we need to get this into the record.

We are going to now move to Agenda Item 5, which is the final proposed regulation for payment of interest and public hearing. We'll start with and introduction of the agenda item by program staff and then move to the public hearing itself.

I'll turn this over to staff now.

DEPUTY EXECUTIVE OFFICER LUM: Good morning, Mr. Chair, members of the Finance and Administration Committee. I'm Donna Lum, CalPERS staff. And joining me today is Anthony Suine, CalPERS staff.

Agenda Item number 5 is an action item. And staff recommends that the Finance and Administration Committee approve the submission to the Office of Administrative Law the proposed regulation establishing the rules and procedures by which interest payments would be made to a defined benefit participant when a defined benefit plan has delayed payment in the correct amount owed to the participant beyond a reasonable administrative processing time.

As a reminder, the interest regulation defines the circumstances underwhich interest should be included to retroactive payments that have been underpaid or otherwise delayed by a reasonable -- beyond a reasonable administrative time, which in the proposed regulations is established at 90 days. And it identifies those situations where interest may not be accrued.

The regulation defines the interest rate to be paid at seven percent, which is consistent with the prejudgment rate of interest paid in court cases, where interest is deemed to be due.

At the April 2015 Board meeting, the Board approved to begin the rule-making process, and a Notice of Proposed Regulatory Action was filed with the Office of Administrative Law and a 45-day comment period began on May 8th and was closed on June 22nd, 2015.

A total of four comments were received. Three of the comments were administrative in nature. One comment was a 21 -- or, excuse me, a 61-page comment submitted by attorney John Jensen.

In general, the 61-page comment letter contends that the regulation raises a vested right impairment, that it is not within CalPERS authority to promulgate, and that it is inconsistent with existing law. CalPERS staff considered the comments and is not recommending any changes as a result.

The primary benefit of approving this regulation is to provide clear and transparent guidelines for staff and participants of the defined benefit plans administered by the Board.

Given the time certain for this hearing, I would like to turn it now back over to the Committee Chair to begin the hearing process and Mr. Suine and I will be available for questions after.

CHAIRPERSON COSTIGAN: Okay. Thank you. All right, if you all will bear with me for a couple moments, as I read the following statement:

We are going to now move to the public hearing. It is 9:31 a.m. on August 18th, 2015. We are located in the auditorium at CalPERS Headquarters, Lincoln Plaza North, Sacramento, California. This is the time and place which has been noticed for public hearing on the proposed adoption of the amendments to Section 555.5 of Chapter 2 of Division 1 of Title 2 of the California Code of Regulations.

The proposed regulation would establish rules and procedures by which interest payments would be made to a defined benefit plan participant, when a defined benefit plan has delayed payments in the correct amount owed to a participant beyond a reasonable administrative processing time.

This hearing is being transcribed for the administrative record. I am Richard Costigan, Chairman of the CalPERS Finance and Administration Committee. Before the Committee opens the floor to accept public testimony and comment on the proposed regulations, I would like briefly to go over some of the rules governing the rule-making process.

The Committee will listen attentively to any testimony which is presented. And all comments which are received today will become part of the rule-making file. Comments received at this hearing, as well as written comments received during the public comment period, will be responded to in writing in the rule-making file.

The rule-making file is a public record, and is open for public review during the rule-making process. Should you wish to review the rule-making file, you can make an appointment to do so by contacting our Regulations Coordinator, Anthony Martin at (916)795-9347.

If you wish to speak at this time, and have turned in a speaker form, you will be recognized in the order your forms were received. If you have not submitted a form or would prefer not to, you will be given an opportunity to speak after the last speaker has completed his or her comments.

Speakers will be given three minutes to present their testimony. Requests for additional time may be granted at the discretion of the Committee Chair. The record of this hearing will close at the completion of the last speaker's presentation. We request that each speaker begin providing his or her name and affiliation for the record.

The purpose of this public hearing is to allow the public to present testimony regarding the proposed regulatory action. The Committee is not required to respond to these comments during the hearing, rather all comments must receive a response from CalPERS as part of the final rule-making file.

Does anyone wish to speak on this matter at this time?

And I believe we have one person listed, is that correct?

MR. JENSEN: It's probably me.

