MEETING

STATE OF CALIFORNIA

PUBLIC EMPLOYEES' RETIREMENT SYSTEM

BOARD OF ADMINISTRATION

FINANCE & ADMINISTRATION COMMITTEE

ROBERT F. CARLSON AUDITORIUM

LINCOLN PLAZA NORTH

400 P STREET

SACRAMENTO, CALIFORNIA

TUESDAY, DECEMBER 20, 2016

1:00 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:

Ms. Marcie Frost, Chief Executive Officer

Ms. Cheryl Eason, Chief Financial Officer

Mr. Ted Eliopoulos, Chief Investment Officer

Mr. Doug Hoffner, Deputy Executive Officer

Mr. Matthew Jacobs, General Counsel

Ms. Donna Lum Deputy Executive Officer

A P P E A R A N C E S   C O N T I N U E D

STAFF:

Mr. Doug McKeever, Deputy Executive Officer

Ms. Fritzie Archuleta, Supervising Pension Actuary

Ms. Tanya Black, Committee Secretary

Ms. Flora Hu, Senior Life Actuary

Mr. Ron Hurle, Acting Chief Information Officer

Ms. Kimberly Malm, Chief, Operations Support Services Division

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

Mr. Gary McCollum, Senior Life Actuary

Mr. Todd Tauzer, Senior Pension Actuary

Mr. Wylie Tollette, Chief Operating Investment Officer

ALSO PRESENT:

Mr. Ivan Carrillo, Association of California School Administrators

Ms. Faith Conley, California State Association of Counties

Mr. Al Darby, Retired Public Employees Association

Mr. Allan Emkin, Pension Consulting Alliance

Mr. Steve Foresti, Wilshire Consulting

Ms. Marcia Fritz, California Foundation for Fiscal Responsibility

Mr. Dillon Gibbons, California Special Districts Association

Mr. Dane Hutchings, League of Cities

A P P E A R A N C E S   C O N T I N U E D

ALSO PRESENT:

Mr. Andre Junkin, Wilshire Consulting

Dr. Ruben Ingram, School Employers Association of California

Mayor Sara Lamnin, City of Hayward

Mr. Dennis Meyers, California School Boards Association

Ms. Leyne Milstein, City of Sacramento

Mr. Jai Sookprasert, California School Employees Association

Mr. Eric Stern, California Department of Finance

Mr. Phil Wright, City of West Sacramento

I N D E X

I N D E X   C O N T I N U E D

P R O C E E D I N G S

CHAIRPERSON COSTIGAN: All right. Good afternoon. It is 1:00 p.m. We're going to call to order the December meeting of the Finance and Administration Committee.

Would we please start with the roll.

COMMITTEE SECRETARY BLACK: Richard Costigan?

CHAIRPERSON COSTIGAN: Here.

COMMITTEE SECRETARY BLACK: Dana Hollinger?

VICE CHAIRPERSON HOLLINGER: Here.

COMMITTEE SECRETARY BLACK: Katie Hagen for Richard Gillihan?

CHAIRPERSON GILLIHAN: Actually, Richard Gillihan is here.

COMMITTEE SECRETARY BLACK: Oh, Richard Gillihan, sorry.

(Laughter.)

ACTING 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: Betty Yee?

COMMITTEE MEMBER YEE: Here.

CHAIRPERSON COSTIGAN: All right.

Good. Everybody is here. All right. Well, good afternoon. We have got a pretty full agenda today as well as a workshop. So we're going to move as quickly as we can.

Ms. Eason, we will begin with you with the Executive Report.

CHIEF FINANCIAL OFFICER EASON: Thank you. Good afternoon, Mr. Chair, Committee and Board members. Cheryl Eason, CalPERS staff.

Under the action consent items today, Agenda Item 3c was reported previously under the semiannual contracting prospective report is the first action item. In order to be consistent with CalPERS policy and Board resolution, this agenda item will cover the one year contract term extension for the external investment manager contracts without defined duration.

Agenda Item 5a is the second reading of the 2016-17 mid-year budget, representing a decrease from the authorized year-end 2016-17 annual budget. Also included in the second reading, you will note the mid-year budget is updated from first reading, reducing by 6 positions and 361,000 from the initial first reading request, which we'll go through at that time.

The second action item before the Committee is the back-up restoration and disaster recovery agreement to extend the current data back-up and disaster recovery services agreement through to June 2018.

We have on Agenda Item 7a, the CalPERS 2017-22 strategic plan. This is the first reading, which is being heard this month, based on Committee direction at the November 15th, Finance and Administration Committee meeting.

Agenda Item 8a is a consolidation of 6 existing actuarial policies related to the contribution allocation where the Actuarial Office and the Enterprise Compliance Division have worked together to review and revise the actuarial policies, delegations of authority, and resolutions.

Staff will also be presenting the annual reports for the semiannual self-funded health plans, and the long-term valuation reports. And finally as mentioned, Agenda Item 9 will -- is a workshop securing CalPERS future, managing funding risks, stakeholder outreach and engagement, based on the direction from the November Finance and Administration Committee meeting.

I'd also like to take a moment to recognize for the third straight year, the CalPERS Financial Office has received the Government Finance Officers Association

Distinguished Budget Presentation Award for the fiscal year 2016-17 annual budget report.

The Budget Office continues to strive for excellence in their practices on budgeting, and I'd just like to thank all the team members that have made this possible.

The next Finance and Administration Committee meeting is scheduled for February 14th, 2017 and will include updates for employer and employee contribution rates for judges and legislators, the 2017 member at-large election, review of the Finance and Administration Committee delegation, the second reading of the actuarial contribution allocation policy, update on the 2016-17 business plan, and first reading of the 2017-19 business plan.

And with that report, Mr. Chair, that concludes my report, and I'd be pleased to take any questions.

CHAIRPERSON COSTIGAN: Thank you, Ms. Eason. Before we move to the action consent, are there any questions, first, on Ms. Eason's report?

Good. Mr. Juarez.

ACTING BOARD MEMBER JUAREZ: I just wanted to make note --

CHAIRPERSON COSTIGAN: Hang a second. Wait a second. Wait a second. You've got to push your button.

Okay. Now, you're on. Okay. Go ahead.

ACTING BOARD MEMBER JUAREZ: I wanted to make note of our discussion yesterday to add the item regarding the Responsible Contractor Policy, that that would be added to the list of things that we would take up in February.

CHAIRPERSON COSTIGAN: So as we discussed yesterday at the Investment Committee with Mr. Jones, if we can make it as an information item on the February agenda, and update on the Responsible Contractor Program, and I think as Ms. Juarez had asked yesterday, is if that were to be expanded into other programs.

So I think what we'd like is how much staff time would be required -- it's not. I know it's going to be a substantial use of staff resources to get ready for February. So just enough information that we get it on the agenda and start getting it calendared for further discussion. So if we could start with an overview and then look at other expansion programs.

ACTING BOARD MEMBER JUAREZ: Appreciate it, Mr. Chair.

CHAIRPERSON COSTIGAN: Anything else on that item?

If not, then we do need -- these are action consent items.

COMMITTEE MEMBER JELINCIC: Pull B and C.

CHAIRPERSON COSTIGAN: I'm sorry?

COMMITTEE MEMBER JELINCIC: Pull B and C.

CHAIRPERSON COSTIGAN: Oh. All right. Mr. Jelincic, would like to pull 3b and c. Actually, Mr. Jelincic, would you like to discuss those right now?

COMMITTEE MEMBER JELINCIC: Sure.

CHAIRPERSON COSTIGAN: Okay. So why don't we go ahead and take up -- Mr. Jelincic, please push your microphone.

Well, let me just -- let's just go through yours first.

COMMITTEE MEMBER JELINCIC: Do you want to approve the minutes first?

CHAIRPERSON COSTIGAN: No. Let's just go through B and C and then we'll see where we're at.

