MEETING

STATE OF CALIFORNIA

PUBLIC EMPLOYEES' RETIREMENT SYSTEM

BOARD OF ADMINISTRATION

FINANCE & ADMINISTRATION COMMITTEE

ROBERT F. CARLSON AUDITORIUM

LINCOLN PLAZA NORTH

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SACRAMENTO, CALIFORNIA

TUESDAY, NOVEMBER 15, 2016

2:35 P.M.

JAMES F. PETERS, CSR
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A P P E A R A N C E S

COMMITTEE MEMBERS:

Mr. Richard Costigan, Chairperson

Ms. Dana Hollinger, Vice Chairperson

Mr. Richard Gillihan

Mr. J.J. Jelincic

Mr. Henry Jones

Mr. Bill Slaton

Ms. Betty Yee, represented by Ms. Lynn Paquin

BOARD MEMBERS:

Mr. Rob Feckner, President

Mr. Michael Bilbrey

Mr. John Chiang, represented by Mr. Steve Juarez

Mr. Ron Lind

Ms. Priya Mathur

Ms. Theresa Taylor

STAFF:

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Ms. Cheryl Eason, Chief Financial Officer

Mr. Ted Eliopoulos, Chief Investment Officer

Mr. Doug Hoffner, Deputy Executive Officer

Mr. Matthew Jacobs, General Counsel

Mr. Brad Pacheco, Deputy Executive Officer

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STAFF:

Mr. Scott Terando, Acting Chief Actuary

Ms. Mary Anne Ashley, Chief, Legislative Affairs Division

Ms. Tanya Black, Committee Secretary

Mr. Dan Bienvenue, Managing Investment Director

Ms. Rose McAuliffe, Chief, Financial Planning, Policy & Budgeting

Ms. Kristin Montgomery, Controller

Mr. Anthony Suine, Chief, Benefit Services Division

Mr. Wylie Tollette, Chief Operating Investment Officer

ALSO PRESENT:

Mr. Terry Brennand, Service Employees International Union

Mr. Dave Hutchings, League of California Cities

Mr. Neal Johnson, Service Employees International Union, Local 1000

Mr. Dave Low, California School Employees Association

Mr. Dan Pellissier

I N D E X

P R O C E E D I N G S

CHAIRPERSON COSTIGAN: All right. Well, good afternoon. It is now 2:35. We're going to get started with Finance and Administration. Before we do, I'm going to call on the Chair of Risk and Audit who's going to make a very short announcement for those waiting in bated breath for the next meeting.

Mr. Lind.

BOARD MEMBER LIND: Thank. So reality of our schedule today is it's not likely we're going to start Risk and Audit till about 4:30. So those that are here waiting for that meeting, you're certainly welcome to stay, but you may want to go get some coffee.

CHAIRPERSON COSTIGAN: Yeah. So we just wanted to make sure that you understood if you're going to be here for the next meeting, you have until 4:30. So anyway.

All right. Let us start with please calling the roll.

COMMITTEE SECRETARY BLACK: Richard Costigan?

CHAIRPERSON COSTIGAN: Here.

COMMITTEE SECRETARY BLACK: Dana Hollinger?

VICE CHAIRPERSON HOLLINGER: Here.

COMMITTEE SECRETARY BLACK: Richard Gillihan?

COMMITTEE MEMBER GILLIHAN: Here.

COMMITTEE SECRETARY BLACK: J.J. Jelincic?

COMMITTEE MEMBER JELINCIC: Here.

COMMITTEE SECRETARY BLACK: Henry Jones?

COMMITTEE MEMBER JONES: Here.

COMMITTEE SECRETARY BLACK: Bill Slaton?

COMMITTEE MEMBER SLATON: Here.

COMMITTEE SECRETARY BLACK: Lynn Paquin for Betty Yee?

ACTING COMMITTEE MEMBER PAQUIN: Here.

CHAIRPERSON COSTIGAN: All right. We have a fairly robust agenda today, so we have -- we probably will go about 2 hours or so. I will say just in advance, we'll probably take a short break before we get to Item 7A, which I think is what most people want to talk about, in order to give the court reporter a couple minutes, and therefore we don't break rake the rhythm of the conversation.

So with that, Ms. Eason, you're up first, please.

CHIEF FINANCIAL OFFICER EASON: Thank you, and good afternoon, Mr. Chair and Committee members. Cheryl Eason, CalPERS. Today's first action item is the approval of the 2015-16 basic financial statements, followed by the first reading of the 2016-17 mid-year budget, representing a decrease of 1.3 million, making this the 6th formal budget process in which the budget has been reduced. Also included in the mid-year budget requests are 14 positions that would provide additional functionality for the Investment and Financial offices.

The third and last action item before the Committee today are policy and technical amendments to the Public Employees' Retirement Law to clarify statutes, reduce system complexity, and encourage employer compliance.

Agenda Item 7A and 7B represent 2 significant information items based on Committee direction at the September 20th Finance and Administration Committee meeting.

Agenda Item 7A is a presentation by the Investment, Actuarial, Public Relations, and Financial offices that discusses funding and market realities to ensure long-term sustainability of the fund. Questions from September's Committee meeting regarding the current cost of the -- cost of -- cost of living adjustments, or COLA, and survey results from outreach with public agency employers and stakeholders will also be addressed.

Additionally, staff will present the collections and termination process for public agencies, which outlines the steps taken to collect required contributions, as well as the termination process.

And lastly, we will hear the first reading of the

CalPERS 2017-22 strategic plan for your review and comment.

I'd like to take a moment to recognize some significant accomplishments from our California Employers' Retiree Benefit Trust Fund, or CERBT. The City Of Pico Rivera joined the CERBT effective October 28th and becomes the CERBT's 5th -- 500th customer currently under contract.

In addition, in June, the trust has passed over the $5 billion mark for assets under management, and in October, passed the 500,000 covered lives mark.

The next Finance and Administration Committee Meeting is scheduled for December 20th, 2016 and will include the second readings of the 2016-17 mid-year budget and the CalPERS 2017-22 strategic plan, the Retirement Benefit Fund Program update, the Long-Term Care evaluation report, and the semiannual self-funded health plans report.

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

CHAIRPERSON COSTIGAN: Thank you, Ms. Eason. I do appreciate that. I see no questions on that item.

So we're going to go to the first action item, which is the approval of September 20, '16 minutes.

VICE CHAIRPERSON HOLLINGER: Move approval.

CHAIRPERSON COSTIGAN: It's moved by Hollinger.

COMMITTEE MEMBER JONES: Second.

CHAIRPERSON COSTIGAN: Seconded by Jones.

All in -- all in favor?

(Ayes.)

CHAIRPERSON COSTIGAN: Opposed?

Motion carries.

Item 4 are information consent items, but I believe, Mr. Jelincic, if you would hit your button, I believe you had a question on item number 4.

COMMITTEE MEMBER JELINCIC: Yeah. 4D --

CHAIRPERSON COSTIGAN: 4D, I'm sorry.

COMMITTEE MEMBER JELINCIC: -- page 4 of 6. And it's on the footnote at the bottom of the investment management expense fees. And one, the CAFR, when we report it out, we report net management fees, so we ignore some significant costs such as offsets, waivers, carry, both paid and accrued. We've -- in the budget, we've included that. You're now saying we're going to go back to -- I won't say hiding -- not discussing those fees. And I would also point out that the CAFR is on a calendar-year basis, ending the middle of the fiscal year. So my question is why are we moving towards the CAFR rather than bringing the CAFR towards a more complete report of the costs?

FINANCIAL PLANNING, POLICY & BUDGETING CHIEF McAULIFFE: Rose McAuliffe, CalPERS team member.

COMMITTEE MEMBER JELINCIC: Pull the mic over to you.

CHAIRPERSON COSTIGAN: Yeah. Crank it up.

FINANCIAL PLANNING, POLICY & BUDGETING CHIEF McAULIFFE: Good question, Mr. Jelincic. Our goal is to always be as open and transparent as possible in our reporting. And the more that we're able to reconcile between the 2 different ways of reporting from management and budget reporting and then CAFR reporting, we -- that's our attempt is to just bring those 2 reporting processes together.

COMMITTEE MEMBER JELINCIC: Okay. Well, why not bring it towards the more inclusive rather than move it towards the less inclusive is my question.

FINANCIAL PLANNING, POLICY & BUDGETING CHIEF McAULIFFE: I think that's a great point. We could take a look at that.

COMMITTEE MEMBER JELINCIC: Okay. Thank you.

CHAIRPERSON COSTIGAN: Okay. INVO, do you want to say anything?

You don't have to.

Okay. Thank you.

All right. Any other questions, Mr. Jelincic?

COMMITTEE MEMBER JELINCIC: No, thank you.

CHAIRPERSON COSTIGAN: All right. Are there any other questions or concerns on any -- on items 4A B, C, 4E?

All right. Seeing none. We will move on to Action Item 5A, Ms. Eason, Ms. Montgomery.

CHIEF FINANCIAL OFFICER EASON: Thank you. Cheryl Eason, CalPERS.

I'm here to present the basic financial statements for the fiscal year 2015-16 and Kristin Montgomery, Controller, will assist me by providing additional detail to this item.

The net position of the PERF is 298.7 billion, representing a decrease of 4.1 billion, compared to the last fiscal year-end. This decrease is mainly attributed to the decrease in net investment income and increases to retirement and beneficiary benefits.

The fund continues to be in a negative cash flow position, paying 20.1 billion in retirement and beneficiary benefits against the contributions of 14.9 billion. The investment earnings cover this deficit of 5.2 billion.

2015-16 was also the year of GASB 72 and GASB 74 implementations. GASB 72 changes the definition of fair value for the reporting of assets and liabilities, and adds new reporting requirements, which were included in this year's CAFR.

GASB 74 standards parallel the pension standards similar to GASB 67. It enhances information, brings further clarity of post-employment benefit liabilities, and better assesses the related financial obligations and annual costs of providing other post-employment benefits, or OPEB.

Now, I'd like to turn to the discussion over to Kristin to provide some more detail on the basic financial statements.

CONTROLLER MONTGOMERY: Kristin Montgomery, CalPERS team member.

As part of an iterative process, we continue to evolve in the transparency of our reporting, while ensuring our internal controls. With the implementation of PEARS in October of 2015, we were able to capture the private equity management fee and carry information from our external managers in a centralized system. Since the implementation was less than 1 year, the Financial Office, along with the Investment Office an external auditor, decided to include this information in the unaudited section of the comprehensive annual financial report.

We wanted to allow us the time to evaluate the internal control process and data from our external managers and within the PEARS system. We are hopeful that the management fee information will be in the audited section next year.

We have successfully incorporated several changes to our processes for the development of the basic financial statements and the comprehensive annual financial report. First, we changed our processes to receive the information earlier to improve the audit time frame, along with providing the basic financial statements to the Board early for their review.

Secondly, we worked with our external auditors to repair the management letter earlier, which will be presented in the Risk and Audit Committee meeting. We successfully changed our timeline to present this information 6 months earlier than previous years.

We also worked with our Actuarial Office and external auditors to prepare and audit the GASB 68 reports at the same time as our basic financial statements to ensure our employers received the information timely.

We will be completed by the end of December, which is 4 months earlier than last year. Lastly, we implemented software to assist us with the development of the comprehensive annual financial report. The software provided us the internal controls to ensure data was updated accurately throughout the various pages, and numbers within the tables were properly summed.

There are a couple questions that I'd like to address related to the basic financial statements. The first one is in reference to note 8 on page 46 of attachment 1. Per GASB 67, the net pension liability is presented only for the cost-sharing plans, which includes PERF B and PERF C; and, the single employer plans, which includes the Judges' Retirement Fund, the Judges' Retirement Fund II, and Legislators' Fund.

PERF A is not presented, since it is an agent fund. We provide separate GASB 68 reports for each of the employers for the net pension liability for the agent plans. Another question is in regard to the State of California agencies amount of 7,415 shown on page 64, and the State Controller's office amount of 9,083, shown on page 74 of attachment 1. The State of California agencies include several agencies that sum up to this total.

The State Controller's amount includes 5,843 to total to the 7,415. The State Controller's office amount of 9,083 on page 74 includes this amount plus 3,240 for check writing and auditing services related to health, which sums to the 9,083.

As we look to next year, we do not anticipate any significant GASB changes being implemented that will impact our financial statements. After Board approval of the basic financial statements and the approval of the audited report in the Risk and Audit Committee meeting, CalPERS will finalize the comprehensive annual financial report by the end of November.

I'm happy to answer any questions.

CHAIRPERSON COSTIGAN: Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: One, I want to thank you for answering at least some of the questions that I had.

On attachment 1, page 22 of 77, the investments in fair value, can you define what those are?

CONTROLLER MONTGOMERY: Yes. The investments at fair value is what the -- so, for example, all the -- the net appreciation -- wait a minute. Yeah, so the net appreciation in fair value of investments is the change of market value for all of the investments that we hold.

COMMITTEE MEMBER JELINCIC: Okay. That was actually the next -- the next question.

CONTROLLER MONTGOMERY: Oh, sorry, you were asking the balance sheet.

COMMITTEE MEMBER JELINCIC: But that's okay. We can deal with 24 first.

CONTROLLER MONTGOMERY: Okay.

COMMITTEE MEMBER JELINCIC: So if that's the net appreciation, then down at the bottom we subtract investment expenses, management and performance fees, and others. Is that really a net?

CONTROLLER MONTGOMERY: It is net, because of some of our private asset classes when we look at the net appreciation, it is the difference between the assets and the liabilities, so it is the net appreciation of that. It also includes, of course, our stocks and our bonds. And again, it's net appreciation of those also.

COMMITTEE MEMBER JELINCIC: And so if -- okay. If -- but if it's net, then why are we subtracting off the investment expenses?

CONTROLLER MONTGOMERY: We do that because we are transparent in our reporting. Per GASB and GAAP, we could include all the private asset class information up in net appreciation. We do the reclass so that we're transparent in our expenses.

COMMITTEE MEMBER JELINCIC: Okay. And now we can go back to the previous page.

CONTROLLER MONTGOMERY: Okay. Sorry.

COMMITTEE MEMBER JELINCIC: The investments at fair value, can you describe what that is? I assume that equities are whatever the Wall Street Journal says they are.

CONTROLLER MONTGOMERY: Yes. So these are all of our asset classes. And it's really what the market value of the asset is. And again, with the implementation of GASB 72, it really defines what all the leveling is of the fair value. So it's -- there's level 1, there's level 2, there's level 3, and there's also at net asset value. So all of those values are listed in the investment section at fair value.

COMMITTEE MEMBER JELINCIC: Okay. On 27, it's not a question about -- 27 of 77. It's not really a question about the numbers. It's a question about the presentation. Identifying management fees and other investment expenses is a non-operating income, since one of the things that we do as a core function is run a portfolio. Why classify them as non-operating rather than operating expenses?

CONTROLLER MONTGOMERY: We follow the guidelines of our GASB reporting and also our GFOA reporting. And this is the format that is followed per the guidelines of that.

COMMITTEE MEMBER JELINCIC: And what --

CONTROLLER MONTGOMERY: And these are for proprietary funds only. They're not for the fiduciary funds. So the proprietary funds will follow a different format than our fiduciary funds.

COMMITTEE MEMBER JELINCIC: And the fiduciary fund is PERF A?

CONTROLLER MONTGOMERY: PERF, the Judges's funds, the CERBT funds, and really the proprietary funds are a health fund and the Long-Term Care Fund.

COMMITTEE MEMBER JELINCIC: So this management fees and investment expenses is for basically the health care?

CONTROLLER MONTGOMERY: Yes, health care and the long-term care.

COMMITTEE MEMBER JELINCIC: Okay. On -- getting into the footnotes on 34 of 77, column 2, second paragraph down, partnership management fees for Private Equity Program are basically reported as -- on a cost basis. They're not considered a cost. And yet, when you look at private equity, in looking at the information we were given, we paid 2.6 million -- $206 million in fees. We paid another 52 million in performance -- in portfolio fees, which were netted out; 46 million in fund of funds, the underlying fees; 539 million in carry -- paid carry. So that was 843.

In real estate, we paid 155 million point 8 in fees, 81.1 in profits, 163 million in accrued carry -- or accrued profit sharing for roughly 400. So that's a billion two in expenses that we're just sort of netting out. How does that actually help one make this more transparent, make it more useful to the Board, and more useful to the readers of the fund?

And while you're thinking about that, the other question related to that, that got identified is we have one point -- basically a billion and a quarter in accrued profit sharing in real estate, and where does that show up?

CONTROLLER MONTGOMERY: Well, you had several questions. So I think I'll first ask -- answer the question on transparency. As I stated in my opening comments, we are trying to be more transparent within our reporting. We are -- we do follow GAAP and we follow GASB. And it is compliant with the way that we report in our financial statements, the information.

Then I think your second question was about where the real estate --

COMMITTEE MEMBER JELINCIC: Where the 1.1 -- one and a quarter billions dollars in accrued real estate profits shows up?

CONTROLLER MONTGOMERY: That is showing up again in the net appreciation/depreciation line item or net appreciation that I talked about earlier on the statement of changes of fiduciary net position.

COMMITTEE MEMBER JELINCIC: Okay. And I will agree that GASB 67 says you can net this out, but it also says that if you can identify it, you should not net it out.

And CEM Benchmarking actually hammered on that point about a year ago. And we obviously think very highly of CEM, because we're actually incorporating a lot of their stuff into our plan. But as you know, I'm an analyst.

And one of the things we occasionally do is reverse engineer. So in our private equity portfolio, we made 1.7 percent, so we made 448.8 million. The fees that I had identified earlier was 843.5 million. So our gross, before fees, was 1292.3. When you divide the fees by the gross, we paid out 65 percent of our earnings in private equity to the GPs, yet, it's not disclosed here. It -- and if we don't disclose that, how does that help this Board make better decisions? How does that help the users of our financial statements have a better understanding of what we are doing? And I see Wylie coming up to help you out.

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE:

Good afternoon. Wylie Tollette, CalPERS staff.

I think private equity is, in fact, our most expensive asset class. That's a oft-discussed subject. Over the -- measuring private equity returns over the one year is a very challenging thing to do. Measuring private equity returns over the long term, as we discussed at yesterday's program review, it remains our best performing asset class, despite the high fees and costs, as well as the profit sharing. One of the things that we've worked to do as well in our reporting is distinguish between fees, which Mr. Jelincic, as you point out, are expensive and charged both to the limited partners, as well as to the portfolio companies within the investments.

Profit sharing, on the other hand, is not necessarily something that we would want to reduce. If we reduce profit sharing, we might, in fact, reduce the profits that CalPERS earns. Would we want to reduce the percentage of profits earned by the general partners? Certainly, that's in our interest. And, in fact, I think CalPERS has actually done quite a good job of that with last year our profit-sharing payout being at 14 percent, and our retention of those profits being at roughly 86 percent.

So I think, given the challenges of the private equity industry, I think our program is, as we discussed yesterday, is performing well. Could it be less expensive? Certainly. We're looking at alternative business models that can help generate that, and -- but that's going to take us a long time to build. And, you know, in the meantime, we think that it's still an important asset class for the fund and for the System.

COMMITTEE MEMBER JELINCIC: When you talk about the 3 billion that we realized in private, part of that -- that all was not earned in one year, which is part of the reason I keep saying, what's the accrual, what's the accrual?

The fees that we paid out, the 206 plus, the 539, was in one year. So we really do need to get to the accrual. And I think we need more transparency on what the real cost of this thing is. I mean, as I -- you know, unless I did the math wrong -- and if I did, it's probably not by much -- when 65 percent of the earnings are going out to the GP, we've got a problem. You can argue that it's high -- it's returning well, and it seems to be. But as I pointed out the other day, risk adjusted, who knows because we don't know what the risks are. And if you don't know what the risks are, it's kind of hard to risk adjust.

You know, I could go to the roulette wheel and have a great return, if I pick the right year and the right number, but that's certainly not an accurate reflection of what the returns and performance is.

CHAIRPERSON COSTIGAN: So Mr. Jelincic, I think you have raised some excellent points. Just a couple observations. One is I do appreciate, Kristin, the increased transparency. I think as Mr. Jelincic raises, we still have more work to do. I think as Wylie allude to.

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE: Yeah, we would agree.

CHAIRPERSON COSTIGAN: Whether you look at 1 year or 3 year, I first don't want a lose of the fact that, J.J., the fact that you were able to come into those numbers is the fact that more information is being provided. I think yesterday, Mr. Jones, we had a very robust discussion on private equity fees. And I think that will continue. I think you guys have gotten the message about where I think the Board stands on private equity.

So Kristin as we move forward, the more that we become -- the more information we can provide -- I mean, one of the questions I was going to ask you -- first of all, excellent report. I have some questions. What is it that people should take away? I mean, the difficulty is we don't all have the knowledge that J.J. does. I understand what's in the report, but as -- you know, you talk about footnotes and increased transparency, what's sort of the 1 or 2 takeaways from this report, if some's is looking at it, that they should really know we're doing?

Mr. Jelincic, thank you.

COMMITTEE MEMBER JELINCIC: I do have one other thing to add, but let Kristin respond.

CHAIRPERSON COSTIGAN: Okay. Go ahead, Kristin.

CONTROLLER MONTGOMERY: I think the key thing is the things that Cheryl touched on to begin with. We're in a negative cash flow position. So when we look at that, we have a deficit of 5.2 this year that we're paying out and that's from the investment returns.

So when we look at those type of things, that's what the key takeaway is, what's happening in the last year, and where do we need to go in the next year?

CHAIRPERSON COSTIGAN: All right. Mr. Jelincic, you have a few question.

COMMITTEE MEMBER JELINCIC: Yeah. You raised the issue that, you know, obviously the numbers are there because I came up with them, but people should be able to look at our financial statement --

CHAIRPERSON COSTIGAN: Agreed.

COMMITTEE MEMBER JELINCIC: -- and not have to go look at this report, and that report, and that report to try and figure out what's going on. The purpose of the financial report is so that people can look at it and analyze what we are doing.

CHAIRPERSON COSTIGAN: And I think again, Mr. Jelincic, and both of you all raised good points. I mean, hyper-technical, still trying to understand the reports. And so where is that happy medium where I'm looking for a dashboard that's easy to understand. And from the standpoint of, again, sort of what the takeaway is, but to have a 75-page document that actually outlines this information I think is a -- continues to be very good for the System.

And I think, as Mr. Jelincic raises, the more, working with Investment, we can identify this, particularly when we pay it out in a year, because similar to yesterday it is saying, when I look at where is the information that I can gather just glancing at it. And I think, as J.J. pointed out, it takes a little mathematics on it. And whether the 65 percent is appropriate or not appropriate really rests with the Investment Committee and Investments to go through what the asset allocation looks like.

So I am learning.

So anything else before I have my questions, Mr. Jelincic?

COMMITTEE MEMBER JELINCIC: No.

CHAIRPERSON COSTIGAN: So just a couple observations. Why, on page 13 of 75, we saw a decrease in the number of Public Employees' Deferred Compensation Fund we had some large employers terminate. I assume those are like 401s that we -- where it says, "Total deductions increased by 75.7 million or 81.2 due to an increase in participant withdrawals from the plan. Several large employers terminated their contracts and converted to other plans." I just was -- are those the DC plans what we were running for some of the counties.

CONTROLLER MONTGOMERY: That's correct. That is defined contribution plans. That is.