CHAIRPERSON COSTIGAN: All right. Would John Jensen please come forward.

MR. JENSEN: Where should I come?

CHAIRPERSON COSTIGAN: Just come up to the dais please.

MR. JENSEN: Good morning.

CHAIRPERSON COSTIGAN: Hang on a second. You've got to sit down. You've got to push the microphone.

MR. JENSEN: Thank you. Do I turn this on?

CHAIRPERSON COSTIGAN: They'll turn it on for you and you will have three minutes once the clock starts.

MR. JENSEN: Great.

CHAIRPERSON COSTIGAN: Are we ready, Pam?

MR. HOPPER: Yes.

CHAIRPERSON COSTIGAN: Okay. Please, have a seat. You don't have to stand.

MR. JENSEN: It's okay if I stand.

Good morning, and thank you for listening to these comments. I am John Jensen, and I am the attorney who represents the eight named class representatives in the class, which we believe contains hundreds of thousands of people that have been delayed payments. And these are -- some of these people are people that have been not paid -- that are widows that haven't been paid death benefits for as much as six months, and they haven't received any funding.

And so what we're asking is we're asking for you to consider the comments that we've made in this -- against this proposed regulation.

The Kesterson case requests that CalPERS pay interest on delayed payment of matured benefits pursuant to the Civil Code 3287. And the relief that we seek in this class action is larger -- in the filed class action, which has been pending for three years, is larger than the relief that could be provided under this regulation.

And so I direct my comments to the regulation, but I want you to realize that this regulation has been proposed in response to this large class action about all of these members that have vested rights to payments that have been delayed. And so my main issues with this regulation is that it's contrary to the existing law about the vesting of pension benefits, and about when interest is due.

Now, the standard which I think most of you are familiar with, is that service pensions vest during employment, and they mature upon the filing of an application. They're due in full in the first warrant after that application has been paid -- has been filed for service benefits.

Now, I also want you to recognize that the Supreme Court three weeks ago took up for review the case called Flethez, which will determine when interest is due on payments of industry disability and ordinary disability.

And the Supreme Court is currently reviewing in Flethez the Weber case, which is one of the foundations of this regulation. And so I respectfully would defer to the Supreme Court myself, and we've actually sought to sever that part of the case and stay it, while that Supreme Court is determining what the law is. But I think it would be at least within prudence to delay this regulation until the Supreme Court has decided this Flethez case.

But I just want to address one other issue about this regulation, which is particularly troublesome. And I would request some additional time.

CHAIRPERSON COSTIGAN: Mr. Jensen, your time is about to expire. I'll give you an additional two minutes and that will be it.

MR. JENSEN: Thank you, Chairman.

The main problem -- well, one of the main problems I have with this is that this regulation seeks to disenfranchise CalPERS members from doing class actions for benefits. This regulation seeks to require each individual person to go through an administrative process, each individual to get a proposed decision. There are hundreds of thousands of people. I know you guys -- excuse me, and gals, go and approve these proposed decisions. But this regulation that was drafted in response to try to negate this class action requires everyone of those individuals to go through an administrative process.

And for those of you who are representing unions, and appreciate the value of collective action and class actions, I think it would be important to recognize that collective action and class actions is a fundamental right under law, and it should not be denied to CalPERS members within delayed payments, simply because there's this regulation that's interposed.

And that brings the last sort of kind of legal issue. And it's about the proposed retroactivity of this regulation. This regulation is -- my understanding is that this regulation is partially sought to go and change the vested property rights of those individuals in this class action that was filed three years ago.

And retroactive changes in property rights are unconstitutional. And you can't take the rights of a prompt payment to these individual members and interest that rose -- that goes on with that obligation to make a prompt payment and then take it away retroactively from them by regulation. It's just -- it's problematic on many levels.

So I just request that -- I mean I could speak to you much longer. I have eight more seconds, but this is fundamentally flawed and it's to the detriment of the people that are the beneficiaries of CalPERS.

CHAIRPERSON COSTIGAN: Thank you, Mr. Jensen. And also thank you for your 61-page submission. We appreciate that.

MR. JENSEN: Thank you very much.

CHAIRPERSON COSTIGAN: I do believe, Pam, we have no other speakers at this time?