COMMITTEE MEMBER JELINCIC: Okay. On B, we just received a new one. What's the difference between what was in the agenda and the one that got handed out?

OPERATIONS SUPPORT SERVICES DIVISION CHIEF MALM:

Kim Malm, CalPERS staff.

On page 1 of your Attachment number 4 is the RFP for GASB 68 and 75. The information that we needed to roll-out that RFP came after I had completed the spreadsheet.

COMMITTEE MEMBER JELINCIC: Okay. And on the first one, the Health Care Decision Support System, fourth generation. Obviously, this is an ongoing project. It's not going anywhere. So my question is why are we contracting it out, why are we not bringing it in-house?

OPERATIONS SUPPORT SERVICES DIVISION CHIEF MALM: He thought he was done.

CHAIRPERSON COSTIGAN: I know.

(Laughter.)

OPERATIONS SUPPORT SERVICES DIVISION CHIEF MALM: But I'm going to let Mr. McKeever help answer this question.

COMMITTEE MEMBER JELINCIC: Especially since he's unflappable.

DEPUTY EXECUTIVE OFFICER McKEEVER: Mr. Chair, members of the Committee, Doug McKeever, CalPERS staff.

Mr. Jelincic, as you know, we've contracted that out for the last 11, 12 years now for very good reasons. The most prevalent one is that data warehouse contains HIPAA information on every single one of our 1.4 million members. Every time they go to the doctor, a claim is generated, and that data warehouse captures all of that information. So I would not, as your health care expert, recommend that that be brought in-house.

Not to mention the fact, the secondary reason is it would require a great deal of resources to do so. And I'm referring primarily to the cost.

CHAIRPERSON COSTIGAN: Mr. McKeever -- Mr. Jelincic, anything else?

COMMITTEE MEMBER JELINCIC: I was going to say the -- you know, there's a cost of contracting it out as well. I will also acknowledge that just because something is ongoing, there may be a good reason to contract it out.

Aon. On the next page the Aon Insurance, you know, we are not going to stop getting insurance. I'm not sure why we can't bring that in-house.

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE:

Wylie Tollette, CalPERS staff. Aon is actually not only our real estate and infrastructure insurance coordinator, they're also the real estate and insurance provider. And so because we link those 2 components of the contract, we believe CalPERS gets a below market rate on the total provision of insurance services to our real estate assets. And there are significant elements of the insurance program that are handled by staff within the real estate -- excuse me, the real assets unit within the Investment Office.

However, these are insurance coordination components that would be very difficult to pull in. They're really associated with the provision of insurance by Aon.

COMMITTEE MEMBER JELINCIC: Okay. And I had some questions about some of the individual contracts in there that we're contracting a million dollars to, the high yield, et cetera. But given the time, I will defer that, but expect it again in 6 months.

CHAIRPERSON COSTIGAN: 3C

COMMITTEE MEMBER JELINCIC: 3C. This is the Investment Manager contracts without duration that we are extending for another year. Some of these presumably have tobacco in them, and so they -- the managers clearly can't figure out that tobacco stocks were overpriced, which is why we decided to divest them. So since they -- if they went far enough to figure out that they were overpriced, why do we want to continue to pay them fees?

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE: As you might recall, we consider our external investment manager contracts, rather than complying with typical 5-year State contracting renewal process, we continue -- we consider them under continual review and renewal.

In other words, our asset classes that are responsible for these contracts review the performance, the management stability, the ongoing viability of the underlying organizations on an ongoing basis, and make decisions. And, in fact, just this year we've actually let go of 13 global equity managers and 1 fixed income manager related to that ongoing review process.

The -- we bring these back, because if they continue to perform, we want to continue to do business with them and have them contribute returns to the fund. That's why it's before you today.

Last but not least, I'll mention that even though many of these managers are listed here, not all of them are funded. So we occasionally keep managers on retainer essentially without actual assets allocated to them. So that if, in fact, a market opportunity arises, we can quickly fund that manager and have them -- have them sort of waiting in the wings for those assets to arrive in there. A number of these managers fall into that category.

COMMITTEE MEMBER JELINCIC: Okay.

CHAIRPERSON COSTIGAN: So just a couple observations before you go. Mr. Jelincic, I appreciate you continuing to raise the contracting out issue. I just want to may, Ms. Malm, I believe in the 7 years I've now been here or 6, I don't think we've had a contract challenged, as I've pointed out before. So I just appreciate the fact that Mr. Jelincic you raise it.

I think sometimes it falls out there on deaf ears, because we haven't -- I no on my other board, I have not -- I don't think I've seen one CalPERS contract challenged on it. So at some point, I think we should have just a discussion about contracting out in general, because either the Board seizes this issue, on the other side it doesn't seem to be a problem, because --

COMMITTEE MEMBER JELINCIC: But even if the -- am I still on?

CHAIRPERSON COSTIGAN: No, you're on. You're still on.

COMMITTEE MEMBER JELINCIC: I mean, if the unions don't challenge it, we could do it more efficiently and cost effectively in-house.

CHAIRPERSON COSTIGAN: No, and I appreciate you raising it. Yeah. No, I agree. I appreciate it. And actually one of the things when we look at cost efficiency and looking at investments is that that's part of the expectation we expect from you all is when you bring it to us, you've done that analysis. You've made a determination that it is both in the best interests of the fund, its members, and from a cost standpoint.

I mean, our preference is to keep this stuff in-house. And I know when we talk about the budget, we're going to go through that.

The other issue is on this rolling one year on just the renewals and on the tobacco issue. If they're not performing, we can cut them loose at any time.

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE: We have the right to terminate a manager within 30 days, give them 30 days of notice.

CHAIRPERSON COSTIGAN: Okay. All right. So, Mr. Jelincic, on those points could we move all 3 items back to the minutes?

COMMITTEE MEMBER JELINCIC: Sure.

CHAIRPERSON COSTIGAN: And then we address --

COMMITTEE MEMBER JELINCIC: Yeah.

CHAIRPERSON COSTIGAN: Okay. So since this is an action consent item, could I get a motion?

COMMITTEE MEMBER JONES: Move it.

COMMITTEE MEMBER YEE: Second.

CHAIRPERSON COSTIGAN: It's moved by Jones, seconded by Yee. All those in favor?

(Ayes.)

CHAIRPERSON COSTIGAN: Opposed?

Motion carries. Thank you.

We covered 4. And so now we are on to Item 5A, which is mid-year budget, second reading.

CHIEF FINANCIAL OFFICER EASON: Thank you, Mr. Chair. The Agenda Item 5a is an action item and represents the second reading of our 2016-17 mid-year budget.

The proposed total budget of $1,786,873,000, and 2,880 positions represents a decrease of $1,627,000 or 0.09 percent from the authorized 2016-17 annual budget.

This second reading reflects a 6 -- reduction of 6 positions costing $361,000 from the first reading of the mid-year budget. These positions were for employer contracts managed meant workload in the Financial Office.

However, through the filling of vacancies within the Division and enterprise wide, this workload will be addressed with existing resources.

FINANCIAL PLANNING, POLICY & BUDGETING CHIEF McAULIFFE: Rose McAuliffe, CalPERS team member, and also to remind the Committee the net decrease of 1.6 million from the annual budget consists of 8 million in vacancy savings, 3.6 million reduction in enterprise projects, 2 million reduction in outside legal expenses. These decreases are offset by salary and staff benefit increases of 10.5 million, an increase of 1.1 million for 8 new positions in the Investment office for global equity and sustainable investment. And an increase of 400,000 to begin implementing the Internet and phone voting methods for Board member elections.

In summary, the proposed 2016-17 mid-year total budget of 1,786.9 million and 2,880 positions is recommended to this Committee for approval.

CHIEF FINANCIAL OFFICER EASON: And with that, that concludes or report and we'd be happy to take any questions.