CHAIRPERSON COSTIGAN: And I have been one, not to give Mr. Gillihan more work, still saying I don't understand why that system is not run out of the 401/457 over at Savings Plus. How big is that program still?

And if you don't know, that's fine. I was just curious, because --

CONTROLLER MONTGOMERY: Yeah, we'd have to get back to you on that. I don't know how many --

CHAIRPERSON COSTIGAN: Okay. Because I would like to know who were the large employers that left.

And then -- well, you could. Although I think there's -- I just had -- there were some comments in here related to the rates on Judges' Retirement and legislative pay, they continue to do well. No issues -- we haven't Seen Judges' Retirement in a couple Judges' Retirement in a couple years.

CONTROLLER MONTGOMERY: I'm sorry. What's your question?

CHAIRPERSON COSTIGAN: I'm sorry. We haven't -- I just don't recall having a presentation on the judicial retirement system in a couple years. So I assume -- other than being in the report.

CONTROLLER MONTGOMERY: Well the, Judges' -- the Judges' I is a pay-as-you-go plan, so that's kind of what we're representing in the financial statements.

CHAIRPERSON COSTIGAN: Great. Okay. Are there any other questions?

This item looks -- all right. So this is an action item, correct, Ms. Eason?

CHIEF FINANCIAL OFFICER EASON: Yes. I just wanted to add, Mr. Chair, that we'd be happy -- staff would be happy to look at more of a summarized report for the Committee that would just provide highlights. This is a -- obviously, the financial statements, as required by GASB and GFOA, are the more detailed, but we'd be more than happy to look at a --

CHAIRPERSON COSTIGAN: I think an executive summary would help for two reasons, not only for the Board, but also for the public, because, I mean, these are difficult documents, and they don't get the opportunity to sit here and ask questions ad nauseam, including myself. So with that, I need a motion.

COMMITTEE MEMBER JONES: Move it.
COMMITTEE MEMBER SLATON: Second.
CHAIRPERSON COSTIGAN: Moved by Jones, seconded by Slaton.
Any further discussion.
All those in favor?
(Ayes.)
CHAIRPERSON COSTIGAN: Opposed?
Motion carries. Thank you.
Next item is going to be Item 5B, which is the mid-year budget, first reading.
CHIEF FINANCIAL OFFICER EASON: Great. Thank you. This is an action item, and it is a first reading for the 2016-17 mid-year budget. And Rose McAuliffe, my Division Chief, will also provide highlights and answer any questions the Committee may have.
So let me just open by saying the proposed 2016-17 mid-year budget represents a decrease of 1.3 million, or under 0.1 percent, from 1.789 billion to 1.787 billion. And as I mentioned in my opening remarks, this is the 6th formal budget process in which the budget has been reduced.
Included in the proposed budget is the request for an additional 14 positions, which takes our authorized position count from 2,866 to 2,872, if approved. The

request for new positions in this process was carefully considered as part of the budget process. The current CalPERS vacancy rate of 6.6 percent represents a significant decrease from the 10.6 percent vacancy rate 5 years ago, as we continue to actively manage staffing requirements.

The budget process requires that each program area take into consideration their outstanding vacancies prior to requesting new positions. Additionally, over the last 3 years, there has been a decrease of over 370 temporary positions from 660 to 283 positions.

And finally, the organization is currently looking at an approach to address vacancies that are over 6 months old through an enterprise position pooling concept. The pooling concept would consider the redirection of positions to the greatest need in the organization prior to new positions being considered. And although the pooling concept is currently managed at the program area level, elevating it to the enterprise level will assist us even further in our resource management efforts.

So with that, I'd like Rose to just go through some of the more details of our 5 main CalPERS budget.

FINANCIAL PLANNING, POLICY & BUDGETING CHIEF McAULIFFE: Thank you, Cheryl. Rose McAuliffe.

CHAIRPERSON COSTIGAN: Hang on. Mr. Jelincic or Mr. Gillihan, do you want to wait till after the presentation?

COMMITTEE MEMBER GILLIHAN: I'll wait till after.

COMMITTEE MEMBER JELINCIC: I'll wait.

CHAIRPERSON COSTIGAN: Okay. Thank you.

FINANCIAL PLANNING, POLICY & BUDGETING CHIEF McAULIFFE: Okay. Of the 5 budgetary sources that propose an administrative budget, increases by 3.4 million, and that includes the following adjustments: An increase of 10.5 million for statewide employee salary increases and benefit adjustments, and 1.5 million for the 14 new positions.

Of those positions, 6 are for the Financial Office for $400,000 to perform financial risk assessments of public agencies seeking to contract with CalPERS for retirement benefits; 8 of the -- 8 positions are in the Investment Office for 1.8 million for global equity special -- specifically, as it relates to environmental and social governance, and sustainable investment realignment efforts. There's also an increase in the admin budget for 400,000 to begin implementing internet and phone voting options for the Board member elections.

Now, we have the decreases. A decrease of 8 million due to vacancy savings that have occurred to date in the budget and projected to occur for the remainder of the year. And there's an additional decrease of a million due to anticipated savings and outside legal expenses.

The next budget is the investment operating budget. And that is proposed to decrease by 1 million from 90.5 million to 89.5 million due to projected savings in outside legal expenses.

The next budget is the enterprise projects budget. And it's proposed to decrease by 3.7 million from 41.4 to 37.7 million, mostly attributed to efficiencies identified in the actuarial valuation systems project. That's 2 million, and security roadmap project of 1 million.

And finally, our last budget third-party administrator costs are proposed to remain the same, flat. Although there are some adjusting costs within the categories.

This concludes our overview of the 2016-17 mid-year budget. We're happy to answer any questions.

CHAIRPERSON COSTIGAN: Okay. We'll start with Mr. Jelincic, first.

COMMITTEE MEMBER JELINCIC: Going back to the agenda item itself. On page 1, the proposed budget, I assume that the private assets are included in these projected costs?

FINANCIAL PLANNING, POLICY & BUDGETING CHIEF McAULIFFE: Correct.

COMMITTEE MEMBER JELINCIC: And the only reason I ask is because of the footnote on 4D.

FINANCIAL PLANNING, POLICY & BUDGETING CHIEF McAULIFFE: Yes.

COMMITTEE MEMBER JELINCIC: And he didn't -- he didn't get the nod of your head, but I saw it.

FINANCIAL PLANNING, POLICY & BUDGETING CHIEF McAULIFFE: Yes.

COMMITTEE MEMBER JELINCIC: On page 2, 3rd paragraph down, only one request was deferred. I want to thank you, because I have traditionally asked you, well, what did you decide not to do? You identified it. I want to acknowledge that. Thank you.

The -- on that same table, we're adding basically 14 jobs that are costing a million -- or, no, I'm sorry. Yeah, 14 jobs that are costing a million four, but we've got these vacancies. Is that 8 million -- does that translate into 80 vacancies that exist, or is it a bigger number, because I do acknowledge that those top ones tend to be more expensive than average.

FINANCIAL PLANNING, POLICY & BUDGETING CHIEF McAULIFFE: That is correct, the investment positions are.

COMMITTEE MEMBER JELINCIC: Do we know how many vacancies that we're --

FINANCIAL PLANNING, POLICY & BUDGETING CHIEF McAULIFFE: Of the salary savings?

COMMITTEE MEMBER JELINCIC: Yeah, the salary savings.

CHAIRPERSON COSTIGAN: Mr. Gillihan -- you had an answer, Mr. Gillihan?

COMMITTEE MEMBER GILLIHAN: Well, while you're looking at it, I was just running the numbers and it looks like, if my math is correct, you have 190 vacant positions in the organization across the enterprise?

CHIEF FINANCIAL OFFICER EASON: That's correct.

COMMITTEE MEMBER GILLIHAN: And so what's the salary savings associated with those?

FINANCIAL PLANNING, POLICY & BUDGETING CHIEF McAULIFFE: We've -- we are already included some of the salary savings at the beginning of the budget build, but on top of that we added in an additional salary savings in this mid-year.

COMMITTEE MEMBER GILLIHAN: I mean, are those positions considered fully funded when you recognize salary savings, or are those salary savings being diverted to offset other budget expenditures, which may be what Mr. Jelincic is asking?

CHIEF FINANCIAL OFFICER EASON: They are not.

Our budget policy does not allow us to divert any of our salary savings. What we do is we reduce -- and that's why you have an offset of $10 million in salary savings. We do not divert that to other projects.

COMMITTEE MEMBER GILLIHAN: And if I could ask one more question?

CHAIRPERSON COSTIGAN: Sure.

COMMITTEE MEMBER JELINCIC: I actually -- I was completed with my questions, so --

CHAIRPERSON COSTIGAN: Thank you, Mr. Jelincic.

COMMITTEE MEMBER GILLIHAN: Okay. Thank you.

So my -- and I appreciate, because a few of us up here have been on this topic for a few years now, and you're probably getting tired of hearing about it. And so I appreciate that the reduction in the vacancy rate, that is a significant improvement over time. And this is perhaps a more modest request for position authority increase in the middle of a fiscal year, but it's still 14 new positions, when you have 190 vacancies.

And I cannot comprehend why this Board would be asked to approve 14 new positions when you have 190 vacancies. Certainly, some of those are in active recruitment. Some are perhaps hard to fill, difficult classifications to fill. But out of 190 vacancies, I would think the organization could find 14, if those were, in fact, a priority, such that you're asking the Board for approval in the current year.

Thank you.

CHAIRPERSON COSTIGAN: Not to pile on with Mr. Gillihan, this also doesn't account for one of my other pet peeves, which I know reduced, which is how many positions are still in the blanket that we're not accounting for?

CHIEF FINANCIAL OFFICER EASON: Well, I mentioned that our temporary positions have gone from 660 to 283, so a reduction of 370 positions, which we've taken that work and we've redirected that to full-time positions that currently exist in the organization.

CHAIRPERSON COSTIGAN: All right. Mr. Gillihan, I don't think you were done.

COMMITTEE MEMBER GILLIHAN: Yeah. Thank you for reminding me about that question. With respect to the 283 positions that are temporary positions, and I again applaud the improvement from cutting the number you perhaps inherited in half, but can you give us a sense of what the 283 positions are doing, what kind of work they're doing in the organization, and why they were established as temporary help?

CHIEF FINANCIAL OFFICER EASON: We have 142 of those positions are in customer support and services.

They're made up of retired annuitants and seasonal clerks. We have approximately 21 positions in our operations area. That would include Operations Support Services, Human Resources, and we have 25 in our technology area.

I think that's -- and just looking at the -- trying to grab some of the bigger numbers here -- and 32 in our Investment Office.

COMMITTEE MEMBER GILLIHAN: So of the retired annuitants, I assume that the organization is adhering to the 180-day sit-out rule before hiring a retired annuitant without prior authorization?

FINANCIAL PLANNING, POLICY & BUDGETING CHIEF McAULIFFE: Yes.

COMMITTEE MEMBER GILLIHAN: Thank you.

CHAIRPERSON COSTIGAN: Mr. Jones.

COMMITTEE MEMBER JONES: Yeah. Thank you, Mr. Chair. Two comments, I guess, and one maybe suggestion. On the salary savings, due to the vacant positions, I know we asked a year ago to put a credit in the budget to reflect the potential vacancies that would occur during the course of a year. And I think that -- and I know you did some of that, but maybe this is an indication that you need to increase that when you get into budget development for next year, so that there's not a wide variance between what's budgeted and what's expended, because of the salary savings due to vacancy, so that's one comment.

The comment about using vacant positions to fund added requests is -- I think it's wonderful, but I think if you do that, you need -- and I don't know if you have a policy, but I think you need to make a budget adjustment to reflect that, because if you just move it -- if you authorize someone to expand for a position that they don't have, and then at the end of the year that office is going to show an over-expenditure, where the other office is going to show an under-expenditure. So maybe you need to develop a budget transfer adjustment policy to reflect those kind of adjustments. And then that will bring it -- your budget and expenditures into line with the policy action.

CHIEF FINANCIAL OFFICER EASON: Thank you. Yes, we agree with that, and we'll look into that for the next budget.

CHAIRPERSON COSTIGAN: Thank you, Mr. Jones.

Ms. Paquin.

ACTING COMMITTEE MEMBER PAQUIN: Thank you, Mr. Chair. Thank you for the report. And I fully understand and can sympathize with the concern about the vacant positions, but I would like to call on Mr. Eliopoulos and Mr. Bienvenue to describe what the 8 ESG positions would be doing, because the Board did spend 8 months this past year putting together a very comprehensive strategic plan for ESG. And specifically, Mr. Bienvenue, if you can describe what those 8 positions would be for versus the other 8 vacancies you have in global equity? Thank you.

CHAIRPERSON COSTIGAN: Mr. Eliopoulos.

CHIEF INVESTMENT OFFICER ELIOPOULOS: Okay. Ted Eliopoulos, Chief Investment Officer. We'd be glad to. So for the Committee's benefit, if you flash back a few months ago, we completed the global governance 5-year strategic plan in the Investment Committee. And the recommendation from the Investment Committee to the Finance Committee was to bring forward the request for the actual positions that would be needed to implement that 5-year plan

So from a governance and process standpoint, the purview of the Investment Committee was to review the plan and approve the plan. And appropriately so, the Finance Committee, right here, this moment of review and accountability is to see whether or not the expenditure and the authorization of these positions is wise and prudent, given the enterprise's competing needs and position.

From the Investment Office's perspective, these 8 positions are meant to effectuate the key tenets of that plan, which the pillars of which align along both the letters of ES&G, which were mentioned, but also the key governance components of the Global Governance Program.

So under that rubric, under the governance rubric, much work on proxy voting on financial market reform and regulation, that's one key pillar. On social, quite a bit of work decked against diversity and inclusion efforts in both the public and private markets. And then on the E pillar, on the environment, much work on the sustainability of our investments, both from a risk and an opportunity standpoint. So that's just to kind of refresh the Committee's memory along that lines.

We've done a lot of work to think through that request, given the most recent U.S. elections, among other things. And we think those pillars, and those priorities, and the plan itself holds up looking at over the course of the next 5 years.

But I'll turn it over to Dan who, at least 5 of the 8 positions in the organization structure, is given the responsibility now to move forward with this plan.

MANAGING INVESTMENT DIRECTOR BIENVENUE: Thank you. Dan Bienvenue, Managing Investment Director for Global Equity.

Yeah. As Ted said, 5 of the 8 positions are coming into global equity. And as Ms. Paquin you point out, we have 8 openings in global equity. I will say that those 8 vacancies probably really overstates the vacancies in global equity for a couple of reasons. One is that some of those are the AIM positions that are in the process of being filled, but then they're actually being given back to either the organization or elsewhere in the investment office. So those aren't really vacancies, and that's 4 positions.

The others are all in active recruitment. We are in the blessed position of having a number of people that have internally moved up and then had internal candidates take jobs, but that tends to overstate those vacancies.

So with the 5 positions that are coming in to global equity, they really reflect the core work that has happened in that sort of corporate governance type space. So as Ted says, it's proxy voting. It's shareowner engagement. It's all -- or, I'm sorry, shareowner campaigns. It's all of the engagement activities, both focus list and sort of ongoing engagement activities. So there's really a lot of work there, and that's a brand new business unit within global equity that requires an Investment Director and a couple of aims to just provide leadership for that team.

Now, part of that has been staff coming over from what had been the legacy global governance team. And we're referring to that kind of as the hub. But I think a lot of that is hub's activities. The other 3 positions are for the quote "hub", and those hub activities, while some of the activities in terms of proxy voting, et cetera is coming out of that global governance team, that's being replaced with the 6 sort of strategic initiatives, as well as a lot of the partnership work and things that are going on in that global governance team.

So they're -- you know, as Ted describe, that -- the plan that was adopted in August, it was an ambitious plan and it -- you know, candidly, it requires resources, and that's the reason for the request.

ACTING COMMITTEE MEMBER PAQUIN: Thank you.

CHAIRPERSON COSTIGAN: So just a question on resources before you go. Each of these positions, I just want to make sure, is around 133,000. Is that salary/benefit? I mean, how did we build the -- how did we build in the fact that 3 positions are only 400,000 for half a year. So 800,000 for a full year includes what?

I just want to make sure I understand this, because it's 3 positions and 4 million for the Investment Office. So you're not saying the cost of the 3 positions are 4 million. How much are the costs -- excuse me, how much are the costs of 3 positions?

Microphone, please.

FINANCIAL PLANNING, POLICY & BUDGETING CHIEF

McAULIFFE: For the 3 positions in the Investment Office?
CHAIRPERSON COSTIGAN: Um-hmm.
FINANCIAL PLANNING, POLICY & BUDGETING CHIEF McAULIFFE: So for half a year, it's 379,000, and for a whole year, it's 658,000.
CHAIRPERSON COSTIGAN: Is that salary/benefits, is that the whole package for the employee?
FINANCIAL PLANNING, POLICY & BUDGETING CHIEF McAULIFFE: It includes incentive and recruitment differential.
CHAIRPERSON COSTIGAN: What's -- I'm sorry, and I apologize, I don't see it here. What are -- are these investment officers? What class are they in?
FINANCIAL PLANNING, POLICY & BUDGETING CHIEF McAULIFFE: So for those 3 PYs, one is an Investment Manager, one is an Investment Officer II, and one is an Associate Governmental Program Analyst.
CHAIRPERSON COSTIGAN: All right. And then the other 6? I'm sorry, the other 5?
FINANCIAL PLANNING, POLICY & BUDGETING CHIEF McAULIFFE: The other 5 in the global equity realignment is one is an Investment Director, two are Associate Investment Managers, and two are Staff Services Analyst positions.
CHAIRPERSON COSTIGAN: And sort of up to Mr.

Gillihan's question, we don't have any SSA vacancies anywhere in this organization?

I would assume we do, since you're smiling.

FINANCIAL PLANNING, POLICY & BUDGETING CHIEF McAULIFFE: Yes.

CHAIRPERSON COSTIGAN: So if 2 of them are new SSAs, why are we not either taking 2 SSAs that are we already have an moving them? I mean, that's Mr. Gillihan's -- I don't want to speak to you, but why are we creating 2 new SSAs when you already have them?

And I understand the 8 positions on it, but if 2 already exist and they're vacant, why aren't we just taking those? Why are we adding 2 more?

CHIEF INVESTMENT OFFICER ELIOPOULOS: I'll take that one. I don't believe we have any vacant SSAs within the Investment Office just to be clear.

CHAIRPERSON COSTIGAN: How about across the organization?

CHIEF INVESTMENT OFFICER ELIOPOULOS: But across the organization, I think this new approach and protocol that Cheryl is spear-heading to put together will allow us to look across the organization to see if we can do that kind of trading.

Candidly, I don't think it -- it's at the point yet that it would be timely for us to effectuate the corporate governance plans that we need to do in order to look to see whether there are any SSAs that are available that we could take from the rest of the organization.

CHAIRPERSON COSTIGAN: So as a compromise or just to throw it out there, why don't we eliminate 2 SSAs somewhere else, and give you -- I mean, if we can -- look, I mean, this is a broader discussion to have. When they're investment officers are one thing. When you're just creating staff positions -- and I know this is part of a global one, and there are other ones that exist, this is also what CalHR and SPB have been working on and broad classifications and trying to on-board people. And instead of looking inside and saying that we have vacant SSAs which are a fairly common position, we're adding 2. We're doing -- oh, here comes Mr. Hoffner.

Mr. Hoffner is going to offer up 2?

(Laughter.)

DEPUTY EXECUTIVE OFFICER HOFFNER: Well, as the collective enterprise. I think -- maybe to the point that was raised, so I think we're talking about -- we actually have it on the agenda for next week to talk about this enterprise pooling concept, so broadly across our 3,000 employees or so. How quickly we could do that? I think based on my previous conversation with our CEO, we're looking to effectuate that immediately. And so that would speak to the opportunity to look at reducing 2, or modifying, or trading is sort of the point that Mr. Gillihan is raising. So we're talking about a more immediate opportunity to make those changes.

CHAIRPERSON COSTIGAN: But again, Mr. Hoffner, one of the issues we still have, and I will be talking about it in budget, is we've got the blankets. We have 192 vacancies. We're adding new positions. We're adding SSAs. I mean, part of this is this more comprehensive look. And so it's always about the power of addition. We don't seem to do a lot of subtraction.

And so one of the issues here is where are we accounting for everybody? At some point I know -- I'd like to see everybody in a blanket, put in a position with 192 -- I would rather you come back -- and because right now we shouldn't have a 10 percent vacancy rate, if we have more people in the blanket than we actually have vacancies.

I mean, at some point -- I know that's a very simplistic look by going in and looking at your employees, but right now, we are actually at, if my math is right, it's 280 -- it will be 288 -- 2,886 PYs pluses 283, which will put us over 3,000. Yet, back to the transparency, which we've really strived for, we'll be arguing we only have 2,886 positions, of which 192 are vacant. We're adding 14 and we have 283 that are off book. That's a problem for me from just a transparency standpoint. I mean -- and one is that's why we're having this hearing so we can talk about it.

Mr. Gillihan.

COMMITTEE MEMBER GILLIHAN: And just one point I've made up here before I think in prior, probably one year ago this time, departments broad latitude to reclass positions. So it doesn't have to be an SSA for an SSA. Once you have position authority, you can reclass it as often as you want, assuming it's below a staff manager II salary. If it's above that, it requires approval by the Department of Finance, but that's not a particularly tough approval to make if you're -- especially manager if you're managing your resources in an appropriate manner and not just throwing additional positions at the budget. I think I've said enough about this, so --

CHAIRPERSON COSTIGAN: And again, I just want to reiterate, Mr. Gillihan, you have CalHR and the State Personnel Board that want to help. I mean, you're in a unique position. So the underlying positions, as Ms. Paquin and Ms. Yee and Ms. Mathur have raised are very important positions to add. I don't want to lose site of the policy. This is a Finance Committee and this is about positions.

And I think the difficulty here is we're adding as opposed to looking at -- so I don't want to policy to get lost. I know this is a first reading. So maybe when we -- and I know, Mr. Jelincic, we'll get to you in a second -- is that we do bring it back. But it is something -- and where we looked to HR, if you see a problem in doing this, let two of the control agencies know, to the extent that we can help. This is not -- because I am still -- and again, I too want to praise you all for this whole blanket.

I mean, we stumbled into it. We're 5 years in. It's great that we're getting down there, but still this is -- the blanket positions are an added number that we're not necessarily counting for. I mean, that's accurate, right, Ms. Eason, the 283 are not accounted for?

CHIEF FINANCIAL OFFICER EASON: That's correct.

CHAIRPERSON COSTIGAN: Okay. They're accounted for in a different line item --

CHIEF FINANCIAL OFFICER EASON: That's right.

CHAIRPERSON COSTIGAN: -- but not the authorized number of PYs.

CHIEF FINANCIAL OFFICER EASON: That's right.

CHAIRPERSON COSTIGAN: And so I know Ted this is not an issue for you. This is more of a global one, so don't go far.

Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: Well, a couple of things. When you move a position from IT over to investments, one of the things you have to address is what are you doing to the IT program. So, I mean, it's not just simply swapping the numbers.

I also recognize that the global investment and, quite frankly, the Financial Office positions really are policy positions, so I'm actually supportive of them.