MS. HOPPER: No.

CHAIRPERSON COSTIGAN: All right. I believe -- thank you.

MR. JENSEN: Thank you very much.

CHAIRPERSON COSTIGAN: So no one else wishes to speak. So at this time, there being no further testimony on this matter, the record of this hearing is now closed, and this hearing is adjourned.

The time is 9:40 a.m.

So, at this time, are there any Committee members who wish to speak?

I don't see any. I heard there might -- there we go.

Mr. Slaton.

COMMITTEE MEMBER SLATON: Thank you, Mr. Chair. Are we now considering the --

CHAIRPERSON COSTIGAN: Yes, I'd like to entertain a motion on staff's recommendation.

COMMITTEE MEMBER SLATON: Okay. Well, I'm -- then I'm not going to -- I am going to speak, but I am not going to make the motion.

CHAIRPERSON COSTIGAN: Do you have other

comments?

COMMITTEE MEMBER SLATON: I do, but I'll wait.

CHAIRPERSON COSTIGAN: Okay. All right. We'll have a substitute motion.

Mr. Jones.

COMMITTEE MEMBER JONES: Yeah, I move staff's recommendation.

CHAIRPERSON COSTIGAN: All right. It's been moved by Mr. Jones. Seconded by?

VICE CHAIRPERSON HOLLINGER: Second.

CHAIRPERSON COSTIGAN: The Vice Chair.

Any comments on the motion?

Is that why your mic is on?

COMMITTEE MEMBER SLATON: Yeah.

CHAIRPERSON COSTIGAN: Mr. Slaton.

COMMITTEE MEMBER SLATON: Yeah. Thank you. I understand all the effort that's gone into this. My concern is the 90 days, and I think I've spoken to staff about this. I think 45 days is a more reasonable time. I don't know about the sequence of the process that we're in, whether it's too late to make that kind of an adjustment.

But to me, I spent a good bit of my career working on leases with the State of California. And we were able to get -- when payments were not made promptly, we were able to get penalty or interest payments, and that was just part of the process. And I think that I am sensitive to the issue that we have people who are relying on payments. And while we do our best, I'm sure staff does its best, to get things processed and get the documentation they need to be able to do that, that we ought to be paying quicker than 90 days. So I'm -- I'm not in favor of the motion as it currently is.

CHAIRPERSON COSTIGAN: Okay. So before we ask whether you want a substitute motion, I'd like to ask staff is there an issue, from a either rule-making process or comment process, from reducing the time from 90 to 45 days?

DEPUTY EXECUTIVE OFFICER LUM: If a substitute motion is made to reduce the time -- or to change the time from 90 to 45 days, the Committee can take action on the substitute motion. If it is approved, then we would go back out in public comment and post the change for 15 days. It would not have to go through a 45-day posting period. Depending on the comments that we receive during that 15-day time period, it would determine whether or not an additional public hearing would be required or requested.

COMMITTEE MEMBER SLATON: So before I --

CHAIRPERSON COSTIGAN: Before you make your substitute motion.

COMMITTEE MEMBER SLATON: Before I make a substitute motion, I have one question for staff.

CHAIRPERSON COSTIGAN: And I'm asking counsel if they could actually come up to the dais.

Yes, Mr. Slaton.

COMMITTEE MEMBER SLATON: So we'll hear from counsel, but I have a more practical question, and I asked this during briefing. What's the financial implication of it being 45 days? I know you're talking about more payments being made, but the question that I have is what's the financial implication if you went back in history and evaluated?

BENEFIT SERVICES DIVISION CHIEF SUINE: Good morning, Mr. Chair, members of the Committee. Anthony Suine, CalPERS staff. To respond to your question, Mr. Slaton, we looked at -- this regulation is broadly defined to pay interest on all types of delayed benefit payments regardless of complexity. So we felt that 90 days encompassed the complex cases, as well as the easy cases in order for us to get all the information in.

So when we looked at the volume of cases, 95 plus percent of our cases are paid within 45 days without having to look at when that last document came in, and when we had all the information sufficient.

Then we took a look at that data between 45 and 90 days, and the majority still needed additional information. And this is what we will have to administratively review once this regulation is implemented to determine if interest is due. And from that 45- to 90-day period, we reduced the outstanding number that haven't been paid without having to look at anything to less than one percent.