CHAIRPERSON COSTIGAN: Okay. We have a couple.

Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: On page 7 of 10, 63 of the iPad. The State Controller is raising our costs roughly a quarter of a million dollars a year. Why? And I assume we had a conversation with them about it.

FINANCIAL PLANNING, POLICY & BUDGETING CHIEF McAULIFFE: My understanding is that part of it is due to the increase in the number of claims being processed, increasing enrollment.

COMMITTEE MEMBER JELINCIC: Is that the bulk of it as far as you know?

FINANCIAL PLANNING, POLICY & BUDGETING CHIEF McAULIFFE: That is my understanding, yes.

COMMITTEE MEMBER JELINCIC: Thank you.

CHAIRPERSON COSTIGAN: So I just want to point a couple things. One, again, you all do amazing work, as Rose is saying walking and be kind, so I'm being kind. You guys, as much as -- the fact that we still have these -- lots of questions, discussions. Each time you all come forward, it's with more and more information.

And I don't want us to lose sight what you guys are all trying to do. While we may see increase in one area and decreases in the other, still as stewards of our members' monies, you guys are doing a fantastic job.

And the fact that we come back almost, it seems as though, each time with lower cost, and more efficiency, just a credit to all of you. I appreciate the feedback on the external legal costs, Mr. Jacobs. Great job. Let's keep patching down those fees. There you go.

So the more that we can do there. And I just want to acknowledge, to Ms. Frost and the work that you all did in taking the advice from the Board and Reallocating positions. So as we continue to decrease both the blankets and the number of vacancies, I didn't want that to go unnoticed.

So are there any other questions?

COMMITTEE MEMBER JELINCIC: I'll move.

COMMITTEE MEMBER YEE: Second.

CHAIRPERSON COSTIGAN: It's been moved by Jelincic, seconded by Yee.

All those in favor?

(Ayes.)

CHAIRPERSON COSTIGAN: Opposed?

Motion carries.

Thank you. That was easy.

All right. Oh, we'll have a new presenter. We're going to move on to Item 6, Information Technology Services. This is an action item.

DEPUTY EXECUTIVE OFFICER HOFFNER: Good afternoon. Doug Hoffner, CalPERS.

I wanted to introduce Ron Hurle. He's the Acting Chief Information Officer here at CalPERS. When Doug McKeever indicated he was going to be taking a different position, Liana took on the responsibility of backfilling behind him at the Deputy level, and Ron took on the responsibility as the CIO.

So rather than having come out here without an introduction, I thought it would be good a opportunity to introduce Ron to all of you. I know he's met a couple of you this afternoon, but put a face with the name.

So with that, I'll let Ron start his presentation.

(Thereupon and overhead presentation was presented as follows.)

CHAIRPERSON COSTIGAN: Good afternoon.

ACTING CHIEF INFORMATION OFFICER HURLE: Good afternoon. Thank you, Mr. Chair and members of the Committee.

The action is to request an extension of 12 months for our current back-up and disaster recovery services. That will take us to June 2018. And the ask is for $2.2 million.

To give you a little bit of background, when the current contract was coming to maturity, we did engage in an RFP process with our vendor community. While that was going on, we simultaneously were also looking at our business continuity plans.

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ACTING CHIEF INFORMATION OFFICER HURLE: As we came to the award season for the RFP, we recognized that there was maybe some additional opportunities we had with trying to get the better solution for the request of the RFP. Through those conversations, we decided to discontinue the RFP process. We now have moved into next steps where we wanted to complete the business continuity plans, use those as the foundation for the new RFP. And if you go to the next slide, our next steps will be --

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ACTING CHIEF INFORMATION OFFICER HURLE: -- that we'll have the RFP launched in spring of 2017 with an award in the summer. And that gives us the year to June 2018 to implement the new solution. That completes my presentation. I'm ready for any questions.

CHAIRPERSON COSTIGAN: So before we take questions, since most of the Board members have not had the opportunity to meet you, why don't give the one minute just who you are, because you have a very impressive background, and I just want folks to know the type of folks that are also working here.

ACTING CHIEF INFORMATION OFFICER HURLE: Thank you. So once again Ron Hurle. My whole career has been in the IT realm. Probably the thing that a lot of people recognize, especially in this location, I was VP and general manager at Intel for their worldwide services for 9 years. I also have run a business where we tested video games, which was part of my fun sabbatical, if you want to put it that way, and that -- so that's kind of a quick one-minute history.

CHAIRPERSON COSTIGAN: So, great. Thank you.

ACTING CHIEF INFORMATION OFFICER HURLE: You're welcome.

CHAIRPERSON COSTIGAN: All right. Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: I'm glad that we didn't go through with the RFP, if we decided it was a problem. But how did we get ourselves in the situation where we are doing an RFP without realizing we are doing things that are likely to change what we're looking for in the RFP? I mean, I just don't understand how sequentially got there?

ACTING CHIEF INFORMATION OFFICER HURLE: So if I could? So a couple things happened, in all my history of a career, as well as what I see in CalPERS. You have a contract that's in place. It's been going on for 5 years. You have a good customer -- or excuse me, partner, that's EMC at the time.

It's not unusual that the business continuity plans sit somewhat idle. And that -- I think that's what kind of happened in this case. I do think that the business continuity plans that Kim Malm and her team put together are one of the most crisp I've seen. They're very focused. They give us a whole different value, I think, of what the RFP process will be.

So no excuses, we shouldn't let them get stale. That discipline I think is in place and it won't happen again, but I do think that that's part of what happened at the beginning.

COMMITTEE MEMBER JELINCIC: Okay. Thank you.

CHAIRPERSON COSTIGAN: Mr. Slaton.

COMMITTEE MEMBER SLATON: Thank you. Hi, Ron.

ACTING CHIEF INFORMATION OFFICER HURLE: How, are you doing, Bill?

COMMITTEE MEMBER SLATON: Good.

So when you look at the next RFP and you have Intel experience, you know, you have a background for this, but there's constraints within State agencies, any governmental agencies. So as you prepare for that, what type of interchange do you do with what other agencies are doing, because every single agency has to have this kind of a plan, has to have a contract. You have a lot of other local government agencies, SMUD is one that has these type of plans as well.

So how much sharing of information is there in strategy, structure, pricing, et cetera for these kind of services with your compatriots in other agencies.

ACTING CHIEF INFORMATION OFFICER HURLE: So I would say that it's somewhat interactive with the groups that we have engagement with. I will tell you first, let me give you a little bit of history that happened. When we actually got into the alignment with the business continuity planning, we also had an opportunity to meet informally with the 16 different suppliers who were part of that, who also have exchanges within other agencies within the group. So there was a lot of cross pollinization that took place.

We found technologies. We found different mitigating approaches. We found process changes. There was a lot of things that educated us on a whole different level than what we were prior to the original RFP. So if you add that together, along with what they brought to the table, we have a much different, I think, robust approach to the RFP as we're going forward. And I'm going to be very willing to share that out with the rest of the other agencies on how we approached it. I think there's a lot that we can learn together as a community.

COMMITTEE MEMBER SLATON: Exactly. Very good. Thank you.

ACTING CHIEF INFORMATION OFFICER HURLE: You're welcome.

CHAIRPERSON COSTIGAN: Okay. I believe we have no further questions, so this, too, is an action item.

COMMITTEE MEMBER SLATON: Move it.

CHAIRPERSON COSTIGAN: It's been moved by Slaton.

COMMITTEE MEMBER GILLIHAN: Second.

CHAIRPERSON COSTIGAN: Seconded by Gillihan.

All those in favor?

(Ayes.)

CHAIRPERSON COSTIGAN: Opposed?

Motion carries. Thank you.

ACTING CHIEF INFORMATION OFFICER HURLE: Thank you.