But, Ted, one of the things that I thought I heard was 32 temporary employees in the Investment Office. And I'm -- you know, we use -- we should be using temporary employees if it's a temporary program and the need is going to go away. Why are -- how did we wind up with 32 temps in Investments? What are we doing in investments that's going to go away?

CHIEF INVESTMENT OFFICER ELIOPOULOS: Twenty-four of those 32 are seasonal clerks. So that many times is student interns, student assistants that we bring in to help out during the course of the year.

COMMITTEE MEMBER JELINCIC: Okay. I can understand the interns, because partly that's really a recruitment effort, you know, but those are -- it's not like they're doing things that wouldn't -- that don't need to be done. And so I think we need to think about what's the appropriate permanent staffing rather than just bringing in interns. But thank you.

CHAIRPERSON COSTIGAN: So I have just a couple more questions. Just so -- and again, don't want to -- after all this, I don't want to say I want to micromanage, but I'm going to raise another issue. I see that on -- you've reduced third-party administrator costs in the long-term care program. Now, it's my understanding, and not to have a policy discussion here that part of -- because it says due to membership trending downward that one of the issues that had been raised is that we may not have the appropriate level of staffing. So I just would like -- want to make sure back to, as Mr. Jelincic raised, that our departments are right sized.

I always noticed, Mr. Hoffner, I didn't see much in IT in new PYs mid-year or a lot of programs, which may be a very efficient department. Although, I know the emphasis that we've have been putting on. So again, I hope I've -- we've conveyed to you all we don't mind having the discussions. Bring forth. These are good. I don't want self-selecting, because on one hand if the result of the reduction in the third-party administrator costs in the Long-Term Care Program is the inverse that we don't have enough staff to recruit or to go out and find folks to join the program, that's a discussion that we should probably have, and so -- because I saw nothing -- I'd understood that at one point there was a proposal for additional positions.

FINANCIAL PLANNING, POLICY & BUDGETING CHIEF McAULIFFE: Rose McAuliffe, CalPERS team member.

In the mid-year budget process, we tried to minimize the PY requests. There is a policy we have in place that for positions they need to meet the criteria for the mid-year, which is unanticipated or directed. And of these positions, we felt they qualified for that.

There -- we are embarking on the annual budget process, and resources are being requested. The due date was today, so --

CHAIRPERSON COSTIGAN: I just wanted to -- because I just note the note is reducing costs because we have a number of folks in the system reducing when we should actually be moving towards the other trying to get more people to go into the system, and so --

FINANCIAL PLANNING, POLICY & BUDGETING CHIEF McAULIFFE: Are you referring to the third-party administrator fee costs?

CHAIRPERSON COSTIGAN: Correct, where it says due to membership trending downward.

FINANCIAL PLANNING, POLICY & BUDGETING CHIEF McAULIFFE: So membership is trending downward in --

specifically in the Long-Term Care Program.

CHAIRPERSON COSTIGAN: Correct. And that's where I've heard we might need more positions to increase membership.

FINANCIAL PLANNING, POLICY & BUDGETING CHIEF McAULIFFE: Okay. I understand.

CHAIRPERSON COSTIGAN: Anyway, something just to a talk about. I heard a little about that when I was -- when we were down in Riverside.

FINANCIAL PLANNING, POLICY & BUDGETING CHIEF McAULIFFE: I did want to add one point on the temporary positions. Of the 280, 180 of them are either seasonal clerks or retired annuitants. And so because of the way they're classified, they will never really be able to be transferred and converted into permanent PYs. I just wanted to mention that.

CHAIRPERSON COSTIGAN: Okay. That would be great. Okay. Again, I just want to emphasize I appreciate the discussion. How far we've come in the last 4 years is rather amazing. And so I appreciate all you have done. And we continue to make the information available. So this was just a first reading. We will see you all in December for the next reading, correct?

CHIEF FINANCIAL OFFICER EASON: It does require approval.

CHAIRPERSON COSTIGAN: Oh, I'm sorry. It is an action item. Never mind. Thank you, Priya.

All right. It's an action item. I'm not reading --

ACTING COMMITTEE MEMBER PAQUIN: I move approval.

CHAIRPERSON COSTIGAN: Moved by Paquin. Seconded by?

COMMITTEE MEMBER JELINCIC: Second.

CHAIRPERSON COSTIGAN: Jelincic.

All those in favor?

(Ayes.)

CHAIRPERSON COSTIGAN: Opposed?

Motion carries.

Okay. We're going to take -- before we go to item 7a, we're going to take -- 6, sorry. I can't read the agenda today.

We'll take up 6a, and then we're going to take a short break. All right.

Mary Anne, hello.

LEGISLATIVE AFFAIRS DIVISION CHIEF ASHLEY:

Hello.

CHAIRPERSON COSTIGAN: Off you go.

LEGISLATIVE AFFAIRS DIVISION CHIEF ASHLEY:

Members of the Committee, Chair Costigan, Mary Anne Ashley, CalPERS team member. I'm presenting agenda item 6a, which is an action item.

CalPERS benefit program areas are seeking Committee approval to pursue legislation to make minor policy and technical changes to sections of the Government Code affecting the benefit programs administered by CalPERS.

The analysis and background of each proposal is included in your Board materials for your reference. And I'd like to first begin with the 2 proposed changes that are clarifying and technical in nature, and that would be included in the annual housekeeping bill. These proposed changes, first, would eliminate the requirement that a member provide CalPERS with signed approval from his or her spouse when designating that spouse as the sole primary beneficiary of his or her lump sum death benefits, or the sole beneficiary of a retirement settlement option that provides the spouse with the same lifetime monthly benefit as the member upon the member's death.

And the second proposed housekeeping change would be to clarify the alternative funding threshold for the Purchasing Power Protection Allowance Program for the State and school retirees.

Both of these proposed amendments are to help ensure the continued efficient administration and good governance of CalPERS. We have run these by our committee consultants. They didn't have any concerns with these housekeeping proposals.

And before moving on to the policy proposals, we'd be happy to answer any questions.

CHAIRPERSON COSTIGAN: So similar to the questions I raised yesterday on legislation, who would oppose this?

LEGISLATIVE AFFAIRS DIVISION CHIEF ASHLEY: We don't have any voiced opposition yet. We're still waiting to meet with the Department of Finance. We have provided them with all the background information. However, we've --

CHAIRPERSON COSTIGAN: None of our external groups?

LEGISLATIVE AFFAIRS DIVISION CHIEF ASHLEY: No. None so far that we've met with.

CHAIRPERSON COSTIGAN: Thank you.

Mr. Jelincic, first.

COMMITTEE MEMBER JELINCIC: Yeah, on the issue of the spousal signature, I can understand why that certainly makes the administration easier. But on the other hand, there is some value in making sure the spouse is aware of the benefits that they have coming, if they wind up being the survivor. And so I think we need to think about that before we go charging down this road. And if you want to comment, you're welcome to or --

CHAIRPERSON COSTIGAN: Anthony, you look like you want to say something. No. Okay.

Mary Anne, any response?

LEGISLATIVE AFFAIRS DIVISION CHIEF ASHLEY: We'll take that into consideration. We are following up also with the family court just to make sure they didn't have any issues as well, so...

COMMITTEE MEMBER JELINCIC: And you may want to discuss it some with the retiree groups, because they're typically the people who deal with survivors more than the actives.

Thank you.

CHAIRPERSON COSTIGAN: Mr. Jones.

COMMITTEE MEMBER JONES: Yeah. Thank you, Mr. Chair.

Yes. Could you expand a little bit on this Purchasing Power Protection Allowance and what is the impact on our retirees?

ACTING CHIEF ACTUARY TERANDO: Sure. Scott Terando, Deputy Chief Actuary. This legislation is basically just cleaning up some language within the PERL. There's no change to the way the benefits are administered, and there's no change to the cost of the benefits, and how it's current administered. It's basically just clean-up bill to clarify the threshold on the PPPA for the state and school employees.

COMMITTEE MEMBER JONES: Thank you.

CHAIRPERSON COSTIGAN: Mr. Slaton.

COMMITTEE MEMBER SLATON: Thank you, Mr. Chair.

Back on the spousal signature, I know in most cases in the private sector, in a 401(k) plan or any kind of investment account where you're doing -- dealing with beneficiaries, normally if it's the spouse, you don't have to get the signature. If it's other than the spouse, then it requires the signature.

Does this situation occur in -- mostly in cases where there's still a family unit, or does this happen across the Board in all sorts of cases?

BENEFIT SERVICES DIVISION CHIEF SUINE: I can take that question. Good afternoon, Mr. Chair, members of the Committee. Anthony Suine, CalPERS team member.

So, Mr. Slaton, this -- you know, this really comes about with -- just to give you the picture of I'm submitting my spouse as the lump sum designation. I'm an active employee. So today if I submit that form, then I turn around and I generate another form to the spouse to let them know, oh, your husband has asked for you to be the 100 percent beneficiary, could you sign this form?

So that's a typical scenario that's just duplicative work, per se, and cumbersome to the member to get that beneficiary designation process. So that's a large volume of the requests. So, you know, we receive about 60 percent of those beneficiary designations that are -- designate the spouse already.

COMMITTEE MEMBER SLATON: Okay. Do --

BENEFIT SERVICES DIVISION CHIEF SUINE: And then on the retirement side it's -- right, I'm leaving 100 percent of my allowance to my spouse. And so that would be the case where, again, if there was no other beneficiary designations, then I would not require the spousal signature on that.

COMMITTEE MEMBER SLATON: So the -- but the spousal signature would be required if it were other than the spouse?

BENEFIT SERVICES DIVISION CHIEF SUINE: Exactly. If it was other than the spouse, if it was not an ongoing allowance that was being left to the spouse, if there was any other -- even if the spouse is the 100 percent lifetime beneficiary, but I designated other individuals for my lump sum death benefit, per se, which may only be $2,000, I would still require a spousal signature for that.

COMMITTEE MEMBER SLATON: Okay. And can you -- and I still -- I guess maybe I missed, because I was trying to get this question clear in my mind, but coming back on the second item that's in the list of the -- I'm missing it now -- the purchasing power. So tell me if we don't do this, what happens, if we don't put this in place?

ACTING CHIEF ACTUARY TERANDO: If we don't do this, right now, nothing would change. We're just trying to clean up the language in the PERL. It's various changes over the year made the language unclear. And we just are trying to clear it up, so it's obvious how we are administering the benefits.

COMMITTEE MEMBER SLATON: So there's not an economic change?

ACTING CHIEF ACTUARY TERANDO: No, there's no impact on costs to the plan or how we administer them or what we pay out in benefits.

COMMITTEE MEMBER SLATON: Okay. All right. Thank you.

CHAIRPERSON COSTIGAN: Okay. Any other questions?

Not seeing any. This is an action item. Mary Anne, anything else?

LEGISLATIVE AFFAIRS DIVISION CHIEF ASHLEY: Do you want to take action --

CHAIRPERSON COSTIGAN: Oh, sorry. Go ahead. Go ahead.

LEGISLATIVE AFFAIRS DIVISION CHIEF ASHLEY: -- on the housekeeping or just go ahead with --

CHAIRPERSON COSTIGAN: No, keep going. Keep going.

LEGISLATIVE AFFAIRS DIVISION CHIEF ASHLEY: Okay. The CalPERS benefit areas are also seeking Committee approval to pursue 2 separate stand-alone bills. One would be to seek legislation that would allow CalPERS to assess employers a $200 penalty per month for each unenrolled retired annuitant or instance of unreported required information for each retired annuitant.

Currently, existing law requires each CalPERS employer to notify the System of any change in the employment status of a CalPERS member and to provide upon request information on employees not enrolled in the System.

Current law allows CalPERS to assess a one-time $500 administrative fee on an employer that fails to timely enroll an active employee into CalPERS membership as specified.

CalPERS has notified public agencies and school employers through circular letters and employer manuals of their duty to enroll retired members working after retirement into the my|CalPERS system, at the time they are hired, as well as to report pay rate and hours worked.

The timely and accurate reporting of hours worked for a retired member is vital as it helps ensure compliance with post-employment statutory restrictions. However, CalPERS audit findings have shown that several contracting agencies have failed to enroll, report pay rate, and hours worked for retired members timely and accurately.

This is at times led to otherwise preventable post-retirement employment violations that have required retired members reinstatement to active service.

In efforts to encourage and increase employer compliance, CalPERS program area is recommending and seeking Committee approval to pursue legislation to allow CalPERS to assess employers a fee of $200 per month for each unenrolled retired member until the retired member is enrolled and/or $200 per month for each retired member for whom the employer fails to report the retired information until that information is received. The legislation would also specify that public agencies, school employers, and State employers would be subject to the reporting requirements.

We have reviewed this proposal with our committee consultants and have expressed it at the stakeholder outreach briefings and have not received any voice of opposition or concerns. And before moving onto the next one, are there any questions?

CHAIRPERSON COSTIGAN: Well, I just want to make sure, because what I was going to move to a moment ago, one -- there are no issues with taking this as one action item?

Okay. I just want to make sure, because it's 3 separate proposals you're pursuing. Although, it may end up in one clean-up bill.

LEGISLATIVE AFFAIRS DIVISION CHIEF ASHLEY: Yeah.

CHAIRPERSON COSTIGAN: But I just want to -- that's why I was going to try and break it. But you all are fine with one.

Okay. Yeah, do the last item, please.

LEGISLATIVE AFFAIRS DIVISION CHIEF ASHLEY: Okay. And the last --

CHAIRPERSON COSTIGAN: Oh, Sorry. Mr. Jones has a question.

COMMITTEE MEMBER JONES: Yeah, thank you, Mr. Chair.

And I support imposing some kind of penalty for noncompliance. But my question goes to what ultimately is the impact on the retired annuitant?

BENEFIT SERVICES DIVISION CHIEF SUINE: So the retired annuitants could be in violation of the working after retirement rules and regulations. So they could -- the consequences are reinstatement into active employment when they didn't intend to ever reinstate, but they violated the working after retirement rules, which then creates a situation where they have to pay back their retirements, potentially impact their health benefits, their cost of living adjustments. So it's quite impactful to the retiree.

And so all these mechanisms will help to ensure that they do not violate. They should know and the employer should know, but having that data reported to us allows us to help them monitor both on the employer and the member side, especially if they're working for more than one agency where they don't -- aren't keeping track collectively.

COMMITTEE MEMBER JONES: But what if the retired annuitant complies with all of their responsibility and the agency is at fault? So how do you forgive the retired annuitant?

BENEFIT SERVICES DIVISION CHIEF SUINE: Sure, Mr. Jones. It's -- we see it as a shared responsibility. It's the -- it's both the member and employer's responsibility. So if the employer for some reason is trying to work the retiree greater than 960 hours in a fiscal year, or they're trying to bring them back prior to

180 days, it's really the member's responsibility as well to know they should not be doing that.

And they're notified when they take this employment. We provide publications and education to them about the working-after-retirement rules.

COMMITTEE MEMBER JONES: So there's no way for CalPERS to know that this retired annuitant has exceeded its number of hours that are maximum?

BENEFIT SERVICES DIVISION CHIEF SUINE: We do if the employer is reporting them as required by the law.

COMMITTEE MEMBER JONES: But if the employer is not reporting, there's no way for the member to know.

BENEFIT SERVICES DIVISION CHIEF SUINE: Well, the member would --

COMMITTEE MEMBER JONES: Unless they -- you know, yeah, by working.

BENEFIT SERVICES DIVISION CHIEF SUINE: -- know, because they're hopefully tracking it on their own. But there's no way for us to know if some employer is employing this retired annuitant illegally or over the allotted time frames.

COMMITTEE MEMBER JONES: Well, if this is successful, I would just recommend that there be some kind of real strong communication process, so that retirees are aware that -- of this potential consequence, if the agency is not complying with the regulations.

CHAIRPERSON COSTIGAN: And that's something to work with Mr. Pacheco on.

BENEFIT SERVICES DIVISION CHIEF SUINE: Yeah. Okay.

CHAIRPERSON COSTIGAN: Anything else, Mr. Jones?

Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: As I said on the briefing, a more effective enforcement mechanism would be say a $20 dollar a month reduction in the retirement benefits of the top 3 executives. I think that would get their attention much more quickly.

CHAIRPERSON COSTIGAN: Mr. Slaton.

COMMITTEE MEMBER SLATON: So I just -- I just wanted to pursue this a bit. So you kind of gave an indication this would help that system in regard to the retired annuitant. I'm not sure I see it helping at all. I mean, it helps in the sense that the employer puts them in the System, but it doesn't do anything regarding if they hit a trigger, and I assume if the reporting hits over how many hours nine hundred and?

BENEFIT SERVICES DIVISION CHIEF SUINE: Sixty.

COMMITTEE MEMBER SLATON: 960. So if the employer reports 961, does the hammer fall? Is it just -- it's like it's automatic, it's -- you're in trouble?

BENEFIT SERVICES DIVISION CHIEF SUINE: Yes.

COMMITTEE MEMBER SLATON: Okay. So, to me, the only way you can really provide additional help to the retired annuitant is once they're enrolled, that they receive a registered letter.

BENEFIT SERVICES DIVISION CHIEF SUINE: So we --

COMMITTEE MEMBER SLATON: Do we do that?

BENEFIT SERVICES DIVISION CHIEF SUINE: We do -- we send them notifications right now. We send -- when people are -- when employers are complying with the rules, enrolling their retired annuitants, and reporting the pay rate in hours, we're able to send the member and the employer warning letters at 800 and 900 hours to let them know they're approaching the limits.

COMMITTEE MEMBER SLATON: Good.

BENEFIT SERVICES DIVISION CHIEF SUINE: And we can also query and make sure that they haven't been brought back more -- less than 180 days from their retirement date. So as we get more compliance with this rule, then we'll be able to do that even more effectively.

COMMITTEE MEMBER SLATON: But it's a passive notification. In other words, we just -- we send something out to both parties, and then we sit back. So we don't -- in other words, do we contact the employer and say you're at 900 hours?

BENEFIT SERVICES DIVISION CHIEF SUINE: Yes.

COMMITTEE MEMBER SLATON: So it's an active contact?

BENEFIT SERVICES DIVISION CHIEF SUINE: It's an active contact. It's a notification that's automated that contacts them and says, this employee is approaching -- has reached 900 hours, please monitor their working, so they don't exceed the 960 hours.

COMMITTEE MEMBER SLATON: And how often does this occur where this problem occurs.

BENEFIT SERVICES DIVISION CHIEF SUINE: The violation occurs.

COMMITTEE MEMBER SLATON: Yeah.

BENEFIT SERVICES DIVISION CHIEF SUINE: Sometimes we're unaware if it, so we find them through or public agencies reviews that's a large number of the findings or we get ethics reports where they're turned in or some of the employers come to us voluntarily. So, you know, we deal with it often, but not voluminous numbers of violations.

COMMITTEE MEMBER SLATON: Okay. Small number.

BENEFIT SERVICES DIVISION CHIEF SUINE: Yes.

COMMITTEE MEMBER SLATON: Okay. Thank you.

CHAIRPERSON COSTIGAN: Okay. Any other questions?

LEGISLATIVE AFFAIRS DIVISION CHIEF ASHLEY: And then the last proposal recommended is to secure an author and vehicle for potential legislation that would be necessary to enact improvements to practices and processes that were designed to reduce system complexity. The most recent cost effective measurement or CEM report notes CalPERS has been scored the highest in total relative complexity compared to all systems participating in the CEM.

CalPERS currently is analyzing the CEM results to identify opportunities for CalPERS to reduce the complexity. And so program area recommends seeking an author and a vehicle for future legislation in the event that legislation would be necessary in order to enact the identified changes and improvements to practices and processes to reduce complexity.

And that concludes --

CHAIRPERSON COSTIGAN: Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: So it's really a request to seek a spot bill?

LEGISLATIVE AFFAIRS DIVISION CHIEF ASHLEY: That's correct.

COMMITTEE MEMBER JELINCIC: Thank you.

CHAIRPERSON COSTIGAN: Yes.

All right. Any other questions?

Seeing none. It is an action item.

COMMITTEE MEMBER JONES: Move approval.

CHAIRPERSON COSTIGAN: Moved by Jones.

VICE CHAIRPERSON HOLLINGER: Second.

CHAIRPERSON COSTIGAN: Seconded by Hollinger.

All in favor?

(Ayes.)

CHAIRPERSON COSTIGAN: Opposed?

Motion carries. Thank you very much.

All right. We are -- oh, I'm sorry. Please record CalHR as abstaining on it. And, Mr. Gillihan, had told me that.

We are going to take a short recess until 4:00 o'clock. And if you've not signed up to speak, please do. So we have -- I have a running list up here. Thank you.

(Off record: 3:49 p.m.)

(Thereupon a recess was taken.)

(On record: 4:02 p.m.)

CHAIRPERSON COSTIGAN: All right. We're going to wait for -- Mr. Jones is in here. Mr. Slaton I saw. Is he still in here? We'll give him a minute to get back in here.

So very quickly before we get started, in talking with Mr. Lind, the next meeting probably will not start till 5:00 For those that are interviewing, it's going to be moved up to the front of the agenda. So I know that there are folks in various rooms. So they can rest or stress out a little bit more, so --

(Laughter.)

CHAIRPERSON COSTIGAN: -- we're going to just wait till Mr. Slaton gets here. I just want to wait one more minute.

Okay. There's Mr. Slaton.

So -- I'm sorry, I have to find -- I need to just read something before we get started. And so as we move into Item 7a, I know this is going to be a very important topic. So I just want to say at the top of the discussion, typically speakers are limited to 3 minutes each. I'm doing this now, so that you guys have the opportunity to think about your presentations.

In light of the complexity of this issue and the number of folks who have wanted to speak on it, we are going to be increasing the amount of time for public comment from 3 minutes to 10 minutes.

So when you come down, we're going to ask you to introduce yourself, your affiliation for the record. The microphone will be turned on. We'll leave you with the 10 minutes. And as we get closer to it, I will give you a little bit of warning, and if you go a few seconds over, but I'm going to try not to cut anybody off. But given the importance of the issue, we thought it would be a good opportunity. So I just wanted to say that at the beginning of it.

So with that, Ms. Eason, you are up.

CHIEF FINANCIAL OFFICER EASON: Thank you very much. And I'd like to introduce who's with me this afternoon. We have the Chief Investment Office Ted Eliopoulos; Deputy Executive Officer of Communications and Stakeholder Relations, Brad Pacheco; Deputy Chief Actuary Scott Terando; Andrew Junkin from Wilshire; and Allan Emkin from PCA.

Today's discussion centers around securing CalPERS future, managing funding risk, stakeholder outreach, and engagement. You will recall in August at the Investment Committee, they were presented the -- we presented the mid-year cycle capital market assumptions, which indicated lower than anticipated 10-year projected returns.

And in September, this Committee received the annual funding level and risk report prepared by the Actuarial staff. That report determined that there was a significant amount of risk being taken in the funding of the System.

(Thereupon an overhead presentation was
Presented as follows.)

CHAIRPERSON COSTIGAN: Mr. Hoffner, I think we need some additional tech positions.

(Laughter.)

CHIEF FINANCIAL OFFICER EASON: So I'll just -- there should be a slide there that's -- okay.

So to secure CalPERS future and long-term sustainability, we recognize the need to understand and manage today's funding and market realities. Ted will lead the discussion on the low return environment, the change in risk assessments associated with return expectations, and the market challenges that lie ahead.