So that's why we chose the 90 day, because then there's just this one percent that we're reviewing for any delays and still determining if we received everything we needed. But again, the majority between that 45 day and 90 still needed a different -- additional information, so we didn't feel that that time frame -- the amount of interest we would pay during that time frame is in the, you know, $10 to $20 range, didn't outweigh that 90-day administrative review time.

COMMITTEE MEMBER SLATON: So if you -- so if you -- if you just assumed that you owed interest on that five percent, the dollar implication of that is?

BENEFIT SERVICES DIVISION CHIEF SUINE:

Unfortunately, I don't have the authority to arbitrarily pay interest. I'm required by the regulation and fiduciary duty to review those to determine.

COMMITTEE MEMBER SLATON: To review it.

BENEFIT SERVICES DIVISION CHIEF SUINE: So I can't just arbitrarily make that decision and pay everything.

COMMITTEE MEMBER SLATON: And the workload of that review, the number of cases?

BENEFIT SERVICES DIVISION CHIEF SUINE: You know, it's not necessarily outweighing the interest that would be paid.

COMMITTEE MEMBER SLATON: So you're saying it's a -- I'm trying to get to the workload now, because you can't -- right?

BENEFIT SERVICES DIVISION CHIEF SUINE: For instance, looking at a specific quarter that we recently had, we had over 7,000 retirement payments. A little -- between three and four percent of those exceeded 45 days. So that's a couple hundred, between 200 and 300. And then we were able to reduce that to less than 50 after 90 days. So we'd be taking a look at 200 to 300 cases, the majority of which still needed additional information before being able to pay that benefit, as opposed to less than 50 after the 90 days.

COMMITTEE MEMBER SLATON: Well, unless counsel has a comment, if there's a legal issue here, or is it just the workload issue?

GENERAL COUNSEL JACOBS: No, I think it's a workload issue only. We're not aware of a legal issue and I think Ms. Lum has correctly stated the administrative process for this regulation.

COMMITTEE MEMBER SLATON: Well, I would make the substitute motion that it be 45 days.

CHAIRPERSON COSTIGAN: I just want to ask a couple follow-up questions before I see if there's a second. Anthony, one of the concerns you would have is that if we don't have the -- for you to guess or to make a determination, or to just go head and make an interest payment, actually would constitute a gift of public funds. And then the question would be reach-back coming back and get it from them.

So we have both the workload -- I understand Mr. Slaton's 45-day fairness. But from a staff perspective, you have looked at it from the case load, the number of individuals that have enacted management issues and all of that. And then it's sort of back if you could maybe expand a little bit on the concern that you raised, which was the ability to go ahead and sort of guess at this point or --

BENEFIT SERVICES DIVISION CHIEF SUINE: Yeah, you're correct, Mr. Costigan. You've identified that clearly. And maybe Matt can opine on the legal issues of not having the authority to pay that.

CHAIRPERSON COSTIGAN: And that's -- and that was the point I just wanted follow up on. All right.

Before we see if there's a second, can we have Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: I had expressed concern about 90 days earlier, as you may recall. But the timeline starts when you have all the documents. So if you are waiting for documents -- so it's 90, or if we adopt the amendment 45 days, after you've received the last document, just so I understand.

BENEFIT SERVICES DIVISION CHIEF SUINE: That's correct.

COMMITTEE MEMBER JELINCIC: Thank you.

CHAIRPERSON COSTIGAN: Okay. So we have a substitute motion from Mr. Slaton. Is there a second?

COMMITTEE MEMBER JELINCIC: I'll second.

CHAIRPERSON COSTIGAN: All right. It's been seconded by Mr. Jelincic that we'll adopt staff recommendation but changing it from 90 days to 45 days.

So we'll start first with a voice.

All those in favor?

(Ayes.)

CHAIRPERSON COSTIGAN: Opposed?

Motion carries.

Thank you very much.

COMMITTEE MEMBER JELINCIC: Just as a parliamentary question.

CHAIRPERSON COSTIGAN: Yes. Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: Just as a point of parliamentary procedure, that was introduced as a substitute motion?