CHAIRPERSON COSTIGAN: Okay. Moving on to the next item, Item 8a, Actuarial Contribution Allocation Policy. I saw Mr Milligan in the audience.

Seven, did I miss an item? I'm sorry business plan. Sorry, Doug. I was so excited that Milligan was here.

(Laughter.)

CHAIRPERSON COSTIGAN: That's 2 days in a row.

(Thereupon an overhead presentation was presented as follows.)

DEPUTY EXECUTIVE OFFICER HOFFNER: Do you want to defer? Let me know.

(Laughter.)

CHAIRPERSON COSTIGAN: Not going to defer again. Let's speed it along.

DEPUTY EXECUTIVE OFFICER HOFFNER: Good afternoon, Mr. Chair and members of the Committee. So this is, as you know, this is the first reading of our strategic plan. We've brought this item -- agendized last month, given the discussions we had earlier today about timing of having to put that over, we're bringing this back to you.

You should be very familiar, and I didn't get this to 5 slides, but I'll move quickly.

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DEPUTY EXECUTIVE OFFICER HOFFNER: We've engaged in a process with our stakeholders, the Board internally and external participants related to our strategic plan. We started off in the spring of this year. As you recall the conversations with Timi Leslie who helped facilitate this ongoing dialogue with all of us. We had 3 Board workshops between June, July, and September related to inputs from stakeholders, yourself, the internal employees and team members at CalPERS.

And we're with you today to talk about basically the 5 strategic themes that we identified, and the actions and objectives that have been identified to go along with that, and then really to talk about the targets and measures, which I know we voted on in September in terms of sort of a straw poll voting with the clickers to get a good flavor as to where the Board and all of you felt we were in terms of those strategic measures for the next 5 years.

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DEPUTY EXECUTIVE OFFICER HOFFNER: As you see by the pyramid here, we look at one hand the work we've done previously in the 2012 to 2017 strategic plan really by embedding a framework that aligns our measures with our strategic goals of the organization for the next five years. It should look familiar.

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DEPUTY EXECUTIVE OFFICER HOFFNER: As you also recall, we refreshed the vision and mission of the organization. This essentially took a refinement of the work that we had in place. Based upon your feedback, we -- I wouldn't say narrowed, but we simplified both the mission and vision and we incorporated the core values that had always been associated with CalPERS, but they weren't aligned in terms of sort of identifiably put on the same page. So we wanted to make sure that that was happening as well.

This refresh clarified and simplified a new vision and mission of the organization that sort of speaks to I think really the objectives of the next 5 years --

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DEPUTY EXECUTIVE OFFICER HOFFNER: -- and the heart of what we're looking to do for the organization and for our members.

The next slide hits on the 5 strategic themes again. You should be familiar with this. Several of them correspond with the themes we have in our current strategic plan and they really build upon that core work we've been doing for the last 5 years.

I would highlight the fact that we're really looking at fund sustainability as a key measure -- direction of the organization, affordable health care, reducing complexity across the enterprise at all levels, identifying greater risk management within CalPERS, and of course, having the talent within the organization, both developing internally, and if we have to going into the external marketplace to bring people in to provide those core services, and the strategic work that we need to do to meet our strategic plan.

This is expanding upon the 3 themes we had from the prior 5 years, but again very much consistent with the work we've been doing.

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DEPUTY EXECUTIVE OFFICER HOFFNER: So jump ahead. I just want to walk through, here are some of the measures. And we'll talk about it from the fund sustainability perspective. What you see here is the overall objective that we did vote on back in September. I say we, I mean, the Board. The measure that was identified, the target, and then our current State.

There's a little bit different information here on the deck in front of you. It includes if we have a baseline and the status of that in play today. And you'll identify and notice that some of them in the later slides we're still establishing those baselines, and we'll bring that information back to you once they have been finalized.

But for those that we do have a current state, we wanted to make sure that was present and available to you today. In addition, we have identified several areas where the actual goal will extend beyond the 5-year life of the plan, which is something that we're all well aware of, but we'd wanted to articulate that, based upon this is a 5-year plan, but the long-term arranging nature of some of these items extends beyond that 5-year period.

So as you can see in the upper right-hand corner, when we did the exercise and voted on these items in September, 80 percent of the Board voted in favor. I think that's -- I want to say that's reflective of 20 percent not voting. I think a couple were probably outside of the room at the time, so I -- I didn't say anything, Mr. Costigan.

(Laughter.)

DEPUTY EXECUTIVE OFFICER HOFFNER: Probably a conference call.

But I wanted to reflect on it. These are very familiar with -- to all of you, based upon the work we've been doing. I'll pause for any questions or feedback on these at this point in time. And if not, I'll move to the next slide deck.

CHAIRPERSON COSTIGAN: So we actually have a few.

DEPUTY EXECUTIVE OFFICER HOFFNER: Yeah, sure.

CHAIRPERSON COSTIGAN: Before we get those, are you going to cover, for example, number 9, transform health care purchasing? Can I ask you a question about that?

DEPUTY EXECUTIVE OFFICER HOFFNER: Slide 9?

CHAIRPERSON COSTIGAN: Well, it's the one transform health care purchasing and delivery.

DEPUTY EXECUTIVE OFFICER HOFFNER: All of the team members behind me will be happy to answer questions --

CHAIRPERSON COSTIGAN: It's actually a very simple one.

DEPUTY EXECUTIVE OFFICER HOFFNER: -- related to the specific items. It sounds like a McKeever question.

(Laughter.)

CHAIRPERSON COSTIGAN: No, it's actually -- it's just actually -- I think he's already checked out.

(Laughter.)

CHAIRPERSON COSTIGAN: When you put objective measure target, what I don't see, for example -- so we'll just say the measure: Prevalence of diagnosed diabetes per 100 adults, the target is 7. Why does the -- what's current? So you're telling me we -- I mean, it says we'd like to get to 7. How do I know what we're coming from?

DEPUTY EXECUTIVE OFFICER HOFFNER: Sorry. So up here, we have a current state, which is identified in this deck. We're at 13.34 adults of the 100 adults that have the diabetes. And so that's not embed in the documents that you have in front of you.

CHAIRPERSON COSTIGAN: Okay.

DEPUTY EXECUTIVE OFFICER HOFFNER: We did add that back in. Again, this is in alignment with the Let's Get Healthy California benchmark that we've aligned ourselves with Covered California, Health and Human Services.

CHAIRPERSON COSTIGAN: No, and that's great. Doug, I'm just asking -- so the document that I'm looking at here --

DEPUTY EXECUTIVE OFFICER HOFFNER: Yes.

CHAIRPERSON COSTIGAN: -- it just has target -- or measure and target is the document we're going to put out. But I'm just saying from an informational standpoint, it doesn't tell me what we're moving from.

DEPUTY EXECUTIVE OFFICER HOFFNER: Right.

CHAIRPERSON COSTIGAN: So I don't know if we need to put this level.

DEPUTY EXECUTIVE OFFICER HOFFNER: We can modify it, based upon your feedback.

CHAIRPERSON COSTIGAN: Okay.

DEPUTY EXECUTIVE OFFICER HOFFNER: This is a first reading. Of course, it is -- always could be actionable. But this is the kind of material we provided at the workshop in September. It was not put in the final document that you have in front of you as the first reading, but it could well be incorporated as it is the current State that we have today, in terms of where our baselines are.

CHAIRPERSON COSTIGAN: All right. So we have a few questions.

Mr. Jelincic.

DEPUTY EXECUTIVE OFFICER HOFFNER: Sure.

COMMITTEE MEMBER JELINCIC: Yeah. I'm trying to bounce between what we were given in advance and the revised agenda item. I assume, and correct me if I'm wrong, that the item that we were given in advance is the one that we will actually publish subject to whatever changes get made and the one we got handed out?