Scott and I will tackle plan dynamics, such as demographics, negative cash flows, and the aging population. Brad will share results of a survey conducted with stakeholders about their awareness, preparedness, and implementation preferences for future higher contribution rate increases with the potential lowering of the discount rate.

Additionally, Brad will outline the feedback from agencies on their ability to pre-fund their pension liability obligations. Then we'll conclude with a recap on discount rate trends from other U.S. pension plans.

Before we start this discussion, last month, the Committee had asked staff to address the question of the impact of cost of living adjustments, or COLA, on the fund. And I'll turn to Scott to address that question.

ACTING CHIEF ACTUARY TERANDO: Thank you, Cheryl. Ill. Scott Terando, Deputy Chief Actuary. In September, we got a request to look at the COLA. And I try and account for how much of the normal cost and accrued liability it accounts for in the pension plan.

And what we found out is that approximately 14 to 18 percent of the normal cost, and the accrued liability are accounted for by the COLA. And with miscellaneous plans, they generally fell around the 14 to 15 percent range. And for the upper range of 16 to 18, it was more around the safety.

Now, putting this maybe in perspective, if we look at the State, their normal cost contribution for the 16-17 valuation year is 5.4 billion. So the COLA amount just for this would amount to a little over $804 million.

For schools, they have about 1.7 billion normal cost. And then we're looking at approximately 252 million in normal cost for the COLA proportion.

Going back to -- for the liability portion, the State plan has around 162 billion in liabilities. So approximately 25.8 billion of those liabilities are associated with the COLA. For schools, we're looking at over almost 11 billion in liabilities associated with the COLA.

And that pretty much approximates the cost for the State and schools. What we found out for public agencies, the percentages are basically the same, around 14 to 15 percent for miscellaneous, and 16 to 18 percent for the safety plans.

CHAIRPERSON COSTIGAN: Thank you.

Ms. Hollinger, I know that -- I believe you were the one that raised that question. Did he answer your question?

Sorry. Turn on your microphone. Hang on a second. Go ahead.

VICE CHAIRPERSON HOLLINGER: Yes, he did. Thank you very much.

CHAIRPERSON COSTIGAN: You're welcome.

Mr. Jones, I'm sorry, I believe on the COLA on this question.

COMMITTEE MEMBER JONES: Yeah.

CHAIRPERSON COSTIGAN: Mr. Jones.

COMMITTEE MEMBER JONES: Thank you, Mr. Chair. On the accrued liability, that's the liability for what group of employees is they go from people just starting to work last year all the way through retirees.

ACTING CHIEF ACTUARY TERANDO: Yeah, it reflects all employee classifications, active separated transfers, and retired members as well.

COMMITTEE MEMBER JONES: So how much of that number is for just retirees?

ACTING CHIEF ACTUARY TERANDO: I'd have go to back and check the breakdown on that.

COMMITTEE MEMBER JONES: I would like that number.

ACTING CHIEF ACTUARY TERANDO: We could provide that information for you.

COMMITTEE MEMBER JONES: Okay.

CHAIRPERSON COSTIGAN: Thank you.

Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: And can you repeat the dollar numbers.

ACTING CHIEF ACTUARY TERANDO: Sure, for State the normal cost was around 804 million, for the normal cost, and 25.8 billion for the accrued liability.

And for schools --

VICE CHAIRPERSON HOLLINGER: How much?

CHAIRPERSON COSTIGAN: I believe he said 25.8 billion.

ACTING CHIEF ACTUARY TERANDO: Yeah. And for the schools we are at 252 million for the normal cost, and 10.8 billion for the liability. And, you know --

CHAIRPERSON COSTIGAN: I'm sorry, Scott. Are you guys being able to hear him back there?

Okay. Speak up. I'm having a hard time hearing you speak.

ACTING CHIEF ACTUARY TERANDO: Okay. For an easy way to double check the numbers, you can grab the current State and schools valuations that were published recently, and they're on the web, and take approximately 15 to 16 percent of the numbers in that report, and you'll get the same numbers that we're looking at here.

COMMITTEE MEMBER JELINCIC: Okay. So the 25 and 10 were just the COLA component?

ACTING CHIEF ACTUARY TERANDO: Yes, correct.

COMMITTEE MEMBER JELINCIC: Okay. Thank you.

CHAIRPERSON COSTIGAN: Okay. Any other questions on the COLA?

Mr. Jones, your microphone is still on, but your --

COMMITTEE MEMBER JONES: I'm fine.

CHAIRPERSON COSTIGAN: Okay. Thank you.

All right Ms. Eason back to you, please.

CHIEF FINANCIAL OFFICER EASON: Great. Thank you.

So managing funding risk in the seemingly ever changing economic and demographic climate has never been more challenging. With a projected funded status of 68 percent, combined with emerging market conditions, and planned demographics, there is a need to look at the funding of the system more closely than ever before to ensure the sustainability of the fund over the long term.

Ted let me turn the presentation over to you, we have a short video from outside investment experts, as well as I know you wish to discuss some of the current and future market challenges.

CHIEF INVESTMENT OFFICER ELIOPOULOS: Great. Thank you, Cheryl. Committee members, Ted Eliopoulos, CIO.

Before I turn to the video presentation, I thought I'd just introduce it just a bit. I feel like I've covered this territory many times with the Investment Committee and at Riverside at the Employer Conference as well, which many of you attended. Very familiar themes and slides and presentations, including -- including this video of some noted investment experts and investment professionals that we admire.

But before we play it, I just want to note many of those -- all of those statements and video clips were compiled prior to the U.S. election last week. And certainly, as you heard yesterday in my comments, it is a significant election. And I'll talk a little bit about that in my remarks today as well.

But as we turn to this video presentation, you can see it really encapsulating both the views of your Investment staff here, as well as most investors globally in terms of the -- really a growing consensus around a number of themes that we've talked about quite a bit in our Investment Committee:  Low inflation, despite quantitative easing throughout the globe; moderate global growth that had been slowing over the course of the past couple of years; living in a world of low interest rates; significant demographic challenges globally, particularly in the advanced economies of Japan, Europe, China more and more so, and to a less significant degree the United States, given our immigration policies.

And lastly, global trade networks as a real central or hallmark -- centrality or a hallmark of the global economy, but certainly we're seeing new threats to that with Brexit prior to the election.

So with that, I wanted to key up this video that we did see in Riverside as well, which I think really does a good job of presenting that consensus, prior to the U.S. election.

So with that, I think if I hit this button, it will start to play.

(Thereupon a video was played.)

CHIEF INVESTMENT OFFICER ELIOPOULOS:  Terrific. So now, let's reflect a bit on the market conditions and other conditions that really reflect that -- that world view. This is a -- this is a diagram that the Committee is very familiar with. I think by now we've covered it a few times now.

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CHIEF INVESTMENT OFFICER ELIOPOULOS: And it's really the Investment Office's attempt to put on one chart some of the major forces that are at work in terms of our current asset allocation, our discount rate, and interest rates. Those are the 3 main pieces of data on this chart.

And the first thing that comes jumping off the page is that what we call, or what is called, this 30-year secular decline in interest rates. And that's that blue line, the big sort of the Matterhorn decline from 1980 to currently, that the 10-year treasury yield has come down quite strikingly over that period of time to, you know, a low of around 2 percent currently.

At the same time, our discount rate has remained fairly steady. It's come down since the 80s to the more current run from about 8¼ to 7½ and that's that purple line. And that spread between the 10-year yield and our discount rate what that produces is that array of colors, the asset allocation that is the backdrop to those -- to those 2 lines.

And what you see there is the construction of an asset allocation in a portfolio that is more and more heavily dependent on equities. And that's what the big green blob on the page is, as well as the red, which is the private equity, and the purple, which is the Real Assets Program.

So you can see over time in order to aspire to earn a 7½ percent return over a longer period of time, you need to invest quite heavily in equity risk. And that's something that we've talked about quite a bit in our asset allocation.

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CHIEF INVESTMENT OFFICER ELIOPOULOS: Now, turning forward to our expected returns on that same mix of asset allocation, that same mix of public equities and private equities, and real assets, and fixed income that we just looked at, what we've been discussing over the course of the last couple of years now is the declining expected rate of return of that same basket of assets within the program.

And this is showing the lower expected returns of each of the components of the asset allocation between 2013 and currently. I think this chart is a little easier for looking at it as one total fund. And here, what this demonstrates is that in 2013 when we put together the asset allocation as part of the ALM exercise, that for a

10-year forecast of investment returns, that basket of assets we would -- we expected at that time to earn roughly a 7.10 percent return. And the volatility forecast for that basket of assets was just shy of 13 percent, 12.94.

Over the course of 2016, our outside investment consultant, Wilshire -- and they're here today -- and the Investment staff and Committee, as we've looked at the return estimates as part of our regular review, as well as the mid-year review that Cheryl mentioned, we have lowered -- we -- I'll start with Wilshire has lowered their expected return for their capital market assumptions for their wide base of clients, such that if you took those lower expected return for the asset classes and put them into our asset allocation, our asset mix as presently constructed, it's about a 90 basis point less expected return for the 10 years. So a significant lowering of our expected return than we estimated just 2 years ago.

And at that lower rate of return, it's still the same level of volatility. You can see the 12.58 percent level of volatility. And that reflects the increased level of volatility that we've experienced over the course of the last year.

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CHIEF INVESTMENT OFFICER ELIOPOULOS: We've mapped those 2 estimates of both return and volatility on our efficient frontier to show under either the 2013 work -- 2013 ALM workshop return and volatility assumptions or in 2016 looking at the current Wilshire asset class assumptions. We're still far out on the right side of the efficient frontier. In other words, we're pushing the limits of the return expectations for unit of risk that we undertake.

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CHIEF INVESTMENT OFFICER ELIOPOULOS: So to sum it all up, there are certainly challenges ahead. This is a time of significant challenges going forward. Investment Committee and we have discussed that quite a bit. Here are some of the most pressing challenges that we've talked about. I won't restate them. I think we can now add to that the recent United States election, which as I said is very recent, very new. We don't -- you know, I think the only thing we can say with confidence is that there's a wide range of potential policy actions that may or may not occur, and may be implemented in a wide variety of ways.

But what I do think we can say, as I said yesterday, it portends a wider range of uncertainty and volatility going forward. While it could presage and help address some of the growth concerns in the United States going forward, it does not do that without significant risk, as I mentioned yesterday.

In addition, the U.S. business cycle, while in what we have termed mid to late cycle, might be extended for some period of time, those results are quite uncertain going forward, and will depend on many inputs that are yet to come. So I think -- I think the challenges ahead are quite pronounced. And it would be wise, and I think it's wise for our institution to take all of that into account, together with the look at really our longer term view of the State of the fund currently, in terms of our funded status and our cash flow position, and really look at what is the long-term strategic positioning of our fund, given the long-term trends that I've just discussed.

So with that, Mr. -- or, Cheryl, that's my presentation. I know we have more to come.

CHIEF FINANCIAL OFFICER EASON: Thanks, Ted.

CHAIRPERSON COSTIGAN: Thank you, Mr. Eliopoulos. Just very quickly, Ms. Hollinger, I know you have a question. Could we -- if it's okay, could we do the presentations, if that's all right with everybody, and then we'll do questions.

Okay.

CHIEF FINANCIAL OFFICER EASON: Thank you.

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CHIEF FINANCIAL OFFICER EASON: So Ted mentioned, there are challenges ahead. And in addition to some of the challenges just outlined, we have demographic factors that also significantly impact our pension funding, and that is our aging population. We are seeing larger numbers of members leaving the workforce in greater numbers than ever before.

To put it into perspective, 2011 was the first year the Baby Boomers to reach the age of 65. On average, 10,000 Baby Boomers turn 65 years of age every day across the U.S., and will continue to do so until the year 2030.

And not only are we seeing more Baby Boomers retiring in large numbers, life expectancy has also increased. For pension systems across the United States, including CalPERS, that means more retirees expected to live longer, and therefore receive benefits for a longer period of time, putting pressure on cash flow requirements of pension systems.

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CHIEF FINANCIAL OFFICER EASON: Because these demographics have a direct impact on the increase of retirees, we consider that CalPERS is in, what we call, a mature State. Fifteen years ago, there were 2 active members to every retiree. That ratio now stands at 1.3 active members to every retiree.

Currently, this maturity of the System is at its highest level than ever before. But more important, it's expect to continue and increase over the next 20 years when the ratio will be closer to 1 to 1. However, CalPERS isn't alone, as other retirement system in the U.S. are also showing a steady decline of active members to retirees. And these systems are also experiencing negative cash flows. So with that, let me turn this over to Scott and he can talk about that.

ACTING CHIEF ACTUARY TERANDO: Thank you, Cheryl.

On the next slide, you -- on the next slide, we can see how the cash flows have occurred over the last few years.

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ACTING CHIEF ACTUARY TERANDO: And the top portion is what we might consider to be the negative cash flow, where benefits exceed the contributions received. And you can see, over the last few years, there's been this steady trend, where we've used more investment income to pay the benefits.

And as Cheryl mentioned this is just basically a process of the planning continuing to mature, our system. We were increasing the number of retirees. Longevity is increasing. And these various items are continuing to put pressure on the negative cash flow.

We do have some mitigating -- some mitigations occurring. PEPRA was enacted about 5 years ago. And while it's really too early to see the impact, I think 15, 20 years down the road, we should see an increase in -- or a decrease in both the contributions and the portion going towards the negative cash flows.

I think one thing -- one thing we need to keep in consideration with all the information we're seeing here is that basically the risk remains high in our system, and we're at a 68 percent funded status. And I think those are some of the biggest drivers to keep in consideration with all the information being provided.

And with that, I'll pass it back to Cheryl.

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CHIEF FINANCIAL OFFICER EASON: Thanks, Scott. Funding benefits is a shared responsibility. The benefits granted by employers to CalPERS members are balanced by investment income and the contributions from employers and employees to fund the System. It's important to remember that while contribution levels are fairly predictable over time, investment earnings fluctuate, depending on market performance.

If we anticipate lower investment returns, and higher benefit payments in the future, increased contribution levels will be required to pay benefits to balance the equation.

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CHIEF FINANCIAL OFFICER EASON: So what's the view ahead?

Well, what we're hearing is that the expectation of market volatility and lower rates of return over the next several decades, when combined with these plan dynamics, requires early actions to reduce risks. We also need to take into consideration, that Scott talked about, our 68 percent funded status, which in the event of a significant market downturn could make the fund more susceptible to lower funded status.

As we prepare for a low return environment, we need to continue to focus on risk. We're in this together, as we have a shared responsibility to our stakeholders. And with that, Brad, I'd turn it over to you to talk about our stakeholder outreach.

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DEPUTY EXECUTIVE OFFICER PACHECO: Thank you, Cheryl. Mr. Chair, members of the Committee, Brad Pacheco. So as Cheryl mentioned at the outset of the presentation, one of the directions by the Committee was to gauge our employer community about their awareness of the discussions that we've had around the low return environment. Potential changes to the discount rate, and how they're preparing for those changes, if any.

So we spent the better part of October and early November, and we touched nearly 600 -- or over 600 employers through a variety of outreach methods. We did some in-person polling at 2 conferences that were sponsored by our employer associations. We spent a lot of time, as many of you that were there at the Education Forum, doing surveys and in doing interactive presentations and tabletop presentations with our employers.

We did an on-line survey that our employer partners distributed for us. And we also had direct meetings with the leadership of our employer associations.

And what we asked our employers was what was their awareness of the discussions that this Board has been having about the low-return environment that our investment team and consultants expect? What actions, if any, are they taking or considering for a potential discount rate change or future employer contribution rate increases, such ass prefunding or budget forecasting? What are their views on the relative importance of risk mitigation, reducing volatility in employer contribution rates, and maximizing returns? What's their ability to absorb increase contribution rates in the next 12 months? And if they had a preference, would they like a discount rate change made in one reduction or phased in over time?

I'm happy to share the results of that survey.

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DEPUTY EXECUTIVE OFFICER PACHECO: So on the topic of general awareness, about 75 percent of our employers said they were following our discussions to some degree. And this level of awareness generally depended on the role of the individual that you were talking about at the particular employer. Our school employers reported a little lower level of engagement, which is understandable, because many of them do participate in our risk-sharing pool.

And what we learned is the action of our employers, and I'll talk about this a little bit later, that they have taken for future pension cost increased ranged from forecasting to making additional payments to CalPERS, and some indicated that they're prefunding pensions.

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DEPUTY EXECUTIVE OFFICER PACHECO: So we presented our employers with 3 priorities to rank, risk mitigation, reduction in the volatility of employer contribution rates, and maximizing returns. And what we found was the highest priority between the employers was the reduction in volatility.

And for most, that was followed by risk mitigation. Now, why the distinction between these 2 is significant in the on-line surveys, the team at the Educational Forum reported that during face-to face discussions with our employers, the volatility in reduction in employer contribution rates, and risk mitigation, tended to blend and be more equal priority since risk mitigation tends to lead to a lessening in volatility.

Maximizing returns was the least selected response. Those who did select it were very clear in their response, urging us to take an aggressive posture in pursuit of hire returns, regardless of market forecasts.

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DEPUTY EXECUTIVE OFFICER PACHECO: And in this next slide, you'll see the responses by our employers of actions taken to anticipate increases in contribution rates. And as you can see the majority have done forecasting of budgets, with the assumption that contribution rates will increase. Anecdotal comments by our team suggested that many of the employers are looking beyond 5 years, and in some cases looking 10 years or more.

A significant number are prefunding, using a trust or considering prefunding the future, and others are exploring making additional payments to CalPERS.

I think what to note what we found in all of our responses that the employers do have some level of preparation underway in anticipation of increased contribution rates

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DEPUTY EXECUTIVE OFFICER PACHECO: When asked directly if they were prefunding pension liabilities, about 30 percent said they were, and 70 percent said they were not.

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DEPUTY EXECUTIVE OFFICER PACHECO: Then we were asked for them to rate the impact on a lowering of the discount rate in the next 12 months. And as you can see, the majority rated it as either a high impact or extremely high impact. Some -- the rest rated it as having some impact. Virtually, no one rated it as having little impact or no effect at all.

And in discussions with the employers, obviously these changes -- these answers changed, depending on the level of the discount rate change that the Board would consider.

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DEPUTY EXECUTIVE OFFICER PACHECO: And then finally, the majority of the employers that we surveyed preferred a phased-in approach to reducing the discount rate over time, as opposed to one larger reduction.

Now, I know the directive by the Committee was to look and engage our employer community around this topic, but we felt it was very important that we also present you with some of the issues, questions, and concerns that our member associations raised. And I know some of them are here today and can articulate on these more, but we did have conversations with them. And their primary concern is around the decrease -- or decrease in the discount rate.

Obviously, it will lead to increased costs to members, especially the PEPRA members, and increased costs to employers. And there was concern around those employers that may be already struggling to meet their current obligation.

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DEPUTY EXECUTIVE OFFICER PACHECO: It was raised that the Board recently approved a Risk Mitigation Policy, and that policy hasn't had an opportunity to take effect. So there was that question raised by the member associations.

They also questioned, as a long-term investor like CalPERS where we typically focus on a 30-year or even longer time period, why we would be focusing on this short

10-year period that Ted and the investment consultants have mentioned.

And then lastly, there was a desire by having an approach that was agreed upon by all parties, and that was long-term focused, so that there -- if there was incremental changes to the discount rate, everyone knew about those well ahead, and knew when they would be happening in the future.

So with that, Mr. Chair, I will turn it back over to Cheryl.

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CHIEF FINANCIAL OFFICER EASON: Thanks again, Brad. We also indicated that we would come back with what other U.S. pension plans are doing in this discount rate space. And we had indicated in the funding levels and risk report in September that the trend nationally for public pension plans in recent years has seen a reduction in the rate of return assumption.

So we took a deeper dive into a -- into the report by NASRA, the National Association of Retirement Administrators. They released a report this year. And some of the highlights from those findings were among the 127 plans measured in the 2016 survey. The median discount rate is 7½. Of those 127 plans in the survey, 59 plans have reduced their investment return assumption since 2012, so just under 50 percent. So let me just dive a little deeper into those plans that have lowered their discount rate, those 59 plans.

Fifteen of those 59 plans dropped their discount rate by 25 basis points, 18 dropped their plans by 50 basis points, and of those, only 17 took a phased-in approach. The average drop in the discount rate was 37 basis points. Now, since this survey has been produced, additional plans have made, or plan to make, reductions such as Florida, Hawaii, and Washington.

So therefore, other pension funds are reinforcing lower rate of return assumptions and have already taken steps, in some cases, towards lowering -- or addressing the low return environment.

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CHIEF FINANCIAL OFFICER EASON: We have some proposed steps, and we also have asked that -- we've invited the Board's consultant Wilshire Associates, and PCA to speak briefly about the -- their projected short- and long-term capital market assumptions and asset return trends. But let me first say that based on the information presented today and your feedback, next month the staff would be prepared to bring back to the Board a discussion on the impacts of a discount rate reduction on contributions, the funded status, and timing options, including staff recommendations.

We would also continue our stakeholder outreach and engagement. As we feel, that's a very important part of the process. And with that, I would just ask for Wilshire and PCA to add any comments that they have.

MR. JUNKIN: Andrew Junkin with Wilshire Consulting.

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MR. JUNKIN: Thank you. I just have a few pages here. The first of which just kind of views -- displays the framework that we use to evaluate risks more holistically, more than just investment risks, what are some of the risks to organizational sustainability across our client base, whether that's retirement plans, or foundation, or endowments. It doesn't really matter. These sort of transcend the type of investor.

It's important to note that some of these risks can really compound each other. And we've talked a lot, probably to the point where you no longer want to hear some of these examples, about how high volatility in a cash flow negative plan, those 2 in particular can compound reach other in particularly deleterious ways, a significant drawdown leads to forced selling at reduced prices, and those assets aren't allowed to recover, because you've got obligations that you've got to pay out.

Another way to think about that, in my view, is being aggressive, having a reasonable amount of volatility and wrong could lead to an unrecoverable loss. Being conservative and wrong, in your case leads to higher contributions, but it's still a sustainable benefit to the CalPERS member.

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MR. JUNKIN: The next page just kind of really shows that reduced expected returns are not new for us. Our forecasted returns have been declining for more than a decade, it hasn't been a smooth ride down, and we've enjoyed some pretty good returns along the way, but that's typically how that works. Prices go up, future returns come down.

But one point that I did want to make is really it's -- as we look a page 4 here, the orange line is kind of the expected returns of just a 60/40 blend, so just a very generic institutional portfolio. The blue line is cash. You can see both have been trending down. The green line is the difference between those 2, the risk premia that you earn for investing in something other than a risk-free asset. And that's actually been pretty steady. So it's not that we think that equity returns have collapsed, or that fixed income returns have collapsed. It that's the risk-free rate is almost 0 right now. And when you take a building block approach to expect returns, that's a significant issue.

I do want to address a question that I suspect is coming, which is what about the difference between our 10-year forecasts and our 30-year forecasts?

Our 10-year forecasts are 6.1, 6.2 percent, given your asset allocation. Our 30-year forecasts are about 7½ percent. And to me one of the biggest issues that CalPERS faces, and this echoes what you've heard from everyone else at this table, is the existing funding status and the existing cash flow status.

And if you were fully funded, and cash flow neutral or cash flow positive, risk is a very different conversation in that case. But the 7½ percent forecast over the next 30 years is an asset only forecast. It doesn't take into consideration the nature of the liabilities, the funded status and the cash flow status.