CHAIRPERSON COSTIGAN: It was a substitute motion, so we don't have to go back to the underlying motion.

COMMITTEE MEMBER JELINCIC: No. What a substitute motion does parliamentarily is replace the existing motion with the new one.

CHAIRPERSON COSTIGAN: Correct.

COMMITTEE MEMBER JELINCIC: So we voted to make that replacement. The revised motion, which is now on the floor, has to be voted on.

CHAIRPERSON COSTIGAN: Oh. Let's have another vote.

So Mr. Jelincic, Mr. Roberts Rules of Order, do we need another motion or the other motion is now before us?

COMMITTEE MEMBER JELINCIC: The revised motions is now before us.

CHAIRPERSON COSTIGAN: All right. So all in favor?

(Ayes.)

CHAIRPERSON COSTIGAN: Opposed?

Motion carries.

Did the court reporter get all that?

THE COURT REPORTER: Yes.

CHAIRPERSON COSTIGAN: Thank you.

All right, Ms. Eason, you're back up. We're back on track. Thank you every one. Back to the executive report.

CHIEF FINANCIAL OFFICER EASON: Thank you. Good morning, Mr. Chair, Committee members. Cheryl Eason, CalPERS staff. I'll keep my comments brief. I just wanted to draw your attention to the first reading of the Treasury Management Reserve Policy the last item on the agenda today. The Reserve Policy governs the practices related to the establishment and oversight of the cash reserves that would enable the payment of member benefits and organizational expenses without interruption, regardless of financial markets and environmental conditions. I look forward to a brief presentation on that in a moment.

Looking forward to the October agenda, we'll focus on a number of important items, including the final presentation of the Treasury Management Reserve Policy, as an action item, the CalPERS 2014-16 business plan fourth quarter update and close-out, the annual diversity report, an update on the annual customer service Cost Effectiveness Measurement, or CEM, an update on the my|CalPERS functional optimization, and the Finance and Administration Risk Report.

Thank you, Mr. Chair. This concludes my report. I'd be happy to answer any questions.

CHAIRPERSON COSTIGAN: Okay. I see no questions on that.

Our next item is the action consent item, which is the approval of the May 19, 2015 Finance and Administration Committee meeting.

COMMITTEE MEMBER JONES: Move it.

COMMITTEE MEMBER SLATON: Second.

CHAIRPERSON COSTIGAN: It's been moved by Jones, seconded by Slaton.

All those in favor?

(Ayes.)

CHAIRPERSON COSTIGAN: Opposed?

I can only hear so far out of here.

All right. Next one, Ms. Eason, is the consent, information consent items. Any comments on that? And then our draft meeting agenda for October, any concerns?

Okay. Hearing none.

All right. We took care of Item 5.

Item 6 is information agenda item, Treasury Management, Treasury Management Reserve Policy.

Ms. Eason.

CHIEF FINANCIAL OFFICER EASON: Again, thank you. Cheryl Eason, CalPERS staff.

This is the -- as I mentioned, this is the first reading of the Treasury Management Reserve Policy.

(Thereupon an overhead presentation was presented as follows.)

CHIEF FINANCIAL OFFICER EASON: The policy is a result of a collective effort of the Investment Office, the Financial Office, Benefit Programs Policy, and Planning, and Customer Services and Support areas. Included in the agenda item is a draft policy and an overview. I will focus on the overview presentation, and only on the highlights of the analysis.

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CHIEF FINANCIAL OFFICER EASON: I would also mention at this time that comments were received during briefings that -- to ask to revisit some of the definitions contained in the policy, specifically to include liquidity coverage ratio and pre-funding. And staff will consider that for when the policy is brought back in October for a second reading.

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CHIEF FINANCIAL OFFICER EASON: There's two areas of focus in developing the Treasury Management Reserve Policy. One was the definition of the stressed and crisis event whose risks the Treasury Reserve is intended to mitigate. And secondly, the understanding of the current liquidity cash flows and operational practices to determine the need for a treasury reserve.

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CHIEF FINANCIAL OFFICER EASON: The treasury management reserves for the purpose of this policy is defined as liquid assets dedicated to the payment of member benefits and other obligations during a stressed or crisis event.