DEPUTY EXECUTIVE OFFICER HOFFNER: Well, this is a first reading, so I think other than removing the voting button exercise percentages in the upper right-hand corner, I think we could include the current state. I think that doesn't hurt, by any means, to tell people where we are today, if it's in development, if we have a baseline et cetera. But the document you have in front of you is the one that was presented in the item for -- as an information presentation.

COMMITTEE MEMBER JELINCIC: Okay. Because -- and the page 4 of what the agenda material, 80 of the iPad, one of the things that in fund sustainability I think is really worth pointing to, although I didn't see it in the hand-out, is keeping our stake -- our stakeholders engaged and educated about how we balance risk and mitigate -- mitigation to achieve this goal, which again leads me to I really would prefer that we tell people why we made the asset allocation decision we made.

On talent management, I think at some point we have to recognize that we have to deal within the CalHR salary matrix. And we need -- and sometimes that gets in our way. And I think we need to call out the need to talk to CalHR about addressing some of those issues. They did the -- they addressed some of them during bargaining, but they're ongoing issues.

CHAIRPERSON COSTIGAN: I'm going to have Mr. Gillihan respond right now.

COMMITTEE MEMBER JELINCIC: Sure.

COMMITTEE MEMBER GILLIHAN: Mr. Jelincic, I can assure you, there's no shortage of talking to CalHR on behalf of the California staff on this subject.

(Laughter.)

DEPUTY EXECUTIVE OFFICER HOFFNER: See I appreciate that Mr. Gillihan said that rather than me.

(Laughter.)

CHAIRPERSON COSTIGAN: Anything else, Mr. Jelincic?

COMMITTEE MEMBER JELINCIC: Yeah. On 7, the -- in the agenda item, funded status was first. I see that we've moved it down, and I think that's a -- an improvement, because we've actually said those things are higher priorities than the funded status, but I actually think we ought to think about moving it even below the total expected volatility.

DEPUTY EXECUTIVE OFFICER HOFFNER: Well, those are falling under different objectives within the strategic plan. So within this funding the system through an integrated view of the pension's assets and liabilities, it falls 4th on the list of 4. So I don't know if it's semantics or not at this point, but...

COMMITTEE MEMBER JELINCIC: Yeah, because as you look at it, at least I would make the assumption looking at it that the one we identify first is our highest priority. So subsequent -- on the transform health care services, I see that you picked up my observation that it's total member health care costs. It's not just the premium. It's not just out of pocket. It's the total cost. So I did see you picked that out, but I wanted to -- thank you for that.

The restructured benefit design, I just want to make clear that we are not proposing to move to a high deductible?

CHAIRPERSON COSTIGAN: I don't think you need to comment.

COMMITTEE MEMBER JELINCIC: We're not proposing to move to a high --

CHAIRPERSON COSTIGAN: But Mr. McKeever might.

(Laughter.)

DEPUTY EXECUTIVE OFFICER HOFFNER: It's his last day. Let him talk about it.

CHAIRPERSON COSTIGAN: No new policies, Mr. McKeever.

DEPUTY EXECUTIVE OFFICER McKEEVER: Mr. Chair, members of the Committee, Doug McKeever CalPERS staff. Mr. Jelincic, I would not couch it in those terms. I don't think you should be absolute and say that there is no discussion that should be had with this Committee relative to high deductible health plans. And, in fact, in January at the Board off-site, we need to talk about value-based insurance design. There is a component of that which includes a high deductible plan.

So I don't think you should take it off the table. It doesn't mean you're going to do it, but I think it should be open for discussion.

COMMITTEE MEMBER JELINCIC: Okay. When we try to do it --

CHAIRPERSON COSTIGAN: Mr. McKeever, why don't stay. We have a few more questions.

COMMITTEE MEMBER JELINCIC: -- I'll raise the issue again.

On the reduce complexity, one of the problems with the CEM benchmark is that it's an index. And so I'm not sure how we improve the complexity score, because we're always going to be the most complex, so I'm just not sure that this actually reflects...

DEPUTY EXECUTIVE OFFICER HOFFNER: Yeah, so the current state is identified there. And I think Ms. Lum might make a comment about that.

DEPUTY EXECUTIVE OFFICER LUM: Good afternoon, Mr. Chairman, members of the Committee. Donna Lum, CalPERS team member.

So analysis is already underway with regards to the information that we have on the CEM report that identifies complexity. And although we are in the most complex system and we are benchmarked against systems, and its average, what we are seeing from the report are areas of opportunity that we can further explore that would reduce our complexity scores.

So whether it's 3 percent or any percent above or below that, and certainly above is what we're aiming to achieve, we do have information that will lead us to opportunities once analyzed and brought back before the

Committee that would definitely enable to us achieve a lesser complexity score.

I think as I've mentioned to this Committee and to the Pension and Health Benefits Committee in the past, the vast majority of the things that would move the needle on our complexity score, would entail things such as changes in legislation and statute and others. But certainly things that we do want to go forward with to review and analyze, and then determine whether or not we can achieve making those changes.

COMMITTEE MEMBER JELINCIC: And I can certainly appreciate wanting to make this organization less complex. And I think that's a worthwhile goal. It's just, you know, part of what I react to is the target is to reverse the weighted average when we're always going to be at the top of the index. We're always going to be 100. So I'm just not sure that that goal really is what we need to focus on. It's a measurement issue, not an objection to what you are proposing.

DEPUTY EXECUTIVE OFFICER LUM: Okay.

CHAIRPERSON COSTIGAN: I have no comment on CEM. You already know how I feel.

Mr. Slaton.

COMMITTEE MEMBER SLATON: Thank you, Mr. Chair.

Doug, you and I have had conversations about this a lot. And so am I reading this correctly that for those items that do not say it's outside of 5 years, that for each of the targets, it is to be done within 5 years?

DEPUTY EXECUTIVE OFFICER HOFFNER: That is correct. And actually, in this slide right here, the measure to reduce the number of external investment managers is actually within those 5 years. I believe it's actually the INVO 2020 plan. So that would be within the 5-year framework would actually be done a couple years earlier.

Everything else though to your point, Mr. Slaton, is identified within that 5-year structure. Unless it's asterisked and identified, that would be beyond that, and specifically on the funding sustainability items at the very beginning.

COMMITTEE MEMBER SLATON: Are any of them 3 or 4 years?

DEPUTY EXECUTIVE OFFICER HOFFNER: Just the one I mentioned in front of you right now on the reducing external managers.

COMMITTEE MEMBER SLATON: Okay. So I think that there's some specificity needed here. If, in fact, they're to be done within 5 years, they should say that on the particular item, so that everybody focuses on it's 5 years. And then the current state should indicate the date. What is current state, because, you know, we see this once a quarter or, you know, however often we see it and we forget where we were.

DEPUTY EXECUTIVE OFFICER HOFFNER: Sure.

COMMITTEE MEMBER SLATON: So having the documentation in here that says the current state as of I think would help us. And then the question is, are there any -- on any of these any interim targets that or is it only 5 years? And if there are interim targets, it would be nice to see those, so we could then measure management on how we're accomplishing.

DEPUTY EXECUTIVE OFFICER HOFFNER: Right. So here you on all those points. We had those discussions previously. I think what we want to identify is this the 5-year plan? There may be an item or two let's say that are less than the 5 years. The next step, once approved, would be to develop the business plan objectives, that we have a 2-year business planning cycle for those things. This would go into effect July 1 of 2017 and move forward. We'd have a reporting structure for you that's sort of the endpoint slide here, which you talk about how to present this information, so if currently incorporating the current status as of whatever date that is, but have routine reporting and frankly have it available on your Diligent Board books and the resource guide, so it's not just an agendized item, but you would have this information at your finger tips all the time.

We would want to do exception reporting to this conversation we've had historically on this issue. And then have probably a couple times a year a deeper dive into the overall status of the plan, 5-year and/or the intermediate steps at that point.