And it assumes that you, as a plan, essentially can live through all 30 years, including what we expect as you can see from our forecast the next 10 years to be pretty slim. But in my view, the long term is really kind of a collection of various short-term periods. And if you don't make it through one of the short-term periods, you don't get to experience the long-term return.

So that's a challenging message to convey, because you could implement, and we think you have implemented, a thoughtful investment portfolio, but there still could be exogenous events that cause a significant loss that no one could forecast that create a significant problem.

So, you know, when I think of this, to me, we've talked about this again, the path of the returns matters. And when I think about the funded status, the cash flow status, I begin to think -- almost -- think of it as almost an IRR calculation instead of a time-weighted return calculation. It matters then how much money you have and the sequence of the returns. And instead of thinking of just the asset value, think of your starting point as kind of the funded status. Low returns at a 68 percent funded status for 10 years means that even if we are right about the next 20 years, years 11 through 30, you know, you're going to be in a position having suffered through a very painful decade relative to the existing discount rate. So I'll stop from there and turn it over to Allan.

MR. EMKIN: In your packet, there is a table. And what it does it provides at the beginning of the year, we did a survey of prognosticators of what did they expect in the capital markets? And it includes both Wilshire and us, and it shows that without very much variance, most of the people who do this kind of forecasting have muted expected rates of return for the next 10 years.

There's a caveat. There's no evidence that any of us know what we're talking about, right? And I'm not trying to make fun there. There's no evidence that anyone in our business has been accurate in forecasting the future, but we have a scientific method. It's an art and a science. And all of these practitioners basically come up with pretty much the same numbers.

And the one column I want to point you to is the first column, the compound expected rate of return for publicly traded equities. That's going to be the dominant factor in the performance of your portfolio. And the highest expected rate of return over the next decade is 7.2 percent compounded.

That's less than your current actuarial interest rate assumption, and that's for the asset class that you're going to be hoping will drive performance over this period. The best performance is from private equity. And even there, the numbers aren't that much greater than public equity. But I do want to reference that if you look at the risk, we assume that there's a significantly high level of risk in private equity. And that went into the forecasting, so those numbers are uncertain.

So this is sobering. We don't go beyond 10 years, because we believe the further you go out, the less precision you'll get, and the less real information or knowledge that goes into the numbers. The numbers speak for themselves. We're happy to answer any questions you may have.

CHAIRPERSON COSTIGAN: Okay. Thank you. So now we're going to do questions from the Board members. So first, Ms. Hollinger.

VICE CHAIRPERSON HOLLINGER: Thank you. And I appreciate all of your updates, and Cheryl and Ted and Brad and Scott and Wilshire and Allan, that you put into this. I also recognize this is a tough situation that we're all in, because of the added hardship that increased contributions would make on our stakeholders. And we're looking -- I'm, of course, being the insurance industry chair, I look to hedge risk. And I also, as a fiduciary in these times, feel that the number one sustainability that we have to concern ourselves with is the financial sustainability of the fund.

So, Andrew, to your point, I think we have to make it through the next 10 years to be in the next 20 years and 30 years for our future generations. So I think it's really important we all have to understand that right now we're going into liquidation mode, because we're cash flow negative. And that when we did set the return at 7½ percent, I confirmed with staff, we were not cash flow negative then.

So about 2.67 percent of any return we get on our investment just goes to fund our cash flow negative. So a little under 3 percent of the return is not even going to increase our savings and compounding.

And when you factored that in that we didn't even think that at 7½ percent we're taking a lot of risk. And in the insurance world, when you're cash flow negative, and you're in the environments that we have, regretfully our risk mitigation strategy that we set in place has not been able to come in place, because of the low return environment of the past few years. And if it's projected, as we've seen today, it's very doubtful it will help us get through this period.

So what -- it's kind of like the equivalent of all of a sudden your retirement income going to 0 and now you're having to live off your principal. You want to make sure that you safeguard that principal for your future and not put it as significant a risk.

So my question to Ted, Scott, Andrew, and Allan is what risk level are you comfortable with? And then maybe we should arrive at the return by looking at -- we are entering a shift where we have to preserve our principal. So that's my question.

CHIEF INVESTMENT OFFICER ELIOPOULOS: Sorry.

I'll start that off. I think the question of what, you know, risk level any of us, and collectively all of us, are comfortable with --

VICE CHAIRPERSON HOLLINGER: Right.

CHIEF INVESTMENT OFFICER ELIOPOULOS:

-- definitely is something that is answered during the ALM process when we have all of the factors in place.

For me, speaking from the Investment Office's perspective, when we looked at the Risk Mitigation Policy, what we concluded at that time is 8 -- a level of volatility or risk of 8 percent is what we felt more comfortable given the funded status and the cash flow status of the fund, but we recognize there are other inputs to that and challenges.

And the attempt of the Risk Mitigation Policy was over a 20- to 30-year period of time, try to reduce the risk profile of the fund from a 13, 12 percent level of volatility to 8 percent level of volatility over that long period of time.

Looking today at the question that the Committee asked us to look at in terms of current discount rate, really with the same level of volatility, what I think the Investment Office is saying, quite clearly our best estimate, in looking at the graphs that Allan and Andrew put together, without even changing the current risk profile of the fund approximately 13 percent volatility of the current asset mix without changing that.

We believe the current market assumptions for that portfolio is to earn about a 6 percent return rather than 7 percent from 2 years ago. And given that, we think it's appropriate for this Committee to look at our discount rate and evaluate, absent even, reducing the overall level of risk within the fund. It's really to reflect the reality of the market assumptions and the projected returns that we see from this current mix of assets.

VICE CHAIRPERSON HOLLINGER: Okay. And Andrew and Allan.

MR. JUNKIN: I'll take a shot at that. Can I have the -- can I go back into the CalPERS presentation?

I'm going to do a bit of math on the fly, which is going to be dangerous.

VICE CHAIRPERSON HOLLINGER: Okay.

MR. JUNKIN: So, you know, when you think about -- I think this is a great question, because I saw a slide, and I just saw it on Thursday, and couldn't get it into the presentation materials, but a manager had taken a look at sort of 3 different windows 1995, 2005, 2015, so

10 years apart. It kind of breaks up some of the incremental changes that we see even in our own assumptions on a quarterly basis, and you think, well, it's five basis points.

An they said, if you had to make 7½ percent, and you had forecasted returns in 1995, they didn't have to right, just a set that was reasonable, you could have done it with a portfolio that was 75 percent bonds and 25 percent cash, and your risk level would have been 6.

If you had to make 7½ percent in 2005, the portfolio began to get a little bit more complicated. It had equities and it had private asset classes. And the risk level went from 6 to about 9.

And in 2015, using their forecasts, which they're not on Allan's page, their forecasted risk level is 17 to earn the same 7½ percent.

VICE CHAIRPERSON HOLLINGER: Wow.

MR. JUNKIN: So I think this is a great question, because what's happened, with you really step back and look at it in sort of decade-long increments, the risk premia has been squeezed. And again, I think a lot of it is just interest rates have collapsed effectively.

So knowing that we've all -- all inventors have had to introduce more risk, more complexity into portfolios to try to generate returns. I don't think you need to go back to a 6 percent risk level. I think that's probably way too low. I think 17, if that's the number that they came up with, that's probably too high. We're saying here this is 12½. So here's the quick math.

So a 1 in 20 bad outcome would be 2 times the green bar subtracted from the blue bar, so that would be 25 percent below 6, right, minus 19 percent. A 1 in 20 negative outcome, I think I saw Scott nod, so that makes me feel comfortable that I'm doing the math right --

(Laughter.)

MR. JUNKIN: -- would be a minus 19 percent return. And so I think the question -- Ted is exactly right, the proper venue for this discussion is the asset liability workshop, but these are the kind of issues that need to be addressed. Is a negative 19 percent return something that CalPERS can manage through and get to the other side?

CHAIRPERSON COSTIGAN: So before I call on Ms. Taylor, because I know we're continuing to --

VICE CHAIRPERSON HOLLINGER: I just have another comment to make.

CHAIRPERSON COSTIGAN: Okay. Go ahead, Ms. Hollinger.

VICE CHAIRPERSON HOLLINGER: My other comment to make, and I want us to do a good job of managing expectations, is that whatever we decide I think we have to understand that it's a good start, but it doesn't necessarily solve the problem. It's just a step in the right direction, and reduces the size of the problem. And that this is something we're going to continue to work at collaboratively.

Thank you.

CHAIRPERSON COSTIGAN: So just very quickly before I call on Ms. Taylor, Mr. Hoffner, we're going to put Item 8a over till December, is that correct?

DEPUTY EXECUTIVE OFFICER HOFFNER: Correct.

CHAIRPERSON COSTIGAN: Okay. And then -- because I'm trying. We still have one more Committee hearing. And then Ms. Lum, Ms. Eason, could we put 7b over or do we need to take that up today?

CHIEF FINANCIAL OFFICER EASON: I think we're fine to move that as well.

CHAIRPERSON COSTIGAN: Okay. Oh, wait a second. I'm sorry. I'm so sorry. Go ahead, Mr. Jacobs.

GENERAL COUNSEL JACOBS: I have to disagree with Ms. Eason on this.

CHAIRPERSON COSTIGAN: Okay. So we'll leave 7b on, but 8a for those -- so those of you that were here for 8a, we can go -- you all can go ahead and go.

All right, Ms. Taylor.

BOARD MEMBER TAYLOR: So I want to thank you guys for the presentation. I have a question for Ted. So we are actually going to be looking at this in the ALM. We're not looking at reducing the rate of return like next month is what you're not looking at that, is that correct?

CHIEF INVESTMENT OFFICER ELIOPOULOS: Well, no. I think we will be --

BOARD MEMBER TAYLOR: Well, no.

(Laughter.)

CHIEF INVESTMENT OFFICER ELIOPOULOS: No. So at the ALM, we will be looking at all of these things for sure and setting these rates. I think one of the questions for -- that this Committee is asking and what we've put forward is whether or not to come back in December with a look at whether it is appropriate to -- or a recommendation with respect to the discount rate to make a decision now, in addition to discussing these things at the next ALM.

BOARD MEMBER TAYLOR: So -- okay. No, I didn't know that. I think that's -- I think we have a process for that with ALM coming up. And I'm not sure that -- I think the panic that you're giving us right now is just that, it is a panic. We haven't even -- PEPRA hasn't had a chance to work. We've had 18 months of our last -- of the last rate reduction, right, and no we haven't been

able to trigger that? You are -- were correct about that.
But here's my other question. I mean, if we reduce the rate of return, we also reduce our funded status, right?
ACTING CHIEF ACTUARY TERANDO: That is correct. When we --
BOARD MEMBER TAYLOR: So don't we put ourselves in the same situation? If we're reducing the rate of return, then we're reducing our funded status, thereby if an event occurs, then we're going to end up with the same situation, which is not being able to pay out. And we can't change the cash flow. That's something we can't change. So I'm a little confused at the panic and expediency that you guys are selling us right now. That's where I'm a little confused.
CHIEF INVESTMENT OFFICER ELIOPOULOS: Okay. Great questions and great concerns. So I think rather than -- rather than panic, I think what you're hearing -- what you're hearing from your investment professionals on the asset allocation side is our view, our methodology of looking at expected returns going forward. And what we've been telling the Investment Committee and telling this Committee here today is our best forecast for rates of return going forward is that they're lower, and substantially lower than we estimated 2 years ago.

Now, that will be looked at again in the next ALM cycle. But given that forecast, and our view that there's not much that will change that going forward, would this Committee and this institution like to address that reality today or now, so that you have some amount of time to plan together with your employers and employees to effectuate changes to meet that reality?

BOARD MEMBER TAYLOR: Well, changing it in December doesn't -- doesn't give our employers and our stakeholders a chance to sort of breathe around that, I don't think.

I think you've been talking about this for a couple months, but -- and maybe I was out on surgery when you were talking about it longer, but I think that -- thinking -- you just stated that you're thinking about having it changed December, maybe -- I don't know, January. And I don't think that gives anybody time to get the money together or whatever it is they need. But also, I'm just concerned that the reduction doesn't mitigate what you're talking about, because in the long -- we haven't even given anything a chance to work. PEPRA hasn't had a chance to work. Our original risk mitigation that we just finished really hasn't had a chance to trigger. We could revisit what those triggers can be to reduce, that's a thought, so that it's a phased-in process, as apparently our employers said they wanted, which is a phased-in process.

But I think we're in a situation where I feel like we're being pushed to make a decision a lot quicker than, and I know you keep saying that this Committee asked for it. They probably did, and I was probably not here, but I think that we need to step back and breathe. I don't know that we're going to see a change, even if we do start a reduction, I don't see that we're going to see a change that's going to resolve any of this right away. So that's where -- that's my personal feeling right now.

CHIEF INVESTMENT OFFICER ELIOPOULOS: So I think that's -- I think that's the question for this Committee, and for this Board. That's -- that is why we have this governance structure. All I can do, as the Chief Investment Officer and your professionals can do, is give you our best opinion on the topics that we oversee, so that the Committee as a whole, and the Board as a whole can wrestle with all these competing interests and come to the best decision for the institution.

CHAIRPERSON COSTIGAN: Anything else, Ms. Taylor?

Mr. Bilbrey.

BOARD MEMBER BILBREY: So Ms. Taylor, I'm going to address what you were saying first, because that's not what I had down here. But I was here -- or I've been here. I remember asking for information. I don't -- somehow I missed in the process that we were going to actually make a decision.

CHAIRPERSON COSTIGAN: There's been no -- let me make it clear. I've not given a direction that there's a decision. There's been direction given to bring this information forward.

BOARD MEMBER BILBREY: Right.

CHAIRPERSON COSTIGAN: Now at the end of this meeting, there may be direction given for a next step.

BOARD MEMBER BILBREY: Okay. But before --

CHAIRPERSON COSTIGAN: But right now, there's no vote today. This is an informational item.

BOARD MEMBER BILBREY: But before today, it was to bring information forward. It wasn't that we were going to be possibly making a decision in December, is that correct?

CHAIRPERSON COSTIGAN: I don't know what we're going to do yet.

BOARD MEMBER BILBREY: Right, but what I'm saying --

CHAIRPERSON COSTIGAN: We're going to continued. If you recall -- I'm sorry.

BOARD MEMBER BILBREY: Before today.

CHAIRPERSON COSTIGAN: We didn't have an October

Board meeting.

BOARD MEMBER BILBREY: Right.

CHAIRPERSON COSTIGAN: So to back up a little bit, and I know it's getting late, we had a low return in July. We had an offset meeting. We had a presentation done to us in August. We had a September meeting where this issue was raised.

BOARD MEMBER BILBREY: Right.

CHAIRPERSON COSTIGAN: We didn't have an October meeting. We brought this to us in November -- or to this Board for discussion. It is my understanding, and we'll get into this in a little while, that in order to hit certain triggers with the State and local, you have to take an action within the next couple months for it to impact 17-18 States and 18-19 locals, that there's a process that they're going to talk about.

But as of right now, Mr. Bilbrey, it was -- over the last 90 days, information has been brought forth by our experts --

BOARD MEMBER BILBREY: Right, right.

CHAIRPERSON COSTIGAN: -- that thought was timely to be brought forth to this Committee --

BOARD MEMBER BILBREY: Right.

CHAIRPERSON COSTIGAN: -- with all that is going on. So at this point, I think it's a little overstated that direction has been given, because there is no vote. I've heard today that we're going to take a vote. There is not vote set for today, so I'm not quite sure where that --

BOARD MEMBER BILBREY: Not today. It's implied in December.

CHAIRPERSON COSTIGAN: Well, but there's no -- but -- I'm sorry, but there were some folks saying there was going to be a vote taken today. There's no vote being taken today. That doesn't mean at the end of the day, I will give direction to staff to bring further information and action back. I'm sorry, Mr. Bilbrey.

BOARD MEMBER BILBREY: And I'm sorry, I don't think we were implying today. We were just implying for December. We were a little -- I'm mean, that's what I'm hearing.

But here or there, I'm hearing both Ted and Andrew talk about the ALM process. You both, through this discussion, have gone -- referred to the ALM process a couple of times. When asked about what is the adequate level of risk, you referred to the ALM process. Why are we not waiting till the ALM process, other than what Mr. Costigan just said, if we're trying to get into some time frame to get to the specific 17-18 year.

I'm going to wrap just 2 or 3 things in real quick in this, so I don't keep it going. Ms. Eason, on your 59 plans, how many of them were above or at 7.5 percent that lowered their discount rate. Do we have that information? If you don't have it right now, we can get it later. But I'd like to know if they were above 7.5. Some might have been, I don't know, 8 or more or some -- I know some plans are higher than we are. And did they lower it to where we are or lower it, so that kind of -- over those 59.

It concerns me, you know, you make a very accurate point, Mr. Emkin, nobody has the crystal ball perfect, you know, answer. We've seen this in a number of things that have gone recently, that people thought certain things were going to happen, and they didn't. So I done always feel so confident anymore that people have these projections that are actually going to take place the way they are.

And so I get concerned worrying about that we're going to go next month and try to make a decision, possibly. I won't put any words in anybody's mouth, but possibly, rather than going through a real thorough cycle of the ALM process that we have traditionally always done. And there have always been short-term periods that have not done well over the last 30 years. I mean, where are we at right now, 30 -- 30-year return.

I mean, there have been 10-year pockets that weren't great. So I'm having a little trouble grasping right this second why we're doing what we're doing right now so quickly. Not to say that we shouldn't be -- I agree with bringing the information forward and we start the review. So if you -- I know those are several things in there I was trying to get. But if you can answer a couple of them.

CHIEF INVESTMENT OFFICER ELIOPOULOS: Sure. I saw Scott moving towards the microphone, so I waited a second. I think it's very wise to -- the crystal ball point is always wise to remember. And Warren Buffett's cautionary note is important, and that video as well.

But I think we also have to look at what data that we have available and the tools that we have available inform us of our decision making. And I think what's driving the presentation of the information is that our forecasts have been lowered quite materially over the course of this last year. And particularly at the end of a business cycle in the U.S. with the timing of our ALM cycle, it seems prudent to at least consider it, because at the end of a 2-year period, and when the ALM is concluding, it is possible that we'd be entering into a recessionary period in the U.S.

So I think it's -- I think it's worthwhile to take into account the information and have the Committee wrestle with all the points that you've made, and Ms. Taylor has made, and the Committee can wrestle and look through the balancing of all those points.

But from your professional staff's point of view and your independent consultant's, this is the exact conversation we need to be having, and have the information before you, so you can make good, wise decisions. Scott, did you want to add anything else on that?

ACTING CHIEF ACTUARY TERANDO: Well, I just want to make one comment about, you know, why now versus waiting for the ALM? I think, you know, some of the responses Brad got is they want -- the employers are looking to kind of have this not in one shot. So they don't want to wait until the '18 -- the '17-'18 ALM experience, the study and the review, and then have this massive cut come and hit it all at once.

And, you know, based on what we're seeing, it could be a large decrease. And so, you know, why now would be, you know, to have that phased in type of approach, that a number of employers are saying look we know this is coming, have a little bit now and a little bit down the road from a phased-in type of approach.

And also from a timing point of view, if the discount rate change would happen in the next few months, we would be looking at the '17-'18 contribution rates for the State and schools an the '18-'19 rates for the public agencies. So we're still talking of well over 14 months notice to the public agencies, if we have a change in the rate.

CHAIRPERSON COSTIGAN: Okay. Mr. Lind.

MR. JUNKIN: Could I?

CHAIRPERSON COSTIGAN: Oh, I'm sorry. Andrew.

MR. JUNKIN: I just wanted to make a couple of points that occurred to me as this discussion was going on. And one, and this may be a distinction that doesn't really matter, you know, the discount rate and the expected return are not the exact same thing.

And so, to me, they're kind of 2 issues. Is the current discount rate appropriate given the environment that you're in in the existing asset allocation? And then the second question, which I think goes to Ms. Hollinger's question earlier, is the asset allocation correct? I think is the asset location correct, that is clearly an issue for, you know, the holistic review that occurs during the asset liability workshop.

To me, this is a separate issue that -- and again, I think, you know, as Ted pointed out, it's really driven by the current environment, but does the discount rate match the current portfolio and the current expected return sets?

CHAIRPERSON COSTIGAN: Thank you.

Mr. Lind.

BOARD MEMBER LIND: Thank you.

Look, obviously, this is a legitimate, important, critical conversation that we have to have and gather as much information as we can, but it feels a little bit like Ground Hog Day to me, because we had a lot of this information when we came up with the risk mitigation strategy. We did the research. We heard the forecast. We heard a lot from the stakeholders. We had lot of debate, a lot of discussion, and we came up with a risk mitigation strategy.

Now, obviously things have changed since then. We've had a couple years of returns to look at. But if someone could, it could be the consultants or Ted, just in general how much have the forecasts changed, both the 10-year forecast and the 20-year or 30-year forecast from the time we did the risk mitigation process and now?

CHIEF INVESTMENT OFFICER ELIOPOULOS: I'll go first. It's about 90 basis points, because I think the Risk Mitigation Policy was adopted about a year ago now. So almost a full percentage point.

BOARD MEMBER LIND: For both 10 and 30 years?

CHIEF INVESTMENT OFFICER ELIOPOULOS: For the 10-year.

BOARD MEMBER LIND: Okay. What about 30 year?

MR. JUNKIN: The 3-year moves much more slowly. It's probably down 10 or 15 basis points. And I think Ted is right on the magnitude of the 10-year move.

BOARD MEMBER LIND: Okay. And I -- you know, we're going to continue to have the discussion and all that. My concern is that, you know, we're reacting to a 2-year period, which makes us sort of short-term thinkers rather than the long-term thinkers. That's a concern that I think we're going to continue to deal with.

CHAIRPERSON COSTIGAN: Okay. Very quickly. Item 8b, just a little housekeeping, we are going to put over. Excuse me, I'm sorry, 7b. 7b we're going to put over till 8:00 a.m. tomorrow morning. So Finance, we're not going to adjourn our meeting tonight. I know. It's so exciting, Scott.

So that -- so those that are here for item 7b, you're free to go as well, but we will reconvene that item tomorrow morning at 8:00 a.m. before we go into closed session.

Mr. Jones.

COMMITTEE MEMBER JONES: Yeah. Thank you, Mr. Chair. And listening to our -- my colleagues, I think we all have the same goal and that's the sustainability of the fund. And just like Ron said when we dealt with the risk mitigation, we had different views of how to accomplish that, but we all wanted to get to the same place. And I think that we -- in this scenario, we all want to get to some kind of place so the fund is sustainable, but how we get there is the question.

And I have a few questions. So, Mr. Chair, do you want me to just rattle off my questions, and -- rather than going back and forth? And so --

CHAIRPERSON COSTIGAN: I think the dialogue is fine. I mean, do you --

COMMITTEE MEMBER JONES: Yeah, I mean, but they're different individuals, so I can just --

CHAIRPERSON COSTIGAN: Go ahead and rattle them off.

COMMITTEE MEMBER JONES: Okay. Well, I'll go with this one first, and it's for Andrew. You talked about the 7.5 over 30 years did not take into account for liabilities. So I would like to know what would that number be if you then take into consideration the liabilities and any other factor that may affect that number?