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CHIEF FINANCIAL OFFICER EASON: As part of the work done by staff, there were 17 actual -- let me just go back. There were actually 17 actual past stressed occurrences based on several criteria as outlined here. Based on this criteria, the definition of crisis event was determined as a one week, or five business day, market lockup, including business continuity events due to environmental conditions.

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CHIEF FINANCIAL OFFICER EASON: Slide 6 just shows some of the definitions that were used as part of a stressed and crisis event that staff looked at. And included in the appendix are additional examples, but this just helps to illustrate the work that was done in looking at what the market events and how they reacted to stressed and crisis situations.

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CHIEF FINANCIAL OFFICER EASON: So based on that analysis, the next step was to analyze the liquidity in terms of coverage. In other words, how much cash is or can be available in relation to the amount needed to pay benefits within a certain time period?

The liquidity coverage ratio is used and is based on the Basel III banking standards a widely used industry measure. Cash flows from dividends and interest are excluded from the liquidity coverage ratio as they are 100 percent reinvested in the fund.

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CHIEF FINANCIAL OFFICER EASON: This slide just illustrates the actual liquidity coverage ratio formula. And so a ratio greater than one indicates a projection of cash available greater than what is needed to pay our benefit obligations.

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CHIEF FINANCIAL OFFICER EASON: So if you were to look at the liquidity coverage during stressed events, we did a analysis of the PERF, using the stressed simulated stressed event as a basis for the analysis, the conclusion is that we are currently sufficient liquidity to pay member benefits and other obligations without the need for a treasury reserve during stressed market events. So as I mentioned earlier, the stressed market is where you still have access to the markets.

In the analysis, it was then determined that there are three types of liquid asset sources, level one being the most liquid, cash and cash equivalents, which would allow 1.6 times the coverage; Level 2, which is made up of public equity and commodities cash collateral and securities lending cash collateral; and Level 3 limited to public market assets, which could be reasonably converted to cash within five business days.

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CHIEF FINANCIAL OFFICER EASON: The timing of the contributions and distributions play a key role in understanding the impact the crisis would have on CalPERS ability to meet its obligations. The cash flow analysis of the last 12 months that you see here indicates a concentration of cash outflows on the last business day of the month when member benefits are paid. That cash flow concentration means that the risks associated with funding of payments is also concentrated within that narrow time frame.

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CHIEF FINANCIAL OFFICER EASON: Currently, the Investment Office raises the cash needed to pay member benefits in three tranches, roughly 10-day intervals during the month. If a five-business day market lockup was to occur, as per the definition of a crisis event, if that were to occur during the last week, there would be insufficient cash to raise that final tranche amount.

Therefore, the conclusion is by pre-funding the member benefit payments by five business days, it is a more cost effective approach to protect the payment of member benefits from a crisis event, then that would occur during the last week of the month.

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CHIEF FINANCIAL OFFICER EASON: So based on the policy before you, the recommendations for the PERF is that this pre-funding approach is the most cost effective approach, and is being recommended in the policy. We also looked at the affiliates and we are recommending that the current treasury management reserve for the Judges' Retirement Fund continue to be maintained. We are not asking for any reserves policy -- or treasury management reserves for any other of the affiliates. And we would also use the pre-fund obligation by five business days for the Legislators' Retirement Fund and the California Employees(sic) Retirement Benefit Trust Fund.

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CHIEF FINANCIAL OFFICER EASON: The next steps would be to incorporate any of the comments and guidance that I would receive from you today from the Committee to bring forward the final and action item on the reserve policy in October. And then based on an approval of a policy, we would commence activities required to implement the policy.

With that, I'll take questions.

CHAIRPERSON COSTIGAN: Thank you. We've got a couple.

Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: Going back to slide 7. The dividends and interest not being included because it's reinvested. But quite frankly, if we are raising cash in order to pay the benefits, why would we reinvest a dividend or interest at that point?

CHIEF FINANCIAL OFFICER EASON: Let me ask the Investment Office to make comment on that Mr. Jelincic.

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE:

Good morning. Wylie Tollette, CalPERS staff.

The key reason that we noted that in this policy and in this presentation is that the current asset liability management assumptions, the capital market assumptions, the returns and the -- our index returns that are used to compare the performance of the Investment Office to its -- you know, to its actual performance all assume the reinvestment of dividends.