But in reality we want to bring back to you whatever is within let's say a yellow or red or need management attention or at risk, those items on a more routine basis. And those things would all be forthcoming. This plan is really the higher level overarching discussion about the 5 years. The other stuff would be built out from here. That would include what we bring forth in the budget for your approval in the spring and early summer next year for implementation in 2017.

COMMITTEE MEMBER SLATON: Okay. And for those that say "in development", so by when do we expect to have those?

DEPUTY EXECUTIVE OFFICER HOFFNER: So when they don't have a baseline, we're looking to really by the spring of next year have those done, so that we can build upon those business plan and budgeted items to bring you with the full documents that have the associated resources, if they either need it externally to do this work, but really have the plans and objectives built out at that point, so really overarching umbrella framework, and then a deeper diver into those areas, many of which require surveys to establish a baseline and get feedback to us, that we even know where we are today in that current state.

COMMITTEE MEMBER SLATON: Okay. So am I correct in assuming then for this plan that the annual budget for this organization is designed to accomplish this plan. So as we pass each incremental a budget, we either have to ratify that, in fact, these objectives are still valid or whether you are, in fact, modifying and based on budget constraints.

CHIEF FINANCIAL OFFICER EASON: That's correct. We align the budget to the current plan.

COMMITTEE MEMBER SLATON: Okay. Very good. Thank you.

CHAIRPERSON COSTIGAN: Ms. Hollinger.

VICE CHAIRPERSON HOLLINGER: Yes. I just -- I wanted to state that I think our number one priority should be sustainability of the fund. As fiduciaries, that's what we're here for to secure benefits to our beneficiaries. So I know Mr. Jelincic maybe you wanted to move that, but I think that has to be our top priority.

DEPUTY EXECUTIVE OFFICER HOFFNER: Well, I think what he wanted to move was the funded status measure. Fund sustainability and strengthening the long-term sustainability of the fund is the strategic theme. That's the --

VICE CHAIRPERSON HOLLINGER: Maybe it should be --

CHAIRPERSON COSTIGAN: Hang on a second. I've got to turn you back on.

VICE CHAIRPERSON HOLLINGER: Perhaps we should rephrase that just in -- the objective being sustainability of the fund and maybe have those listed underneath.

CHAIRPERSON COSTIGAN: Mr. Hoffner, would it make it easier for you, since this is a first reading -- we'll continue with questions -- is to give you if there are some changes, just have the folks --

DEPUTY EXECUTIVE OFFICER HOFFNER: Yeah, that's the whole point of the item today. So yes, that's fine. I just think --

CHAIRPERSON COSTIGAN: I just want to make sure, because I think we may not be reading it differently, so I think giving Mr. Hoffner this script -- because I agree with you, Ms. Hollinger, from a priority standpoint, I think Mr. Jelincic yours helps make it clear, but -- and I'll have some additional items as well, but -- Mr. Jones.

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

Doug and I have had this conversation also about the workforce diversity. And while I recognize the limitations of Prop 209, I don't think the target in the workforce diversity is adequate to give us information of what kind of progress we're making.

So based on my conversation with Doug is that he would review this again and bring something back, recognizing that this -- once the plan is adopted, then you have to have strategies to deliver and execute on these. And hopefully, something can be presented back to the Committee with a year or two to how do we get to having something that gives us information about what kind of progress we are making, as opposed to having the target, getting a report. So I just wanted to make sure that that's part of our plan going forward.

CHAIRPERSON COSTIGAN: Okay. Thank you.

Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: Yeah. One other point on the cultivate risk assess -- or risk intelligent organization, 12 of the original, and I guess 17 of today's handout. I'm just -- as I said on the conference, I'm not sure that's the right question. Yeah, responses to serve -- "That CalPERS has effective functions and programs to address compliance and risk".

I'm sure if you asked Wells Fargo customers 3 years ago, if they had a good compliance and risk assessment, the answer would be yes. But the problem is they really don't have a basis to make that assessment. So I'm not sure what the question ought to be, but I think we need to think about do they actually have the basis to give us a response that's meaningful?

And I suspect the Wells Fargo survey would be a very different answer today.

DEPUTY EXECUTIVE OFFICER HOFFNER: Well, like anything, I think, Mr. Jelincic, that's all point in time. And I think it's going to be predicated on the amount of information, education, development that we are able to do with our employees and others related to this kinds of questions. So again, we're in this -- in the development status stage. And really, as we build out compliance programs within CalPERS, I think it should speak to the things that we're doing. And there's probably a greater awareness to come in terms of these issues. But again, it's sort of point in time, I think, to some degree.

COMMITTEE MEMBER JELINCIC: Our employees actually would have a basis for evaluating our risk and compliance program. I'm just not sure that our stakeholders really have a basis for that evaluation.

Thank you.

CHAIRPERSON COSTIGAN: Anything else, Mr. Jelincic?

COMMITTEE MEMBER JELINCIC: Thank you.

CHAIRPERSON COSTIGAN: Controller Yee.

COMMITTEE MEMBER YEE: Thank you, Mr. Chair.

Just kind of a process question. This was mostly developed before the arrival of our new CEO. So I guess whether it's through Ms. Frost or others, if additional goals or different goals are identified during this strategic plan period, what's the process for accommodating those?

DEPUTY EXECUTIVE OFFICER HOFFNER: You want to speak to that?

CHIEF EXECUTIVE OFFICER FROST: Good afternoon, Mr. Chair, members of the Committee and Board. Marcie Frost, CalPERS CEO.

As you indicated, Ms. Yee, the strategic plan was well under development by the time of my arrival, and so I did not disrupt it completely. But what I can tell you where I have been working with Mr. Hoffner and the strategic planning team is for your next iteration. So as Doug was talking about having more frequent access within Diligent to what's happening on a monthly basis, having a quarterly Board review of not only the strategic priorities, but also the business operations and the peformance measures there, giving me a little bit of time to work with the team, so that we could update the current strategic plan with Board approval, but also start making that much more transparent and visible to you, including performance measures that would have end targets, gating targets, by when dates for example, and giving me a little bit of time to work with the team to get those in place.

I do believe the current schedule is to bring back a template to you in -- is that February, Mr. Hoffner?

DEPUTY EXECUTIVE OFFICER HOFFNER: (Nods head.)

CHIEF EXECUTIVE OFFICER FROST: -- in February to get your approval and guidance. But it would contain those components.

COMMITTEE MEMBER YEE: Okay. Great. Thank you.

CHAIRPERSON COSTIGAN: So, Mr. Hoffner, I know this is an information item only, so rather than wait until Committee direction, the staff -- we're going to give you additional feedback, just written feedback. You're going to try to address Mr. Jones's adding additional targets on the diversity and setting -- I just want to make sure I understood that correctly, Mr. Hoffner.

DEPUTY EXECUTIVE OFFICER HOFFNER: Yeah. So I think -- let me go to that one real quick. So I think the conversation that was had was related to what's the level of information we can provide. And we talk about an annual report. We can do comparisons to other statewide data sets, to CalSTRS a peer agency that does similar work. I don't know that we could ever come up with a true target. I do think we can do annual reports and look at how we compare ourselves historically to where we are today.

But given the constraints of the law, I think there's -- there's some challenges there, but I do think we talk about robust reporting in terms of looking at those other sets of data with CalHR and others from a statewide perspective, but also I think, frankly, CalSTRS does a good job in -- from a very peer-to-peer comparison in the State as to how things are playing out within similar functions of the organization would be beneficial to both us and them.

CHAIRPERSON COSTIGAN: Great. All right. So did that capture it, Mr. Jones?

COMMITTEE MEMBER JONES: Yeah.

CHAIRPERSON COSTIGAN: And I believe that did capture it all. So, Mr. Hoffner, we will see this as an action item on the February agenda.