My next question is, Scott, you mentioned that the -- I think it was Scott mentioned that we're at 68 percent funded status. And there has been some data that indicates to what level of funded status goes to that there's no return. If anyone have that information, I'd like to know? In other words, if it drops to 50, does that mean that you're automatically changing the program as we know it today? So that's a question I would like to know. What does the data show that how low a fund can go before there's no return?

And the subpart of that question also goes to what Theresa was talking about, that if the -- we continue to get negative returns, what's the impact on that 68 percent funded status? Is there some formula that says for every 2 percent negative return it's a corresponding impact on the funded status?

The question for Brad is that you mentioned that 9 percent of the institutions have pre-funded. My question is, is that all for health as opposed to pension benefits?

And also on -- your report indicated that there was a very low response from ACSA in your report. And so my question is for the schools, and that's whether or not the chief business officials were surveyed, because those are -- generally, the chief business officials and the chief financial officers are the ones dealing with this problem. So I would like to know if you surveyed them and see what they had to say about that?

I think that is it for right now.

CHAIRPERSON COSTIGAN: So, Andrew, you're up first.

MR. JUNKIN: I'm up first. I had the longest to think about my answer.

(Laughter.)

MR. JUNKIN: And the question was since -- I stated that the 30-year return doesn't really take into consideration the liabilities. What would it be if you did take into consideration the liabilities? Really, the return itself wouldn't change. The point I was making was simply the asset only expected return is completely unaware of your funded status, it's unaware of cash flow status, and it's unaware of your ability to withstand a significant drawdown that might, in your year 1 or year 11 or year 29 be so significant as to cause CalPERS to -- or the State of California, I guess, to decide whether or not that he still wanted to be in the defined benefit business.

So really it -- I think the point that I was making was simply that it -- not that the returns would change, it just ignores those considerations entirely, right. There could be an event. I'll use this phrase. I don't mean for it to be inflammatory. There could be an event -- a return that puts you out of business somewhere before you get to year 30. And so the returns over that 30-year window really don't matter if you go out of business in year 8, right? That was the point I was trying to make.

COMMITTEE MEMBER JONES: Okay.

ACTING CHIEF ACTUARY TERANDO: I think I get the next 2 questions. For the -- I think youR second question, what would happen to the funded status if we continue to get lower returns, and kept our 7.5 percent assumptions.

Basically, what would happen is we would incur, you know, the losses year after year. Our funded status would continue to drop year after year, because we would have the losses and contributions would continue to rise year after year.

So, you know, if we had 10 years worth of investment losses, you'd have 10, 15 years plus worth of increasing contributions year after year after year. And your funded status would continue to drop year after year. So where would we be? Ten years from now we'd be higher contributions, and lower funded status.

Yes, if you drop the discount rate now, we have a drop in the funded status, but you'd have increased contributions now, and you'd have 10 years worth of those contributions at a higher level.

I think your next question of is there a -- what's the point of no return for the funded status? I don't think there's a magical term or a set term set in stone. Generally, 50 percent is looked at as being a very bad position. If we drop below 50 percent, I think it's very, very difficult to get above it. I think one important thing to consider is not so much the absolute number, but the trend.

You know, if -- for plans starting out, if you're at 50 percent, but your were 40 percent the year before, and 30 percent the year before, and it's going up 10 percent a year, 50 percent is a great number. If you're at 50 percent, and the year before you were 60, and the year before you were 70, it's going down, it's a worse situation.

So I think you need to take in consideration both the absolute level and actually the trend. And our recent trends have been downward. And so that's -- I think that's more of a concern than the actual number. But, you know, we do reach a point where it becomes very problematic.

COMMITTEE MEMBER JONES: Okay.

DEPUTY EXECUTIVE OFFICER PACHECO: Mr. Chair, I'll just go ahead next. We'll go down the line here.

Mr. Jones, the question that we asked about whether employers were financially preparing for pension increases was specific to pensions. And so we did not ask about health care. So the 9 percent that are prefunding already in a trust is pensions, and the 18 percent that are considering a prefunding or prefunding is related to pensions.

And then in answer to your question about school employees, so we worked with the Association of California School Administrators to do an on-line survey with them, and we got about 63 responses from that. You may be referring to the California Association of School Board Officials, CASBO.

COMMITTEE MEMBER JONES: No, CASBO.

DEPUTY EXECUTIVE OFFICER PACHECO: Yes, CASBO. So there may have been CASBO representatives at our Educational Forum that participated in the survey. We did not work with that group directly. With the on-line survey, we did work with ACSA, but as Cheryl noted, you know, we are continuing to do our stakeholder outreach, and try to expand this as much as we can. But this was what we were able to accomplish within the October time frame before this item was due.

COMMITTEE MEMBER JONES: Okay.

CHAIRPERSON COSTIGAN: Are you done, Mr. Jones?

COMMITTEE MEMBER JONES: Yeah.

CHAIRPERSON COSTIGAN: Thank you.

Mr. Slaton.

COMMITTEE MEMBER SLATON: Thank you, Mr. Chair.

You know part of this discussion reminds me of the climate change discussion, because it's a slow train. And sometimes you can't feel it. And I think we're in a somewhat similar situation in that we have the scientists sitting in front of us saying here's what we forecast. And if you don't take some action, the difficulty becomes even greater when you have to take action later, and the ramifications get worse.

So I guess my question is this, I -- the issue of what we would address -- what we address in an ALM process is what our investments should look like and what our risk profile should look like. But I think what we're facing here is the issue of do we need to inject more cash into the System?

So I would like to hear some response of if we inject that cash, what do we avoid? What does the world look like if we don't do that versus if we start injecting more cash in the system?

CHIEF INVESTMENT OFFICER ELIOPOULOS: I'll start with -- the first part of it is you have less reliance on investment income, which what -- with the volatility that we're forecasting and the returns we're forecasting, we think is a good idea. In terms of the magnitude of that injection of cash, I would look to Scott and Cheryl, you know, to quantify it or describe it to you. But the notion of having a less reliance going forward on investment income, given what we've talked about, is worth considering.

COMMITTEE MEMBER SLATON: So just to expand on that question a little bit, we saw the chart. You ended up stopping at the current time of about 5 billion negative cash flow. But I know we've seen a chart before that projects that out. So what are those numbers? Do you happen to know -- do we happen to have on hand what those numbers are another 2, 3, 4 years out?

CHIEF FINANCIAL OFFICER EASON: I do.

By 2035, it's anticipated that we would be paying out benefits of about 35 billion versus collection of contributions of 17 billion. So that gap can get as high as 17 billion from currently 5 or 6 billion.

COMMITTEE MEMBER SLATON: So that then drives the need for earnings to make that up. Otherwise, you end up with a smaller fund. Is that -- am I painting an accurate picture there?

CHIEF INVESTMENT OFFICER ELIOPOULOS: Yes, you are. And you're -- and what we're saying is at least at this 10-year forecast, the projection for returns are about 90 basis points less than when the last time we looked at this last year.

COMMITTEE MEMBER SLATON: So it just -- it appears to me that this -- you know, the issue is not do we need to inject more cash, how do we do that? And I think this is where we're going to have to conversations. And, you know, the reality is we have a system in place that requires a lot of work to implement anything. And I think as our actuary said, it's already for locals, even if you do something by early -- you know, late winter or early spring by the February time frame, it's not till 2018-19 that anything would take effect for the local agencies. And if you didn't do it by then, then it's '19-'20. And meanwhile, the negative cash flow has gone from 5 and has increased, which exacerbates the problem.

So I think this is not a -- it's not a panic. It's a realization that we have a train moving here and our best advisors are telling us, based on this 90 basis point move, which we didn't have that information available to us, that we need to consider making some adjustments.

So I look forward to the continuing of the conversation, but I think we're ultimately going to have to potentially make some decisions that are not going to be comfortable that we'll have to weigh in the near term.

CHAIRPERSON COSTIGAN: Ms. Paquin.

ACTING COMMITTEE MEMBER PAQUIN: Thank you, Mr. Chair. I have 2 questions. And the first question is for PCA and Wilshire. And I'm just curious, I know that you did these investment earning projections sometime over the summer. And then last Tuesday, the world change on everybody.

So once it becomes clearer what the new administration's first 100-day policies are, and spending policies and tax plans, could that potentially change your 10-year earnings estimates?

MR. EMKIN: Never say never.

(Laughter.)

MR. EMKIN: But the answer to that is we're telling all of our clients the same thing, and that is we are not changing our expected returns, but what we're considering is expecting our risks. We are less certain about what will happen than we were before the election.

ACTING COMMITTEE MEMBER PAQUIN: Thank you.

MR. JUNKIN: A similar story for Wilshire. We, in fact, sent an email to all of our clients yesterday saying we plan on using the same forecasting models that we always have. There's certain inputs that go into that that are going to be market driven. And so we've seen break-even inflation move up 15 or 20 basis points. We've seen the 10-year treasury rate move up, you know, 40 or 50 in the last week. Those will filter through our projections, but it will not create radical changes anywhere.

And I think, like Allan said, the -- we're solidly into the Rumsfeldian "unknown unknowns" realm here. And so there may be more volatility around our projections, not volatility in our projects, but they may move around a little bit more as the market reacts to policies.

ACTING COMMITTEE MEMBER PAQUIN: Okay. Thank you.

My other question I had was regarding the employer outreach. I really appreciated that feedback. And I think that, in particular, Ms. Eason did a great job with that. But the Controller and I were at the Educational Forum and had a chance to speak with employers. And at one of the roundtables, they were some school district folks there. And they were not following this conversation very closely, but that one of the recommendations was to work with CCSESA which I believe is the California County Superintendent of Schools Organization[sic].

And they do meet monthly here in Sacramento. And

I also had a question as far as the continued outreach. I know that you've had a few meetings with the employer -- employee associations. Do you plan to do a similar survey and outreach with those associations as well?

DEPUTY EXECUTIVE OFFICER PACHECO: So we've scheduled a meeting with our member associations right after these meetings are occurring this week. And that's something we can talk with them about. The direction specifically from this Committee back in September was to gauge the employer community. And that's why we crafted the survey the way we did. But as you see in our presentation, we wanted to make sure that you did hear from the member associations, and we did have conversations before coming here. But that's certainly something that we can look at, and -- a survey from a member perspective, the thoughts and impacts from them.

ACTING COMMITTEE MEMBER PAQUIN: Okay. Thank you.

CHAIRPERSON COSTIGAN: Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: I noticed in this little video presentation, we did not have Tony James, who has recently said that a well balanced portfolio can do 8, 9 percent a year over the long term. And we obviously have some respect for him, because we've entrusted him with billions of dollars.

The -- but let me react to a number of the slides. On slide 7, which is the challenges. And you don't have to go there. Global growth is slowing. There's a mixed bag, but that seems to be the consensus.

U.S. Growth will struggle to make one and a half. You know, the last 3 revisions of GDP have been upward. Business cycle is late to mid-term. They don't die of old age. Typically, they die because of inflationary pressures, and wages have been suppressed for years.

Historically, a low interest rate environment, I think everybody agrees that is changing. Looking at slide 10, the negative cash flow. If you look to the left where the negative cash flow was almost as large as it is today, that was a period where we were getting 20 percent returns. We were using the investment to pay it, because we put the employer contribution at close to 0. So I'm not sure that we're drawing the right conclusion.

On slide 12, we're focused on risk, and I would agree and say probably overly so. Slide 15, you talk about the employer doesn't -- really considers it important to reduce volatility. At least at the tables I sat at, that was a well set-up expectation.

I thought they were largely guided that way. Nobody could complain about volatility when the rates were going down. The -- and so it's really not necessarily volatility. And then on slide 20, the next step is labels a Board workshop. Is that the intent to have a workshop or is it coming back as an agenda item?

And I don't know the answer to that.

CHAIRPERSON COSTIGAN: We still have a ways to go. We haven't gotten to the end of the agenda yet.

COMMITTEE MEMBER JELINCIC: Well, okay. So we may be doing --

CHAIRPERSON COSTIGAN: It's a staff recommendation. So we're going to give direction to staff to bring a recommendation back.

COMMITTEE MEMBER JELINCIC: Okay. So we may be doing a workshop rather than bringing it back.

Okay. Henry asked what the point of no return is. And I would point out that I don't think anybody expects the judges pension system to default. Although it's funded status is down in the 1 percent area.

Changing the discount rate changes nothing except estimated costs. It changes our estimate of the funded status. It changes the estimate of the normal cost. The truth of the matter is, pensions are going to cost whatever they're going to cost. We're going to write certain checks. We're taking a guess at what they are, but it really doesn't change anything.

What impacts us is, quite frankly, the portfolio composition. The -- I believe that we can actually design a portfolio that will give us 7½ percent over the long term, if we pick the right assets.

Unfortunately, that's not what we're doing. With the current assets we have, you know, as we have moved asset -- reviewed asset allocation, I have consistently said that I really need to see the risks that we are giving up. It's easy to get a chart that shows how we're reducing our chances of getting to 50 percent because that's the agenda, but it's impossible to get a chart that says what are -- how much are we reducing our risk of getting to 110 percent.

If our job is to balance risk, we have to look at both upside and downside. The -- and Wilshire actually gave us a good example. They talked about, you know, if 2 standard deviations. We've got a 20 percent -- or a 5 percent chance of being negative 19. Did not point out that 2 standard deviations, we also have a 5 percent chance of being up 31. We need to look at both sides.

Given the last 4 asset allocations this Board has made, including the one made in closed session in October, applying the, what I think are, realistic expectations, and they're higher than our consultants are currently giving us. But given our current asset allocation, I do not think we can justify a discount rate of above 6¼, unless we're going to change the assets. And I think that that's probably what we really need a discussion about.

So those are the points, and I could go on. But we're going to go late anyhow, so I will stop at that point.

CHAIRPERSON COSTIGAN: Thank you.

Mr. Gillihan.

COMMITTEE MEMBER GILLIHAN: Thank you, Mr. Chair. I just want to start by responding to a few comments I heard up at the dais today. First of all, I'm surprised that anybody is surprised we're having this conversation.

As Board members, this is about tackling a problem head on, and this is the most important issue facing this system today and for the foreseeable future. I've heard PEPRA thrown out there, as we need to see -- PEPRA -- as somebody that helped develop it, PEPRA was a long-term fix on the benefit payout side.

PEPRA, while it had short-term immediate fixes for funding, on the benefit side, we have to wait for the workforce to turnover, and then for those people to retire in 30 or 35 years before we start reaping the benefits of PEPRA. Certainly, we can't wait that long.

I've heard about the risk mitigation process that we put in place some 12 or 18 months ago. Well, all of our experts, the ones that work for us, and the ones that we trust enough to hire to come in as consultants have just sat here and told us that in their forecast period there's virtually no chance of hitting those thresholds that would trigger any sort of rate reduction. So again, I don't know what we would be waiting for.

And then with respect to ALM, as Board members, we shouldn't be hiding behind artificial processes and dates to take action. This is something that if you care about this system, if you're concerned about the payment of benefits to members, the most important thing we can do is shore up the funding. And we can't wait to do that. It's pay now or pay more later. I've said that before when I was sitting out at that side of the table. And we always -- we know that pay more later doesn't make good fiscal sense, and it's not good for our members and it's not good for this Board.

CHAIRPERSON COSTIGAN: Mr. Jelincic and then we're going to go to Mr. Juarez. And then I would ask Mr. Low and Mr. Brennand to go ahead and make your way down, please.

COMMITTEE MEMBER JELINCIC: Just a couple of short points. One of the things Bob Carlson used to say, and I will remind everybody is, the biggest risk we can take is no risk. We're funding long-term liabilities.

The other observation I will make is our staff, our consultants, and quite frankly the industry tends to take a short-term viewpoint. That which is true today, will always be true. And I think we are reacting to the political pressure from the media. But as I said earlier, given the asset allocation decisions we made, we cannot support 7½ and be intellectually honestly. Thank you.

CHAIRPERSON COSTIGAN: Mr. Juarez, then Mr. Bilbrey.

Mr. Juarez.

ACTING BOARD MEMBER JUAREZ: Thank you, Mr. Chair. I just want to -- I want to follow on something that Bill Slaton mentioned about the infusion of cash. And just to better understand from staff and consultants, does the infusion of additional cash start to address the problem that was raised at the outset, which was having to basically take money out of existing investments in order to pay our obligations? And so would the infusion of cash help keep our investments invested longer, presumably until they can mature and generate the type of return that we would expect? So that's my question to whoever wants to answer it.

CHIEF INVESTMENT OFFICER ELIOPOULOS: I'll give the short answer is yes.

ACTING BOARD MEMBER JUAREZ: Is there a longer answer?

(Laughter.)

CHIEF INVESTMENT OFFICER ELIOPOULOS: The longer answer is --

CHAIRPERSON COSTIGAN: Ted, microphone.

CHIEF INVESTMENT OFFICER ELIOPOULOS: The longer answer is yes, and, you know, every dollar infused through contributions is a dollar less, since we are already in a negative cash flow position, less assets we have to sell. It won't solve the problem completely. But every new dollar that we get in in contributions is a dollar less in asset sale.

CHAIRPERSON COSTIGAN: Mr. Bilbrey.

BOARD MEMBER BILBREY: I'll only take a minute. I just wanted to clarify that it isn't that we didn't know we were going to have this conversation. It was the idea that we may be voting right now at this point in time. We certainly knew that we needed -- that this conversation was going to be happening. And we absolutely agree with it happening, but we didn't know we were going to be maybe taking some sort of action right now.

CHAIRPERSON COSTIGAN: And just to be clear, we're not taking any action today. Again, I understand. This is why -- I appreciate the long discussion. And we're going to now give the opportunity to Mr. Low and Mr. Brennand. That's why we've extended time. And then we're going to have Mr. Johnson, Mr. Pellissier, and Mr. Hutchings. Is there anybody else? If you want to sign up, please do.

Dave or Terry, doesn't matter, which one of you would like to go first.

MR. LOW: Thank you, Mr. Costigan.

CHAIRPERSON COSTIGAN: Dave goes first.

MR. LOW: So I think that one of the last points was made by Mr. Jelincic, which is, you know, these decisions need to be made driven by facts, not by -- and data, not by emotions or press or public pressure. And some of the facts just aren't really being fleshed out in a matter that we feel comfortable.

The same Wilshire study that staff points to as projecting short-term -- low short-term earnings over the next decade, also projects a 7.83 percent over the next 30 years. We always hear that CalPERS is a long-term investor, and looks to the long term.

We feel like CalPERS is -- some people are recommending we change course, and take a much more short-term approach to this. You know, the experts -- you know, I think that the video speaks for itself. I think Allan mentioned it and so did Warren Buffett, his answer about the projections, "I don't know, and they don't know either".

The experts are making educated guesses. But the fact is, is that we don't see enough data that shows us that -- an immediate change is warranted, and that a contracted timeline is warranted and a different process is warranted.

You do have an ALM process. The beauty of the ALM process is that you gather all the information and you consider everything as a totality, and you do look at risk, and you do look at asset allocation, and you do look at discount rate. And now, we're taking discount rate and we're just isolating it into a 2-month discussion. Quite frankly, we feel like we're being jammed in that respect.

This deviation short changes everybody. It abbreviates the process. It reduces the amount of research. It reduces the ability to do analysis. And it also short changes discussion. And that, we don't think, is a great process.

CalPERS has already made a number of decisions that have increased the cost to the employers and employees in recent years. We talked about the -- Cheryl brought out the issue of life expectancy. The fact is, is that's been factored in. And that caused an increase in cost to the employers and the employees.

These back-to-back decisions do have dramatic implications for State, school, and local agencies, and to my employees and everybody's employees. They make budgeting more difficult for the employers. They reduce funding available for maintaining and expanding jobs or providing cost of living adjustments.

And they can cause employee contributions to go up. So reducing the discount rate now, especially a large dramatic increase, would de-stabilize budgets and would have huge impacts on our workers.

We don't think that this type of decision should be made in a vacuum. I think that it needs -- the System needs to assess what is the impact on employers? Does CalPERS know whether some employers are on the verge of financial dissolution, whether the discount rate reduction or the concomitant increase in employer costs could cause insolvency to some employers? If you don't have that data, we don't think you're making an intelligent decision. So I think that it's irresponsible to make your decision without exploring all of these factors.

The rationale for the decision and justification can be different depending on the agencies. For example, schools are not in the same funded status as others. School employees, my members, they generally have the Lowest benefits. You know, they're just barely recovering from the -- you know, they're just getting their furlough days back. They haven't had raised in -- they haven't had raises for 5, 6 years. They're just scratching their way back. And these types of decisions are going to have a dramatic impact on some of the lowest wage workers.

So, you know, what may be justified for one local agency may not be justified for others, for example, the schools.

This is far too an important and impactful decision to be rushed. Even if the facts warrant some level of change in the discount rate, this decision merits a thorough discussion, an assessment of the appropriate target rate, a timeline for achieving the rate, discussion with the Governor and the legislature about funding, discussion with the employers and employee organizations about some level of predictability, affordability, stability, and phase in that has been discussed.

So, you know, I think that the train needs to be slowed down. I think we need to gather all the information and research. I think we need to treat this with the import that you continue to tell us how important this is, and then you bring it up at a November meeting and ostensibly maybe voting in December. I think that's not a good process. I don't think that's a fair process. I don't think that's a process that gives everybody the opportunity to engage. And as I said, it feels like a jammed process and does not feel comfortable to us.

I think that the Governor's representatives here seem to be the ones that are pushing the hardest for this. What is the Governor willing to put up here? You know, this should be part of a budget discussion. You know, injection of money. We're for an injection of money. Where the money comes from is important.

You know, if it's coming from the pockets of my members, it feels a lot different than if it's coming from Governor Brown and he's actually putting money in the budget for it. We should have that discussion. We're not going to have that discussion between now and December.

Finally, I think a reasonable thought-out process warrants more than just a couple hearings. And you can't negotiate out something like this in a public hearing, and have a vote, and have labor feel like we've come to the table.

You know, they say if you're not at the table, you're probably on the menu. We feel like we're on the menu in this discussion. So, you know, we believe that this requires a lot more discussion and a better process.

Thank you.

CHAIRPERSON COSTIGAN: Mr. Brennand.

MR. BRENNAND: Mr. Chair and members, Terry Brennand on behalf of SEIU California. I'm going to try and not repeat a lot of what Mr. Low said. I really appreciate the spirited conversation from this Board about what's gone on here, and all the information that was provided. I wanted to highlight a few things that weren't -- that were missing from this presentation.

They've been in prior presentations, but they weren't in part of this. What is the impact on the employer and employee rates, at what increment, at which cut, at which reduction, how much more are our members and our member agencies going to pay at every 25 basis point reduction?

Mr. -- I think Mr. Jones I think hit -- or one of them hit the message about, you know, we had that nice pretty chart about where people have reduced their -- no, it was Bilbrey. Sorry, Michael, I forgot you did it. But, you know, it didn't tell you where they went from to get to a medium of 7 -- median of 7½. How many are above, how many are below? That wasn't very informative. All that data is available I'm sure for us to look at.

Also, there was no doubt analysis of the probabilities of hitting any of these objectives. In the past, we've had something that showed, you know, here's the probability of hitting, you know, 7.5, here's the probability of hitting 6.2. Here's the probability -- and what happens when you do those probabilities? How much does it reduce the probability of going above that?