So we can certainly re-examine that assumption. However, it will change the expected long term rate of returns that we will need to include in the asset liability management study. So our recommendation is, is that we take up that question and that conversation as part of our portfolio priorities and benchmark discussion.

If we take -- the short story is if we take the dividends out of the returns, we may have to choose a different index for the overall plan.

COMMITTEE MEMBER JELINCIC: Okay.

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE: It is a reasonable question. As it stands today, the -- if we had not reinvested dividends and assumed that reinvestment, we would actually have far too much cash on a monthly basis, primarily because our private equity portfolio has been generating significant amounts of cash. It's difficult to predict those types of cash flows. And so if we hadn't reinvested, we would have been -- we would have very low on cash, and would have had to actively reinvest that.

So at present, the decision to continue reinvestment has been a wise one. But going forward, it's definitely a question that I think the Investment Committee, as well as the Finance Committee, can examine.

COMMITTEE MEMBER JELINCIC: So we're going to incur the cost of investing it -- the transaction costs of investing it, and then incur the transaction costs of selling it to raise cash. And we're doing that to match the index?

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE:

We're doing that because our asset liability management assumptions assume the long-term reinvestment of dividends. We can change that assumption. However, it will change the whole ALM mix. So it's tied into the asset liability management conversation. It's not -- it's not a subject we can take up independently here. It's a subject that requires the whole asset liability management exercise to take place.

COMMITTEE MEMBER JELINCIC: Okay. And then on slide 9, a Level II is potential borrowed liquidity. That's the cash in the various asset classes that are awaiting reinvestment, if I understand correctly. It's potential borrowed liquidity. And that's -- if I remember correctly, that's the cash in the various asset classes waiting investment.

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE:
Level II, as I understand it and as I believe it's crafted in the policy, is actually the cash that -- the cash collateral that is kept on hand to secure the commodities futures contracts in the synthetic equity portfolio, and the cash collateral that's received when we lend securities.

COMMITTEE MEMBER JELINCIC: Okay. And the Level III liquidity, which is the public market assets, by definition don't exist if we're in a stress period, because the markets are frozen up. Now, it's --

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE: I think you've just -- actually, you've just defined a crisis period when the markets are locked up. A stress period we have the assumption that some of the markets are working. They might not be working fully, but they're working at least partially.

COMMITTEE MEMBER JELINCIC: Okay. And then on 10 - and, Cheryl, I'd warned you this question was coming - in April, there's two spikes. So it's kind of off pattern.

CHIEF FINANCIAL OFFICER EASON: Yes. The -- actually, for each of the months it's a little hard to see on this graph, but we -- we typically do get two payments at the end of the month. I guess the anomaly is the

October 2014 where that came in one payment. So that was the -- that's the explanation for those two payments. They actually do come in, in two payments.

COMMITTEE MEMBER JELINCIC: Okay. The April spikes look higher than the other spikes, but okay.

And can you define what you mean by pre-funding, or will you get to that later?

CHIEF FINANCIAL OFFICER EASON: It will be what we will include in the policy as per the discussion. And really the pre-funding just points to the fact that we would be providing funds five days -- five business days earlier than the end of the year or the end of the month.

COMMITTEE MEMBER JELINCIC: Providing to the Treasurer's office or just raising it so we have it on hand?

CHIEF FINANCIAL OFFICER EASON: It is raised. And then at the two days before the end of the month, we wire transfer that over to the State Treasurer's office is the process.

COMMITTEE MEMBER JELINCIC: Okay. Thank you.

CHAIRPERSON COSTIGAN: Okay.

Mr. McGuire.

ACTING COMMITTEE MEMBER McGUIRE: Thank you, Mr. Chair. Wylie, I'd like to go back to the issue that was -- you briefly discussed of the reinvestment of dividends and interest.

That assumption that goes into the benchmarks and so on, isn't that sort of a general assumption that dividends and interest will be reinvested, but not necessarily in those specifics asset classes?

In other words, income from fixed income doesn't all necessarily get reinvested in fixed income. The same with private equity, and so on. Isn't it more of a general assumption?