DEPUTY EXECUTIVE OFFICER HOFFNER: Thank you.

CHAIRPERSON COSTIGAN: Thank you. All right.

We're going to move on to Item 8a, which again is an informational item, the Actuarial Contribution Allocation Policy, first reading.

SUPERVISING PENSION ACTUARY ARCHULETA: Good afternoon, Chairman and members of the Board -- Committee. This is Item 8a -- oh, sorry. Fritzie Archuleta, CalPERS team. This is Item 8a. It's the first reading of the actuarial contribution allocation policy.

In this ever-changing pension world, the Actuarial Office has produced several policies on contribution allocation to keep up with the times. This agenda item is the first reading of the team's consolidation of these policies in one easy-to-read document.

While writing the consolidated document, the team conducted a comprehensive review of the previous policies. There have been no material changes.

With that, I'll open it up to questions.

CHAIRPERSON COSTIGAN: Great. You may luck out.

Oh, Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: Since we've consolidated this into quote, "One easy-to-read document", can I have a copy of that?

SUPERVISING PENSION ACTUARY ARCHULETA:

Absolutely.

COMMITTEE MEMBER JELINCIC: Because it doesn't strike me that it's particularly easy to read, but thank you.

(Laughter.)

CHAIRPERSON COSTIGAN: You mean in the actuarial world.

All right. So this was an information item. Just so I understand it, will there be an action item coming forward or is this it until the document is provided?

SUPERVISING PENSION ACTUARY ARCHULETA: Well, the're going to be a -- oh, go ahead, Cheryl.

CHIEF FINANCIAL OFFICER EASON: Yes. There's a second reading of this in February.

CHAIRPERSON COSTIGAN: Okay. So we will make -- so it will be brought back for action in February, just making my notes.

CHIEF FINANCIAL OFFICER EASON: Yes.

CHAIRPERSON COSTIGAN: Okay. Thank you.

SUPERVISING PENSION ACTUARY ARCHULETA: Thank you.

CHAIRPERSON COSTIGAN: Okay. Now, we're going to go to 8b, the Semi-Annual Self-Funded Health Plan Report. This, too, is an information item.

SENIOR LIFE ACTUARY McCOLLUM: Good afternoon, members of the Board. Gary McCollum, CalPERS team. This is Agenda Item 8b. It's an information item on the semi-annual self-funded health plan financial report.

This report summarizes the financial results for the HMO plans, except in Kaiser, and the PPO plans as of June 30th, 2016. Attachment 1 summarizes the results for the PPO plans. The highlights are that actual reserves above the actuarial reserve requirements are 147 million. And overall, the self-funded PPO health plans have a ratio of assets to reserves of 127 percent.

At the end of 2015, that ratio was 114 percent. Just to give you a little perspective on that, one month's worth of premiums and claims for the PPO program is just around 200 million now. So this is not quite one month's worth of excess, you might say.

Medical and pharmacy claims costs are currently trending favorably in the low single digits for most plans. The exceptions are the Select -- PERS Select plans, both basic and Medicare. They have medical trends right now around 10 percent. And the Medicare plans are also experiencing mid to high single digit trends in their pharmacy component.

Specialty drugs -- to be a broken record, specialty drugs continue to fuel those large increases in the pharmacy side. Total enrollment for the PPOs increased by 3 and a half percent over the 2015 enrollment. Risk adjustment is still influencing enrollment shifts between the plans, the basic plans that is.

We are -- 2016 is the third year for risk adjustment, and enrollment in PERSCare basic continues to increase. It moved up about 30 percent from 20,000 to 26,000. And enrollment in PERS Choice basic is very stable and PERS Select basic decreased by about 10 percent over the 2015.

Now, for the HMO plans, the assets decreased from the end of 2015. That's primarily due to the elimination of the Medicare plans, where we gave it all to United. And the NetValue plan continues to experience unfavorable claims experience.

Medical and pharmacy claims costs are shown on pages 5 through 8 of attachment 2. The variation in claims costs between the plans represent the demographics of the population covered in the regions they live in. Those claims costs that are shown are not risk-adjusted. Those are the claims costs that each plan is experiencing.

In addition, the plans are still experiencing significant enrollment changes, which makes analysis of any claims costs difficult to interpret. So for the year-end 2016 plan, I intend to include trend analysis for the HMO plans.

Now, the new plans over the 3 years have tripled their -- they tripled their enrollment from 2014 to 2015, and then they just about doubled the enrollment from 2015 to 2016. So they are growing significantly.

That concludes my report. I'll be happy to answer any questions.

CHAIRPERSON COSTIGAN: Okay. We've got several questions.

Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: On page 2 of the agenda item, you talk about medical claims are looking favorable at the current time for Care basic at 3.5. Is that a 3.5 percent increase over the previous year, is that what you're telling me?

SENIOR LIFE ACTUARY McCOLLUM: Yes, sir. That is actually 3 and a half percent increase for the 12 months ending June 30th, 2016 over the 12 months ending June 30th 2015.

COMMITTEE MEMBER JELINCIC: Okay. And Medicare it actually went down.

SENIOR LIFE ACTUARY McCOLLUM: Yes.

COMMITTEE MEMBER JELINCIC: Okay. Are we going to look at the risk adjustment some more? Because intuitively, if our risk adjustment is encouraging people to move from the basically 80/20 plan to the 90/10 plan, are we actually capturing real risk, or is there something else that's being captured there?

SENIOR LIFE ACTUARY McCOLLUM: Well, risk adjustment spreads the risk over the whole pool. So really what you're doing is pricing the plans -- the risk-adjusted price is the price of the plans relative to each other, based on their benefit package. So it smooths out the demographics, which before we did risk adjustment you'll remember PERS Care was very high and PERS Select was very low.

COMMITTEE MEMBER JELINCIC: Right.

SENIOR LIFE ACTUARY McCOLLUM: And that was a reflection of their demographics. PERSCare had an average enrollment age of 54 -- so 54/55, something on that order -- and PERS Select had an average age down in the low thirties. You risk adjust and before enrollment shifts, you assume basically every PPO member is in each of the 3 plans, and then CALCULATE a cost, so that demographics are taken out of the price that's published. So that the price reflects the difference in benefit structure between the plans.

COMMITTEE MEMBER JELINCIC: But if we have reduced the difference, between the 90/10 and the 80/20 plan to literally a couple hundred dollars, have we actually done our risk adjustment correctly, and have we looked at it, because I don't -- I don't understand why we would be pushing people towards the richer plan.

SENIOR LIFE ACTUARY McCOLLUM: Well, okay, the goal was not to push them toward the richer plan.

COMMITTEE MEMBER JELINCIC: I -- no, I understand the goal. I'm just wondering if we're looking.

SENIOR LIFE ACTUARY McCOLLUM: The price differential is a representation of the cost difference between a 90/10 plan and an 8020 plan. So that's a function of what the risk adjustment does.

COMMITTEE MEMBER JELINCIC: Okay. And we're confident that we've done the risk adjustment consistently. I know there are some discussions out in the larger community about the appropriate methods of risk adjusting. I remember when we first looked at it, we basically threw every -- kind of pushed everybody out of the HMOs into the PPOs, and said, no, they really are different pools, so we needed to look at it. So I'm just trying to get a feel are we confident that we're doing it correctly and what are the issues that may be there?

DEPUTY EXECUTIVE OFFICER McKEEVER: I'm back.

(Laughter.)

DEPUTY EXECUTIVE OFFICER McKEEVER: Mr.

Jelincic --

COMMITTEE MEMBER JELINCIC: We're going to keep reeling you back in.

DEPUTY EXECUTIVE OFFICER McKEEVER: Mr. Jelincic, to answer your question, I think what's fundamentally important is that the health care team is looking at the risk-adjustment model. As Gary mentioned, we've been using this since 2014. We've got 3 years under our belt now of using the model, so the team is looking and working with our outside actuaries to look to the actual risk-adjustment model itself to make sure that it's still in compliance with the mandates and the statutes that put it in place that this Board approved back in 2013.