If you reduce the discount rate by 1 percent or your assumed rate of return by 1 percent, you're also going to reduce the probability you ever go over that, and have money for the glide path risk mitigation program you've already adopted. Every time you get more conservative, you reduce the opportunities on the upside.

And with regard to the one off-the-cuff math demonstration, you know, he was talking about a 1 in 20 probability. And in that 1 in 20 probability, even if you had 8 percent or 10 percent risk mitigation, you're still in a negative 10 to 12 to 15 percent category, instead of negative 19. You're still really in trouble.

Why aren't we talking about the other 19 out of 20 scenarios and planning on those? Because you can't, without doing a 0 risk portfolio, you can't protect against that 1 in 20 scenario he put forward.

Additionally, I'd like to know how this compares to just adjusting your ALM for a bear market, for a downturn in the market and an upturn shortly afterwards, rather than looking at 10 years -- a decade and going we're in the dumps for a decade? What other adjustments could you make that might help mitigate this?

And additionally, I'm with Dave and others, I'd love to have a conversation about what objective quantitative criteria or benchmarks we could look at that would say, you know what, if we get below X on the funded status, we need an infusion of cash. If we get below a certain return in how low is it, how many years, how fast, those are all conversations we need to have before we start talking about adopting some level of reduction in the assumed rate.

And short of having all that information for both the Board and for the members of the public, you're not ready to make a fiduciarily responsible decision about something so dramatic as this.

Some of these things work at cross purposes. If you're concerned about funded status, and not having it drop to a level that's so low, just taking this action sends you that direction without doing anything, except adding more funds. It helps you on the cash flow side, but it doesn't help you on the funded status side.

And I guess I'll just close with that. These are all unanswered questions. I'm happy to meet day and night with you, your staff, and anybody who wants to about how we work through this. But this has got to be worked through before you guys can make a decision.

Thank you.

CHAIRPERSON COSTIGAN: I just want to say one thing. Mr. Brennand I appreciate the comments. I am willing to have a conversation. I don't think -- I know that other Board -- you talk to other Board members. I'm happy to talk any time and have this conversation. I wish of phone call, because it appears to have been -- everybody thinks we're taking an action. There is no action set for today.

So again, you guys see me on the street every day. It's not like I'm not local. So pull me, stop me, have a conversation. I think a lot of the confusion today is the fact everyone seems, except the Chair, thought there was a vote going on today. And so I --

MR. LOW: We're not -- we're not -- we didn't think there was a vote today. We -- but we understand it's being potentially agendized for December. And that's --

CHAIRPERSON COSTIGAN: But I would still appreciate the opportunity --

MR. LOW: That's an issue that we're very concerned about. And we're happy to talk to you. And the phone works both ways.

CHAIRPERSON COSTIGAN: Okay. Thank you.

Mr. Johnson. And then -- I lost my notes. Mr. Pellissier.

No, Mr. Pellissier is next. We have Terry, Dave who have spoken, Neal Johnson, Dan Pellissier. Come on down, Dan, and then Dave. That's it.

MR. JOHNSON: I'm Neal Johnson with SEIU 1000.

I thank you for the opportunity to address the Board -- this Committee, the Board on this important issue. But one of the things I sort of thought about is I probably need to go tear up Investment Belief number 2, which says a long investment horizon is a responsibility and an advantage. And yet, we seem to be, in this case, more interested in the short-term. What happens in 3 years, what happens in 5 years, what happens in 10 years? All which are important, but we are sort of losing site of the long term.

On slide 12 in your presentation, or in the staff's presentation, one of the bullets said we're focused on risk, and risk is multi-faceted. It has various Probability distributions associated with it. And as Mr. Brennand said, there's the upside, there's a downside. And Mr. Jelincic constantly tries to hammer home this point that -- and, you know, the -- we also brought up have the ALM process, where we go through and really look at in a very in-depth what the portfolio needs to be to earn a return necessary to make the System work.

Yeah, the 2013 one appears not to work at the present time, but is that the reason to necessarily throw out the baby with the bath water at this time? I don't think so. I think we need to really look at it.

And a question your operating investment officer said in a previous agenda item dealing with returns on private equity that -- and fees that you can't just make a decision based on one year. You have to look at a much more long-term basis to make that decision. And yet, here we're being brought towards making a decision, not necessarily today, not necessarily next month, but soon, and that will stick with us probably forever.

You know, I appreciate the problem that arises with not being well-funded. I look at the State which has several plans, which range over various levels of funding from, I think, State miscellaneous up about 88 percent to the Highway Patrol plan bouncing around 60 percent. But there's a range, and that is true of, you know, the various public agencies within PERS. There's a wide range. We're not all right clumped in the same place. So there's going to be different impacts on different groups.

And I think we need to really look at what those impacts are. So what I'm actually saying is, you know, we have a little time. Yes, I understand the problem is get -- not getting necessarily better, but let's not rush to judgment.

If so, we probably should also reject Pension Belief number 1 that a retirement system must meet the needs of members and employers to be successful.

Thank you very much.

CHAIRPERSON COSTIGAN: Thank you, Mr. Johnson.

Mr. Pellissier.

MR. PELLISSIER: Good afternoon. I guess it's still afternoon. I want to thank the Board for this opportunity to address this very important meeting. My name is Dan Pellissier and I'm a CalPERS retiree with 19 years of State government service. Like most public employees, I worked hard for my retirement benefit, and I'm counting on the CalPERS Board to make sure I am paid what I earned.

In deed, the California Constitution describes your fiduciary duty to assure the competency of the assets that back our retirement promises, and gives you absolute authority over the actuarial assumptions and methods used to fund those retirement promises.

That privilege of absolute authority carries with it the burden of absolute accountability. So there is no one else to blame for the fact that my retirement promise is less than 70 percent funded or that the CalPERS fund has experienced growing negative cash flow for the last 7 years.

What's even more troubling is the derision and condescension that has been heaped upon concerned reformers, who for many years have pointed out these simple facts and offered good faith solutions. The CalPERS Board can't solve an unsustainable math problem until it admits that it has one. It needs to be honest and transparent about its circumstances and solutions.

But today, the Board can chart a new course, one that accepts expert opinions about future investment earnings; one that requires the State and local agencies to full pay for their employees' benefits; one that makes painful progress towards promptly reducing the unfunded liabilities it has intentionally created; one that places its fiduciary duty to employees and retirees over its goal of reducing short-term employer costs; one that stops passing the growing costs of its failures to a future generation; one that better secures my retirement promise.

Last year, with stunning hubris, the Board adopted a funding Risk Mitigation Policy that fails the most cursory analysis. It established a needlessly complex process that maintains a 7.5 investment earnings assumption, even if the fund has 0 earnings for many years.

The current policy only reduces the earnings assumptions, after years when the fund's actual earnings exceed it. This absurd policy is completely backwards, and violates the Board's fiduciary duty to its members. When actual investment earnings are less than your assumptions, you must correct your assumptions, regardless the painful consequences for employers.

Providing employers with an easy payment plan has reduced their short-term costs, but has run up more than $100 billion of avoidable long-term debt that threatens my retirement security. Your well paid experts say that you can expect an average of 6.2 percent return for the next 10 years, believe them. Set 6.2 as your earnings assumption now.

While I have no independent projection of future market returns, I am certain a fully funded retirement promise is better than a partially funded one. I do not understand why anyone who has a fiduciary duty to protect my interest does not share this simple point of view, and allowed the funding level to fall below 70 percent.

True retirement security is a real money backing retirement promises, not a misleading slogan for those trying to divert attention from the unsustainable status quo.

I would like to leave you with a recent quote from Chicago Mayor Rahm Emanuel, who is struggling to correct the decades of negligence that have nearly bankrupted his city, and left his pension fund severely underfunded.

Rahm said, we are not honest. The whole system wasn't honest. The city didn't contribute the honest amount. Workers were not contributing the honest amount, and we winked at the public, yet left them with a problem, because no one had the leadership to be honest.

Thank you.

CHAIRPERSON COSTIGAN: Thank you. And we have one more, Mr. Hutchings.

MR. HUTCHINGS: Good evening. Dane Hutchings at the League of California Cities. While we do not have a formal position on what is being deliberated by this committee, I did want to share -- you know, Brad shared the aggregate of the survey results from the employer community. I wanted to highlight some of the key points from the city perspective, and then make a few comments, and then happy to answer any questions should there be any.

So approximately 200 cities responded to the CalPERS survey, and 95 percent of those responded were either finance directors or an executive officer, such as the city manager. So I believe the survey did go to the right folks when making his determinations.

Given the option between lowering the discount rate incrementally with a phase-in approach, we had nearly 82 percent of agencies prefer that method over a -- you know, one straight reduction, perhaps after the ALM cycle is complete.

Regarding the most important effect of lowering the rate, 70 percent of our respondents considered reducing volatility of the employer contribution rates to be the most important aspect when determining when you know when applying that phased-in approach -- excuse me -- and over 26 percent of our agencies rate the impact of their ability to absorb employer contributions if they happen within the next 12 months as extremely high, as having an impact, and then 41 percent of agencies describe the impact as being high.

So, you know -- you know, I think what we can take away from this from the city's perspective is, you know, we see this coming. And while the impact will be severe to our -- to the fiduciary responsibility that our councils have to their constituents, it is something we would rather see phased in over time, rather than one big hit to the fund.

There were many comments today, both from the Committee and folks that came and testified. And from our perspective, I think we agree with the experts here on this panel that essentially say that, you know, 30-year projections are irrelevant, if we can't make it out of the past 10.

You know, the Committee that I report to regarding pension -- you know, all things pension contributions and OPEB contributions, they don't relish the fact that they want to make these cuts. You know, it's -- it is incredibly difficult to retain public service employees. And having a pension is something that, you know, gives them an added benefit over these in the private sector. That being said, we have cities that are very close to filing for bankruptcy.

And, you know, I think after the full phase-in of the GASB rules that shows really the true unfunded liability within our cities, I think it's going to be, you know, that much more pressure to make a corrective -- take corrective action to ensure that we can, you know, make ourselves whole.

So while we have not formally taken a position on what could be voted on in December, it is something that I believe our members feel that this is coming, and they would much rather see a phased-in approach rather than a one drop after the ALM cycle.

Thank you.

CHAIRPERSON COSTIGAN: Ms. Mathur.

BOARD MEMBER MATHUR: Thank you. I've been listening to the discussion. I think there is no question that we all find ourselves in a very uncomfortable position today, and that 68 percent funding is not where we want to be.

What I've also heard quite clearly is that we've done a really excellent job of reaching out to employers, and that we've gotten quite a robust set of feedback from employers, and that that has -- that can really be useful in informing our path forward.

What I've also heard is that maybe we haven't quite done as good a job of reaching out to other stakeholders, particularly members. And I think given what we learned so well through the risk mitigation process is that involving all stakeholders is really how we get to the best decisions and really get everyone on board.

So I guess my concern is just really that we ensure that we do get -- that we answer the questions that are out there from both employer and the member side, that we have enough time to do whatever robust analysis and dialogue is necessary to bring people along. And so I don't know what that timing is. I don't know what that looks like, and maybe that's really a question for all of you. But it doesn't sound like we've gotten there yet, so...

CHAIRPERSON COSTIGAN: Okay. That looks like those were all the questions before I make some closing comments.

Any other questions?

Did you guys want to respond to anything?

Okay. I know. It's been a long day, and you all still have one more meeting.

All right. So here's what I'd like to do is I would like to give direction to staff to bring back a recommendation at a workshop in December. And I'm not sure how to phrase this without is we need to go to the next step. We need to have a recommendation as to what you think we should do.

I'm not sure it's teeing it up for an action item, because I want to be careful in the conversation, but this -- today is not the last day. So the question -- and I want to try and get some of these timelines down, so I can understand them. It's my understanding, and please correct me if I'm wrong, is that action must be taken in early fall -- excuse me, early winter by February in order for the State component to take effect July 1 of '17, and for the locals.

If you wait -- because it is my understanding, Scott, it's about the reports that you do, that if you -- I want to make sure we're all on the same page, that if we don't do it, that is what's the reason it pushes it out for everybody. And I'm not -- I have no idea which way anybody is going to go. So I'm just look at timelines.

ACTING CHIEF ACTUARY TERANDO: Right. What we do is in the past we've also presented the State and schools in April. So if we need -- we would need a decision early enough that we actually incorporate the change in the discount rate in those rates that we present in April. Any --

CHAIRPERSON COSTIGAN: Otherwise we missed the window.

ACTING CHIEF ACTUARY TERANDO: And any later than that, then we would have to go forward with current 7.5 discount rate. The April rates would be based on the 7½. And then it would be a full year until we can look at the knew contribution rates.

CHAIRPERSON COSTIGAN: Mr. Slaton.

COMMITTEE MEMBER SLATON: Yeah, it appears to me -- I mean, we heard a lot of the member representatives had a lot of questions, a lot of issues raised. I think that those are legitimate, and I think that they need to be addressed. I don't think it takes a year to do that, and I would suggest that the Chair direct staff and our consultants to work with member groups, to work through the specifics of this issue, so they have a level of understanding, so we can see if we can reach an understanding of what action, if any, would be reasonable to take.

But I think that we want to try to do it in a time frame, where we have the option of making a decision that could take an effect July 1 of '17 and '18, if any action at all. But I think that we owe it to them to come with answers and to work through this. And I think we have time to do that, and I think we can do that by the February meeting with us participating as well as staff.

And so I encourage the Chair to seek outlet's, see if we can do that, and if we can reach some level of understanding among all of us of what action is prudent to maintain the fiduciary soundness of this fund.

CHAIRPERSON COSTIGAN: I mean, Mr. Slaton, I think you're absolutely correct. I mean, I was assuming that was a given that we would be following up with Mr. Low, Mr. Brennand on their concerns. Mr. Pacheco, I know that you would be working over the next few weeks before the December meeting and as part of any discussion in December. I know we've extended the courtesy of additional time today, but they should be participants as we move forward at least on December.

DEPUTY EXECUTIVE OFFICER PACHECO: I was going to say, Mr. Chair, I'm -- absolutely correct. And I think many of the points that Mr. Brennand brought up about the data that he was looking for, and my colleagues can correct me if I'm wrong, but I think we've presented it in many different occasions. It just needs to be updated and that's probably something that we can do.

And, Mr. Chair, for risk of interrupting the conversation, I just wanted to remind you that the California Special Districts Association left you with some comments.

CHAIRPERSON COSTIGAN: Yes. I was going to read them right as we got done. But we keep --

DEPUTY EXECUTIVE OFFICER PACHECO: Okay. Thank you.

CHAIRPERSON COSTIGAN: No, thank you -- keep having more inquiries.

Ms. Paquin.

ACTING COMMITTEE MEMBER PAQUIN: Thank you, Mr. Chair. I also agree with Mr. Slaton and Ms. Mathur. I think that we need to make sure that the process is really inclusive of the employee associations. And so we want to make sure that we do reach out to them and answer their questions, and don't feel compelled to take action at the next Board meeting.

Thank you.

CHAIRPERSON COSTIGAN: Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: The discount rate is a function of the asset allocation decision that you've already made. So, you know, in many ways, the decision has been done. But what I wanted to point to was, you know, we don't really have a April deadline. I mean, the Governor in his budget can put in whatever money he wants. If he wants to assume a 3 percent discount rate, he can do the math and figure out what it is, and put it in his budget.

Now, by April, our normal procedure would be to set the rate, but the Governor can put in his budget whatever number he wants. So if we make the decision later, it really doesn't matter. What matters is the Governor's decision.

CHAIRPERSON COSTIGAN: That will be --

COMMITTEE MEMBER JELINCIC: -- and the legislature's.

CHAIRPERSON COSTIGAN: Well, that's been -- it's been long enough. Let me read this statement and then I'll give the closing.

Dillon Gibbons gave us come.

While CSDA does not -- doesn't have sufficient feedback from our membership yet on the current proposal being reviewed, I can share that last year when discussing the risk mitigation strategies with our members, the most common response received was that of our members believed CalPERS needs to take action to mitigate risk in the fund.

CSDA members strive to take a fiscally prudent approach to their CalPERS liabilities in order to minimize financial liabilities in the future, and keep current CalPERS payroll rates as low as possible. However, low rates are not the driving factor in their approach to fiscal responsibility.

Overall health and sustainability of the system is a more important criterion. If that means higher employee and employer contributions are needed to ensure the health of the fund, they understand.

So I appreciate Mr. Gibbons.

You know, I can't remember the acronym, but it's California SDA. What's Gibbons group? I'm sorry, Brad.

It's not school districts.

DEPUTY EXECUTIVE OFFICER PACHECO: It's Special Districts Association.

CHAIRPERSON COSTIGAN: It's Special Districts. So I understand. Yes. Thank you. I understand.

Mr. Jones.

COMMITTEE MEMBER JONES: Yeah. I think we need a clarification because Mr. Jelincic was referring to the Governor's budget, and I thought we were -- just heard that we needed to make a decision, so that the agencies can get the information they need for budget planning.

CHAIRPERSON COSTIGAN: Mr. Jones, that's a -- it's the latest -- our actions are independent of whatever the administration takes.

COMMITTEE MEMBER JONES: Yeah. And I just didn't want to --

CHAIRPERSON COSTIGAN: And either the Governor puts money in the budget or not, you're absolutely right.

COMMITTEE MEMBER JONES: Right. Okay. I just wanted to --

CHAIRPERSON COSTIGAN: And whether the Governor puts money in the budget or not is independent of the actions that this Board takes. And so the two are not in correlation, and that is the part of a further discussion. I mean, we're going to probably have a discussion on fiduciary. Mr. Jacobs, since it had been raised on both sides, it becomes a very important discussion.

There is still another committee meeting to go. The direction I would like to give, if the Committee is okay, is that staff brings forth recommendations in December as to what we do next, because when you're looking at the calendar -- and, Mr. Jelincic, whether it's the Governor or not, what I look at is to our experts and our experts are telling us there are dates coming up that if we're going to take action, we have to look towards.

And so as we move to December, I would like to have the interest groups back, to have more -- continue this discussion, and for staff to bring a recommendation based upon the timelines that the Chief -- the Acting Chief Actuary offered of having to have his work done by April in order for the effect, if the Board chooses to take action, for 2017-2018 and 2018-2019.

Does that work for folks?

No, I mean, speak up. I just -- okay. Okay. Ms. Eason, Mr. Eliopoulos, does that work for you?

CHIEF FINANCIAL OFFICER EASON: Yes, it does.

CHAIRPERSON COSTIGAN: Okay. I just want to make sure we're all on the same page, because I know some of the folks that spoke have actually left. So would we please reach out to those folks and make sure that they are invited to attend December. We'd like to meet with them.

We are going to recess, because we haven't had enough fund today, until 8:00 a.m. tomorrow to take up Item 7b, which although it is informational, we need to take up prior to the closed session tomorrow morning. We will then go into closed session tomorrow at 8:00 a.m. -- or excuse me 8:30 or whenever we concede.

Mr. Lind, what time would you like to meet?

BOARD MEMBER LIND: We're going to meet, the Risk and Audit Committee at 6:35. Heads up everybody, it is going to be at least a 2 hour meeting.

CHAIRPERSON COSTIGAN: So we will reconvene --

I'm sorry. We will recess until 8:00 a.m. tomorrow morning. Risk and Audit will convene at 8:00 a.m. -- or excuse me 6:35 p.m. Expect it to go 2 hours. Thank you very much.

(Thereupon the California Public Employees' Retirement System, Board of Administration, Finance & Administration Committee meeting recessed at 6:18 p.m. to reconvene on Wednesday, November 16, 2016 at 8:00 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 21st day of November,

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

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

WEDNESDAY, NOVEMBER 16, 2016

8:00 A.M.

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

A P P E A R A N C E S

COMMITTEE MEMBERS:

Mr. Richard Costigan, Chairperson

Ms. Dana Hollinger, Vice Chairperson

Mr. Richard Gillihan, represented by Ms. Katie Hagen

Mr. J.J. Jelincic

Mr. Henry Jones

Mr. Bill Slaton

Ms. Betty Yee, represented by Ms. Karen Greene-Ross

BOARD MEMBERS:

Mr. Rob Feckner, President

Mr. John Chiang, represented by Mr. Steve Juarez

STAFF:

Ms. Marcie Frost, Chief Executive Officer

Ms. Cheryl Eason, Chief Financial Officer

Mr. Matt Jacobs, General Counsel

Ms. Tanya Black, Committee Secretary

Mr. Tom Noguerola, Senior Staff Counsel

Ms. Arnita Paige, Finance Office

ALSO PRESENT:

Mr. George Linn, Retired Public Employees Association

# I N D E X

P R O C E E D I N G S

CHAIRPERSON COSTIGAN: I'm going to reconvene the Finance and Administration Committee meeting. We have one item left that we're going to take up today.

Ms. Eason, we're going to turn it over to you, please.

COMMITTEE MEMBER JELINCIC: Do we need another roll call?

CHAIRPERSON COSTIGAN: No, because we never adjourned.

CHIEF FINANCIAL OFFICER EASON: Good morning and thank you, Mr. Chair, Committee members. Cheryl Eason, CalPERS team member.

At the September Finance and Administration Committee, staff were asked to provide the Committee with an overview of the process to collect delinquent contributions when agencies do not pay their pension obligations, and the process for the voluntary and involuntary termination of contracts.

Scott Terando, Deputy Chief Actuary, and Arnita Paige manager for the Pension Contract Management Services are here today to assist in presenting the item.

But first, let me talk briefly about the recent escalations in delinquent contracting agencies of late, which has led CalPERS staff to focus carefully on the collection and termination process.

The agenda item outlines the process and the estimated time lines for voluntary and involuntary terminations, and the cross-divisional efforts of the Actuarial, Legal, Customer Service Support team, Communications and Stakeholder Relations, and Office of Audit Services through the coordination of the Financial Office.

All participants of the case management team, the governance created to provide cross-divisional expertise committed to working with agencies to improve the education, coordination, and development of collection and termination solutions, as a shared approach with all contracted agencies.

When a public agency voluntarily chooses to provide retirement benefits to their employees through participation in the system, the agency contracts with CalPERS and agrees to be bound by the statutory requirements governing the system, including, among other things, an agreement to pay required contributions on time.

Now, let me turn the agenda item over to Scott and Arnita to briefly talk about the improvement efforts to collect employers' contributions on a timely basis, which is necessary to sustain the system, while ensuring the System's integrity in order to pay benefits.

ACTING CHIEF ACTUARY TERANDO: Scott Terando, CalPERS team. After we reviewed this process, we believe we now have a complete picture of the process from beginning to end, we've included various divisions throughout CalPERS, and we believe it enhances the coordination among all the divisions. It helps reduce the risk within the System in terms of calculating the correct benefits. And with the addition of audits in the process, we feel that the information that the Actuarial Office gets is more accurate and provides better calculations and results. It also gives the employers a great way to understand our process, and gives them a complete picture of everything involved in the termination process. And I'll pass it along to Arnita.

MS. PAIGE: Thank you, Scott. Arnita Paige, CalPERS staff. Our collection and termination process, pension contracts, and collection functions were centralized to strengthen coordination and expedite solutions to complex cases working closely with the case management team.

Through cross-divisional coordination and communication, we made improvement in employer service delivery, and developed opportunities to mitigate operational risk through employer education, repayment options, and contractual compliance. We've also made significant efforts in our reporting of our delinquent employers to our case management team.

This concludes our presentation, and we're happy to answer any questions you may have.