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE:

That's true. However, the index that we use, the FTSE CalPERS index X tobacco, Sudan, Iran, that index actually -- its returns are calculated assuming 100 percent of the dividends that are received on that index are then subsequently reinvested. So for us to begin using these dividends for other purposes, such as the payment of benefits, rather than Reinvest them, we actually have to re-examine that index and choose a different one that does not assume.

There are certainly -- those indices are certainly available. And we expect the portfolio priorities discussion that the Investment Office is leading. That's one of the choices that the Investment Committee will have in front of it later, I think, early in 2016 to consider the use of alternative indices for alternative global equity indices for the fund. And that is certainly one of the choices.

ACTING COMMITTEE MEMBER McGUIRE: All right. So that's pretty specific to the global equity index.

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE:

That's right.

ACTING COMMITTEE MEMBER McGUIRE: What about the other indices?

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE: The other indices do not assume the reinvestment of income.

ACTING COMMITTEE MEMBER McGUIRE: Okay. So in some respects it's not across the whole portfolio.

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE:

That's right.

ACTING COMMITTEE MEMBER McGUIRE: You have that concern, because in some respects, some of that dividend interest income could be considered to be reinvested in the liquidity one percent.

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE:

That's right. The cash that is received -- once it's received, it's -- essentially, it's a fund asset not necessarily an asset of the particular asset class.

ACTING COMMITTEE MEMBER McGUIRE: Okay. So this is mainly a global equity issue.

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE:

Global equity issue, that's right.

ACTING COMMITTEE MEMBER McGUIRE: Thank you, Mr. Chair

CHAIRPERSON COSTIGAN: Mr. Slaton.

COMMITTEE MEMBER SLATON: Thank you, Mr. Chair.

I this is a good body of work. I like what I see. I want to do a shout out to Mr. McGuire next to me who has been focused on this issue like a laser for quite a period of time. And I think he and the Controller's office have done an excellent job in pressing on this issue to make sure we had a good solution, so -- and I think this collaboration between Finance, the Investment Office, Actuarial Office really important, and it shows in this body of work. So my compliments.

CHAIRPERSON COSTIGAN: Mr. McGuire, did you want to speak again?

ACTING COMMITTEE MEMBER McGUIRE: Well, thank you, Mr. Slaton for that comment, but I was going to try to express some of the same thoughts, not with respect to myself, but with respect to --

(Laughter.)

ACTING COMMITTEE MEMBER McGUIRE: -- or Chief Financial Officer and the Investment Office, Wylie. Liquidity and treasury management I think it's taken about a year and a half to have this focus, but I think the results and the outcome I think are going to benefit the organization tremendously going forward. And it's -- I think we're in the right place. And I appreciate the work by staff in this area. Thank you.

CHAIRPERSON COSTIGAN: Okay. Ms. Eason, just fantastic work. And I appreciate you taking the advice from the Board -- or the suggestions from the Committee members on the stress testing and going back and working with the Department of Finance. And I just -- I think overall again it goes back to what Ms. Stausboll and others have been really talking about on the transparency issue and making sure that the information is available. So I think it's great between Investment Office and your office. And it's great to see the collaboration that's going on.

So with that, we are almost done, unless there is any public comment?

Anything else?

We are adjourned.

(Thereupon the California Public Employees' Retirement System, Board of Administration, Finance & Administration Committee meeting adjourned at 10:09 a.m.)

C E R T I F I C A T E O F R E P O R T E R

I, JAMES F. PETERS, a Certified Shorthand Reporter of the State of California, do hereby certify:

That I am a disinterested person herein; that the foregoing California Public Employees' Retirement System, Board of Administration, Finance & Administration Committee meeting was reported in shorthand by me, James F. Peters, a Certified Shorthand Reporter of the State of California;

That the said proceedings was taken before me, in shorthand writing, and was thereafter transcribed, under my direction, by computer-assisted transcription.

I further certify that I am not of counsel or attorney for any of the parties to said meeting nor in any way interested in the outcome of said meeting.

IN WITNESS WHEREOF, I have hereunto set my hand this 24th day of August, 2015.

James F. Peters

JAMES F. PETERS, CSR
Certified Shorthand Reporter
License No. 10063