CHAIRPERSON COSTIGAN: Okay. I've got just a few before we get started. So again, I appreciate the report, and again the reemphasis that this is a difficult situation. We don't set the benefits. In the voluntary termination it's them coming to us.

MS. PAIGE: Correct.

CHAIRPERSON COSTIGAN: And in the involuntary it's because they've not made the payments. And so I know we're going to -- we've struggled with this over the last few months with a couple of the employers. Where, from an employee perspective, just so I can understand the process a little bit more. City A seeks voluntary termination, so we're going to go -- the city council -- it's noticed, the city council sets it for a vote. How are the employees informed that that is going to happen?

Because the other -- where I'm a little bit concerned is employers may want to transfer their responsibilities and have this Board reduce benefits by looking at the true-up, so I'll take a voluntary termination action. There's not enough money in the system, so I'm going to shift the responsibility to the CalPERS Board and Scott and his team, who are going to come up with a lower valuation, and then we would be in a -- can that happen, and then how are the employees notified?

MS. PAIGE: Okay. We've been -- in steps 1 and 2, we make significant efforts when an employer states that they want to terminate. When we receive that information and provide them their hypothetical termination amount, at that time that's when we start discussing termination and what it means. And when they file the intent to terminate, it can go -- it goes a year thereafter when they adopt it. When we receive the resolution, that's when staff start talking to the employer and start moving forward with the termination. So there is that gap in between that we're trying to correct with up front more communication with the employer when they first come in.

CHAIRPERSON COSTIGAN: I understand, and that's great on the employer. I'm just trying to figure out the other side is how does the employee know?

MS. PAIGE: When they -- when we receive the final -- when the employer finalizes the termination.

CHAIRPERSON COSTIGAN: Okay. So unless they're watching what their employer is doing.

MS. PAIGE: Right.

CHAIRPERSON COSTIGAN: Okay. But there's no, obligations, nor do I want to create the obligation on us, but the employee -- as we saw I believe at the August meeting with some of the folks coming in front of us. They don't know.

MS. PAIGE: Correct.

CHAIRPERSON COSTIGAN: And it's okay, well, that was 3 years ago. Your electeds took that action.

MS. PAIGE: Correct.

CHAIRPERSON COSTIGAN: On the involuntary side, again when the employer is not making their payments, are we notifying the beneficiaries at all? Is there an obligation or is that just back to the -- back to the employer?

MS. PAIGE: Well, we did implement a process. I believe it's step -- step 6, and the involuntary process, where we send a -- when we send that final demand letter to the employer, at that time, we did notify the participants in the plan that a final -- final, excuse me, demand letter was sent to the employer, so we attach a copy. You know, we did send the participants a letter at that time.

CHAIRPERSON COSTIGAN: Thank you. All right. We have a few other questions. Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: Yeah. I want to get back to the employees.

MS. PAIGE: Okay.

COMMITTEE MEMBER JELINCIC: I don't know how the employees can know that the employer is behind. And, you know, I mean we're not going to involuntarily terminate somebody because you're one month behind. It's that it's been awhile and they're not making progress. And I'm -- so I'm -- I'm concerned with the how we let the employees know, because they're the ones who are going to take the hit. So I -- and I'm not -- so I ask you to think about that. I'm not --

MS. PAIGE: Okay.

COMMITTEE MEMBER JELINCIC: In the write-up you said that we can move things to the terminated agency pool without benefit reduction, if it would not impact the TAP's actuarial soundness. Is that possible? I mean, can you move anybody in there and not have it have an impact on the soundness or does the statute have a materiality concept to it?

ACTING CHIEF ACTUARY TERANDO: When you look at the statute, I think that's like an -- that's an old statute. And I think it was put in there for a specific case. And when you think about it, if you put any plan in there, you will reduce the surplus. So, you know, to the extent that it has an impact on the plan, there will always be an impact. Sometimes, you know, if it's a very, very small amount, you would say, no, it's not a big impact. But in all the cases we've seen, you know, the amounts are fairly substantial.

COMMITTEE MEMBER JELINCIC: And while we're looking at legislation, one of the things that we ought to think about is some sort of legislation to make sure that the top 3 CEOs or 3 executives have some skin in the game. Maybe if they are behind in their contribution, they don't get any service credit that month, you know --

(Laughter.)

COMMITTEE MEMBER JELINCIC: -- but I think we need to think of someway of seriously getting their attention, recognizing it will take statute, not going to try and write statute on the fly, but we really do need to give some thought to make sure that the senior leadership has some real personal skin in the game.

Thank you.

CHAIRPERSON COSTIGAN: Thank you, Mr. Jelincic.

Mr. Slaton.

COMMITTEE MEMBER SLATON: Thank you, Mr. Chair. I want to come back to the voluntary versus involuntary, so I can make sure that I understand what I'm seeing here. So my understanding is that if it's -- that there is more flexibility in terms of how CalPERS deals with an unfunded liability if it's involuntary versus voluntary, is that correct, in terms of being able to do some -- there's some negotiation capability regarding payments, if it's involuntary, is that correct?

SENIOR STAFF COUNSEL NOGUEROLA: Good morning, Tom Noguerola, CalPERS legal staff.

Mr. Slaton, it's the same for both. Once there's a termination, the Board can negotiate the terms and conditions including payment with the governing body of the terminating agency.

COMMITTEE MEMBER SLATON: Okay. So it doesn't matter whether it's voluntary or involuntary?

SENIOR STAFF COUNSEL NOGUEROLA: That's correct.

COMMITTEE MEMBER SLATON: Okay. So let's step back to the -- so tell me the difference between -- other than the fact that who initiated a letter, what's the difference between voluntary and involuntary? What's the substantive difference between them, other than who initiated it?

SENIOR STAFF COUNSEL NOGUEROLA: That's really the difference. The agency makes the determination on its own that it would like to terminate its contract with CalPERS, where involuntary, it could be because they're not providing information that staff has requested of them. Mostly, it's because they've missed payments. And if the payments have gone too -- too many missed payments, and there's a sense from staff that they're not going to be able to come current or have no interest in making payments or not engaging with staff in trying to come current, that's when involuntary processes begin.

COMMITTEE MEMBER SLATON: So from some moment in time, the treatment is identical and the level of flexibility is identical between a voluntary and an involuntary.

SENIOR STAFF COUNSEL NOGUEROLA: Once the termination is in effect.

COMMITTEE MEMBER SLATON: Okay. So, now, let's come back to the notice issue that they were talking about about employees knowing about this. Why wouldn't we on day one of a voluntary termination process where there's a notice of intent filed and we receive it, why would we not let the employees know at the time that first item is filed with us?

SENIOR STAFF COUNSEL NOGUEROLA: There's no reason not to, I suppose. But this action, the resolution will be taken at a public meeting of the city council of the governing body. It could not -- it also might not lead to a termination. They may consider after getting the preliminary valuation that they don't want to proceed with the final adoption of the resolution.

So I think it -- it depends on the circumstances. If it's an agency that's going to voluntarily terminate, presumably they are in a position to make the final termination payment, and there would not be any reductions to the current employees or retirees. It would be something going forward to people who are not members, so --

COMMITTEE MEMBER SLATON: But that's not our current experience. That's not the experience of one of the situations that have -- has occurred here.

SENIOR STAFF COUNSEL NOGUEROLA: That's correct.

COMMITTEE MEMBER SLATON: Okay. So I guess the 2 issues are when is it appropriate for the employees to know that there's something going on here, where -- when should that trigger be? And the other thing is from this timeline of voluntary termination, it looks like the Board doesn't know about this until month 20. And so that would be, at least in my mind, a concern. And, Cheryl, we talked about this about the issue of accounts receivable and where we are. But I think that -- at least I think the Board would want to know if we have agencies that are starting the voluntary termination process, just so we're aware and can be aware of our status.

On the involuntary side, again I think that's an

A/R issue. And I think it's -- it's instructive for this Board to have that aging schedule to be able to see what the status is. So those are my 2 concerns.

Thank you.

CHAIRPERSON COSTIGAN: Just as a follow-up to Mr. Slaton, not to put -- I don't mean Mr. Pacheco or the website, how difficult -- because I don't think it's our responsibility to notify the employees. What I think is -- would be an issue is as we get these applications, is it something that we can put on the website? Again, as you put more information available, as Ms. Hagen and I were talking, a lot of this is just notification. If they file the application, whether they go through or not, having somewhere on the website, that the employee groups can come on see who's filed for voluntary?

I get -- because the argument the employers will make is there's public notice because they've said it for a public hearing. You know, at some point folks are taking responsibility for themselves. So continue what's the notification. Well, if it's in a public hearing, there's public notification for folks of that system. I don't for us, from a transparency standpoint, having just another link to the applications would suffice. And then the question is on the involuntary as well, again, just putting more. I know it's all out there somewhere.

Again, people have the advantage of getting the reports that we do to look at. So just -- that would, I think, follow up a little bit of what Mr. Slaton is talking about on the notification.

Ms. Hollinger.

VICE CHAIRPERSON HOLLINGER: Yes. Thank you. I just want to make sure I understand something that assuming it's an involuntary termination, because as you suggested that when it's voluntary people typically shore up. It's on the involuntary that there's probably outstanding money owed us. And when that happens, you're saying it's automatically put in the terminated agency pool, correct? Is that an automatic?

MS. PAIGE: When an employer terminates, they receive their bill for their termination costs. And if they do not pay it, it goes into collections. So -- and that's part of the involuntary process here. It goes into collections. And if they don't pay it in 36 days, we send them a letter, and that's where the collection process starts. So it doesn't automatically move. The employer is actually billed for the amount.

VICE CHAIRPERSON HOLLINGER: Okay. So -- but my concern is does it end up in the terminated agency pool? I guess my question is if it ends up there, does it impact the people who are shored up, in terms of the -- you know, there's a pot of money. It's not like it's delineated, correct, or segregated?

ACTING CHIEF ACTUARY TERANDO: Yeah. When we move -- before we move the plan into the terminated pool, what we do is we do the final valuation, where we look at the outstanding liability for all the members, and then we look at the amount of assets that the plan has. And, you know, that difference, you know, we try to collect from the employer. And depending on how much they pay of that, we reduce the benefits appropriately. So before we move the plan into the terminated agency pool, there's a balance between the liabilities and the assets going in, so there's no harm to the existing members.

VICE CHAIRPERSON HOLLINGER: Okay. I just wanted to verify that. Thank you. Appreciate it.

CHAIRPERSON COSTIGAN: Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: Just an observation. You know, we're saying, well, the voluntary, they do it in an open meeting. It's been noticed, and so it's -- you know, it's really available. However, the salary of the executive officer, done at an open meeting, would not necessarily be considered readily and publicly available. So we have a little dichotomy on how we approach what's reported in public meetings.

CHAIRPERSON COSTIGAN: Thank you.

Mr. Slaton.

COMMITTEE MEMBER SLATON: Yeah. Again, coming back on the voluntary versus involuntary. So on the involuntary side, it looks like, according to the timeline you've constructed, it's about a 7- to 8-month process. And I'm sure that varies depending on individual situations. But you've kind of defined the optimum as being a 7- to 8-month process. You stop paying and within 7 to 8 months, you're in the terminated agency pool and benefits, if they had to be reduced, are reduced. Is that -- am I reading it correctly?

CHIEF FINANCIAL OFFICER EASON: That's correct.

COMMITTEE MEMBER SLATON: Okay. So now let's move to the -- so on the voluntary side, it looks like a 22-month process. So I'm just -- I see a disconnect. Does that mean that from the time the intent letter is done, do they stop making payments, could that occur, and now they've bought themselves a 22-month process to end up because they did that letter of intent --

CHIEF FINANCIAL OFFICER EASON: No.

COMMITTEE MEMBER SLATON: -- or if they stop paying, do they immediately shift to the involuntary?

CHIEF FINANCIAL OFFICER EASON: So unfortunately, what we have been seeing is that, in some cases, the voluntary have stopped payments when they -- when they begin that notice of intent. And that's -- but they are obligated to continue to make those payments. The reason why the voluntary termination process is that much longer is the employer, the agency has that 1 year from the notice of intent, they have a year to decide whether they're actually going to finalize that. So that adds 12 months to that process.

COMMITTEE MEMBER SLATON: So they -- I guess I'm at a loss here. So if they file the letter, they have an extra year?

CHIEF FINANCIAL OFFICER EASON: No. No. They -- and that's part of the improvements that we've -- we want to make sure as part of the collection process that there's no misunderstanding by the agency. That notice to intent does not mean that they now stop making payments. Those payments have to be continue.

COMMITTEE MEMBER SLATON: No. No, I get that. But if they stop making payments, then what happens? Does this 22-month process still continue or do they get treated equivalent to an involuntary termination, if they stop making payments after doing a letter of intent?

MS. PAIGE: If they stop making payments, then we would follow the collection process. Even if they filed an intent to terminate, we would move the termination forward following the process. We wouldn't wait for them to terminate. We would pursue them for payments at day 36, if they're late on their payments.

COMMITTEE MEMBER SLATON: So they would be moved into the category equivalent to an involuntary termination?

MS. PAIGE: Correct.

COMMITTEE MEMBER SLATON: That's what I was trying to get to.

Thank you.

MS. PAIGE: You're welcome.

CHAIRPERSON COSTIGAN: And just from a policy perspective, why is it 1 year? If they've given -- if they've noticed -- is it a staffing issue on our side or what's the 1-year period?

SENIOR STAFF COUNSEL NOGUEROLA: That's pursuant the statute.

CHAIRPERSON COSTIGAN: So that's just a -- so I would potentially ask you to revisit that, because 1 year seems for -- what -- what's the public -- I mean, I get 1 year, but for what reasons?

SENIOR STAFF COUNSEL NOGUEROLA: They actually did revisit that issue. I think, in 2003, there was proposed amendment to remove the 1-year waiting period, and then it was removed from the amendments. And I think the policy behind it, or the thought was, it gives the agency an opportunity to rethink the decision to not participate in CalPERS. That's all that really was in the legislative history about it.

CHAIRPERSON COSTIGAN: All right. We may want to relook at that, because 12 months for -- I mean, considering the amount of information we now make available, that Scott and his team make available, that is out there -- I mean, we're 13, 14 years later, the information is much more accessible, provided, as I understand it, on a much more annual basis, that it may be something we want to look at.

Because back to Mr. Slaton's point, 12 months, you file -- I mean, now I don't want to put a nefarious intent with anyone, but what we're sort of looking at is you could almost avoid something for 2½ to 3 years, and then still have a fight with us about what you actually owe, what that -- I mean -- and so we -- I think, at some point, we need to look and try to tighten up timelines the more we can. I mean, 1 year seems an awfully long time.

Mr. Slaton.

COMMITTEE MEMBER SLATON: So I just -- I'm sorry. I just want to make sure that I have clarity around this issue. So even though you have a statue which gives a year, that CalPERS has the authority to change the designation of a termination in the event of nonpayment from a voluntary to treat it as an involuntary.

SENIOR STAFF COUNSEL NOGUEROLA: Okay. The voluntary termination is a 2-step process. It is the initial filing of a resolution by the city council or the governing body of the agency saying that they're intending to terminate.

COMMITTEE MEMBER SLATON: Right.

SENIOR STAFF COUNSEL NOGUEROLA: That starts the 1-year -- at least the 1-year waiting period before a governing body can adopt a final resolution of termination of the contract. During that period of time, they have to stay current with payments. If they don't, it's not that they automatically become -- it's an automatic involuntary termination, but it could start a collection process if the agency skips or misses payments. And that could lead to involuntary termination.

COMMITTEE MEMBER SLATON: Okay. So if they do the notice of intent, and then immediately stop making payments, they go into collection mode, and we essentially go into the second chart of steps. And if you try all the collection, try all the collection and we get to month, you know, 6, 7, et cetera, and you were not able to collect the money, you have the authority to treat them as an involuntary termination, and we can terminate them at that point in time, is that correct?

SENIOR STAFF COUNSEL NOGUEROLA: Yes.

COMMITTEE MEMBER SLATON: Okay. Thank you.

CHAIRPERSON COSTIGAN: Okay. Ms. Hollinger.

VICE CHAIRPERSON HOLLINGER: Yeah. Just because I think we've dealt with cases on this, I just want to make sure another issue is clear or that I understand it. Once somebody either stops making payments or, as Mr. Slaton said, either through involuntary or voluntary process, we've come into some situations where we're still paying those recipients their benefit checks as if their agencies are still paying in. Is there some mechanism where -- I don't want to see us get into this situation where we have people who've been collecting money as if their agencies have been paying, and then all of a sudden several years later, we're turning around and asking them for money back. So is there some notification that adjusts for that?

ACTING CHIEF ACTUARY TERANDO: Yes. When we do the final valuation, we look at, you know, the liabilities that the plan has. We also take into consideration the assets --

VICE CHAIRPERSON HOLLINGER: Yeah, but is that 3 years later, 2 years later? Like, are we covering for the period up to --

ACTING CHIEF ACTUARY TERANDO: When we -- when we do the final assessment, we look at the liabilities, and then we look at the assets, including any outstanding receivables. So, you know, if they hadn't made payments for the last say year, or so, we would take into consider -- we would reduce the assets available. That offsets the benefits, so it does get taken into consideration before we move it into the TAP.

VICE CHAIRPERSON HOLLINGER: Without us having to collect for back --

ACTING CHIEF ACTUARY TERANDO: Yes, can make that adjustment when we do the -- our analysis.

VICE CHAIRPERSON HOLLINGER: Okay.

CHAIRPERSON COSTIGAN: Okay. No other questions. I know this was an informational item. I think we -- at a future meeting, we should follow up both on the statute -- just, I'd like to see what the 2003 legislative history was, and then Ms. Hagen did raise a real good point as it relates to the employer conferences. Have we done this type of training, this type -- a workshop for employers?

CHIEF FINANCIAL OFFICER EASON: We have, based on the experience that we've gone through in the last couple of months, recognized the need to really educate and inform. And unfortunately, we were too late to put anything into the recent October Educational Forum, but we will be working with the Customer Service, Donna Lum's area, and ensure that we get out there and talk to employers. It's important. We're realizing that that's -- there's a void for -- in employers and agencies around the education around this. So that's certainly a strong lesson learned for us throughout this process.

CHAIRPERSON COSTIGAN: And I might ask, you know, on a quarterly basis just as a report item, the number of agencies that have filed for voluntary termination and involuntary. I'd like to at least have a quarterly status report.

CHIEF FINANCIAL OFFICER EASON: We will do a follow up on your feedback as well as commit to looking to greater transparency, and bring back on a more timely basis the termination -- agency's intent to terminate.

CHAIRPERSON COSTIGAN: Okay. So any public comment?

There's one. Come on down. And then we'll do staff direction and closing, so I wasn't sure if it was on this item.

Three minutes.

MR. LINN: Good morning.

CHAIRPERSON COSTIGAN: Good morning.

MR. LINN: Good morning, Mr. Chair and Committee members, I'm George Linn, President of RPEA. I have concerns about when retirees get notice late in life that they owe all this back money. I don't know what the answer really is, because obviously it hasn't been paid for under the terms of the contract agency or whomever, but I think that the notification of what may happen to the members is a very important issue, and that should be almost the same day we tell the contract agency that they're in default. The members need to know.

CHAIRPERSON COSTIGAN: No, and we agree with you. We're looking for a solution. The question is, as you well know, any time you talk about our election process, you talk about the costs associated with it, and so we're going to start with something incremental -- make it available -- what information we can make available, so any ideas that you have. I mean, really part of this goes back to the locals and the conversations that you have with League and CSAC, where are they on the notification front, because again -- we're, again, the administrator. I mean, you know, this better than I do, but we're open to it. So ideas that you and your members have on it, please let us know. And you don't have to wait for public comment. You can always bring --

MR. LINN: And I apologize for being late. I was here a little late last night and I just didn't move quickly enough this morning.

(Laughter.)

CHAIRPERSON COSTIGAN: Hey, you take to Mr. Feckner, I thought we'd start at 7:30.

MR. LINN: So you may have -- you may have covered some of those issues before I walked in the door. But I still -- you know, this is a major concern, because someone who is 78 years old, all of sudden to get a bill for however much it might happen to be is probably something that sends them into cardiac arrest, because, you know --

CHAIRPERSON COSTIGAN: No, we agree. So please bring anything --

MR. LINN: So I think that we, as a retiree group, would like to work with you on coming up with a solution for these things, because we're all in there together, and I think that we need to work together on the issue.

CHAIRPERSON COSTIGAN: Soon we're all going to be members of your organization, so --

(Laughter.)

MR. LINN: Thank you.

CHAIRPERSON COSTIGAN: -- thank you.

All right. Before we get to staff recommendation -- or staff direction, just a couple things. One is I want to thank all the staff for yesterday. It was a very long, very hard hearing. And I appreciate Cheryl, Scott, Wylie, and Ted, who must be sleeping in, for all of their hard work yesterday. Also, I really do want to thank both Mr. Gillihan and Ms. Taylor for their comments. After I got home last night, and was reading my Twitter feed, I saw it had been a very exciting day in the world of SEIU and CalHR. So on top of being here and being very active participants yesterday, I just want to thank them, because I know they both had a very stressful day as well.

It was an important dialogue. Again, I think part of yesterday's discussion was again the evolution and -- of this -- the continued evolution of this organization. It was a fascinating discussion. A lot of thought went into it. And as you saw, we had lots of folks agreeing to disagree in a respectful manner. And I think that's extremely important, and I think yesterday again showed it.

With that, we are going to come back for 7a in December. So why don't we go over staff direction for this Committee, and they we will be adjourning. 7a, which was yesterday's, where most of it was. Item 8, we're going to bring back in December, Mr. Hoffner. That's correct. So, Ms. Eason, the staff direction you believe you have?

I think they were -- because of the finishing up today, we're still working on the Board -- or the Committee report, so just give us 2 minutes to get that. I just want to make sure we're all on the same page. We can work backwards. So starting with 7b the staff -- the direction to staff is?

Use your microphone, please.

CHIEF FINANCIAL OFFICER EASON: So the direction that we've been provided is to look at the legislation and timelines around the voluntary process. We also have asked that the Committee receive reporting on the delinquent agencies, and the agencies with intent to terminate, and also look at the posting of -- for transparency purpose the posting of information.

CHAIRPERSON COSTIGAN: I believe that's correct. Any -- that's correct on 7b. And then on Item 7a?

CHIEF FINANCIAL OFFICER EASON: 7a, we have to continue discussions with stakeholders regarding follow-up questions related to Agenda Item 7a. And in December, staff to bring back further information and a recommendation for action to the Board based upon the timelines, if the Board chooses to take action, for 2017-18 and 2018-19.

CHAIRPERSON COSTIGAN: I believe that capture -- I believe that captures yesterday. Okay. And were there any other -- I believe those were the only 2 staff directions on 7a and b, and with what Mary Anne is working on, which were action items that we'll report out today.

Anything else from the Board members?

COMMITTEE MEMBER JELINCIC: And bringing back 8a.

CHAIRPERSON COSTIGAN: Yeah. 8a, I've already said Mr. Hoffner will be bringing back in December. If that's it, this meeting is adjourned and we will be going into closed session at 8:45.

Thank you, all.

(Thereupon the California Public Employees' Retirement System, Board of Administration, Finance & Administration Committee meeting adjourned at 8:35 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 21st day of November,

James F. Peters

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