So it is a process that we're looking at to doing an assessment, and then making a determination moving forward whether or not there's a need to make any amendments to it for the 2019 to '23 contract period.

COMMITTEE MEMBER JELINCIC: Okay. And then on page 1 of 9, attachment 1, is each of those bars a year?

Just cause the time --

SENIOR LIFE ACTUARY McCOLLUM: Yes, sir. Those are years. And actually, I didn't realize there's a -- that's a mistake in the formatting. That should be the year underneath it. I'm sorry.

COMMITTEE MEMBER JELINCIC: Each of those bars is a year?

SENIOR LIFE ACTUARY McCOLLUM: Yeah, so 2014, '15, and then '16.

COMMITTEE MEMBER JELINCIC: Okay. But I just needed to know what I was looking at.

Thank you.

CHAIRPERSON COSTIGAN: Mr. Jones.

COMMITTEE MEMBER JONES: Yeah. Thank you, Mr. Chair. Yeah, my question goes to the PPO plan's data. The excess reserve requirements is now sitting at 127 percent, as you stated.

SENIOR LIFE ACTUARY McCOLLUM: That's correct.

COMMITTEE MEMBER JONES: And what is our policy on that reserve and/or what is a prudent level of that reserve? And if it hits that level, then when is that -- or what kinds of programs that money -- excess reserves can be used for. And I recognize this is a Health Benefit Committee question, but I'm just trying to understand while I'm looking at these numbers.

SENIOR LIFE ACTUARY McCOLLUM: Okay. The prudent reserve is what I referred to as the actuarial reserve requirement. So we're currently in excess of what I would consider to be a prudent reserve. Theoretically, we'd like to be --

COMMITTEE MEMBER JONES: So what is that prudent reserve though? What is the level?

SENIOR LIFE ACTUARY McCOLLUM: Well, it would be 147 million less than what it currently is. I don't have the number in front of me, but we're currently over the prudent reserve --

COMMITTEE MEMBER JONES: Right.

SENIOR LIFE ACTUARY McCOLLUM: -- by 147 million. Do you want to know what the basis of the reserve is?

COMMITTEE MEMBER JONES: No. The prudent reserve, if we -- and I support having a prudent reserve, and I don't mind having a reserve -- overly prudent reserve. But at some point it gets so high, you shouldn't leave that money in that reserve. You should start using it for some other program.

SENIOR LIFE ACTUARY McCOLLUM: That's correct.

COMMITTEE MEMBER JONES: And I'm trying to understand where is that number, and at what point do we try to address this in the Health Benefits Committee?

SENIOR LIFE ACTUARY McCOLLUM: Okay. Well, over the -- over these last 3 years, since we implemented the risk adjustment and the new HMOs and the flex funding all in 2014, I have advocated for not doing anything with the excess PPO reserve, just in case we ran into any troubles on the HMO side that we might need the cash available.

We're at a point now where I think we're stabilized with both the HMO and the PPO programs, and we can start looking at ways to reduce the excess reserve.

COMMITTEE MEMBER JONES: Okay. So then I guess, Mr. Chair, maybe since Doug is here, he won't be here for the next Health Benefits Committee meeting, but somehow --

DEPUTY EXECUTIVE OFFICER McKEEVER: Mr. Jones, may I offer a suggestion?

COMMITTEE MEMBER JONES: Yes.

DEPUTY EXECUTIVE OFFICER McKEEVER: In the past, what staff have done is when we've reached a level that we believe is above the necessary excess reserve, as Gary has indicated, staff then will come back to the Pension and Health Benefits Committee for a conversation on what are some of the approaches that staff are recommending.

In the past, there have been things like a holiday for the individuals who are in the PPO plan where they wouldn't pay a premium that month. So those are -- that's an example of an approach that's been used in the past. And then staff could formulate those recommendations and bring them to the Committee for consideration.

COMMITTEE MEMBER JONES: Okay.

CHAIRPERSON COSTIGAN: Ms. Hollinger, you have a comment?

VICE CHAIRPERSON HOLLINGER: Yeah. I was just going to say what you're really talking about, Henry, is a surplus.

COMMITTEE MEMBER JONES: Yeah, yeah.

VICE CHAIRPERSON HOLLINGER: And at what juncture would we consider it prudent that we had a surplus, and then what are our options?

CHAIRPERSON COSTIGAN: Ms. Yee.

COMMITTEE MEMBER YEE: Thank you.

I just had a question regarding the flex funded United plan. And I guess the substantial recent deficit on top of strong growth in that plan in the last year, is it as simple as just translating that to be claims and costs exceeding what was anticipated in the rates or are we to be worried about something else going on?

SENIOR LIFE ACTUARY McCOLLUM: It is a combination of the rapid growth. And at the beginning in 2014, and even in 2015, we had to estimate or guess at their risk scores, when risk adjusting. And honestly speaking, those guesses weren't the best, so that the plan generated a deficit.

It has improved from the June number to the October number. And I don't see any major problem with it but we are keeping an eye on it.

COMMITTEE MEMBER YEE: Okay. So it is getting better.

CHAIRPERSON COSTIGAN: Anything else, Ms. Yee?

COMMITTEE MEMBER YEE: (Shakes head.) That's it.

CHAIRPERSON COSTIGAN: Okay. Your mic is still on. Sorry. I thought you were --

COMMITTEE MEMBER YEE: Thank you.

CHAIRPERSON COSTIGAN: Okay. That is it. I just -- so I can keep track in my mind, are we going to see an action item in February or is this just still informational.

SENIOR LIFE ACTUARY McCOLLUM: No, this is just an information item.

CHAIRPERSON COSTIGAN: Okay. Thank you very much.

Okay. Next Item is 8c, the Long-Term Care Valuation Report. This, too, is an informational item.

SUPERVISING PENSION ACTUARY ARCHULETA: Hi. Fritzie Archuleta, CalPERS team. With me today is Flora Hu, the actuary for the Long-Term Care Program. And she is here to present Item 8c, the Long-Term Care Valuation Report.

SENIOR LIFE ACTUARY HU: Good afternoon, members of the Committee, Flora Hu, CalPERS staff. This is Agenda Item 8c, 2016 Long-Term Care Valuation Report.

The funded status was 106 percent, and the margin was about a 9.6 percent as of 2016. The margin jumped by almost 5 percent over the last year. On the top of page 3 of the agenda item, there's a table providing the breakdown of the reasons for change in margins between 2015 and '16.

As you can see from the table, the major contributor to the margin decrease was the change in the claim cost assumptions. There are many factors leading to the increase in claim cost assumptions in this year's evaluation. One factor is that there's a trend of a higher claim cost during the years of rate increase, which is normally -- which is very common in the rate increase activity. Participants either take the rate increase or decrease their benefits or go on claim earlier than what they would have normally done.

Another factor is higher CalPERS credibility leads to more reliance on the progress experiences, which has been slightly worse than industry assumptions.

The slightly lower actual than expected investment return in last year also contributed to the decrease in the margin. This year's valuations still utilize the discount rate approved in September 2012 by the Pension and Health Benefits Committee, which reflects the revised investment mix, which was approved in April 2012 Investment Committee.

The valuation results are very sensitive to the investment returns. As you can see under the risk analysis section of the valuation report, if the investment return increases by half a percent, the margin would go up to 22 percent. But if the investment return decreases by half a percent, the margin would go down to negative 3 percent.

It is scheduled to have a full comprehensive review of the Long-Term Care Fund asset allocation and its corresponding expected return in March next year.

The conversation in 2016 on helped improve the margin. As part of the stabilization plan starting in 2013, participants subject to the 85 percent rate increase were given options to convert it to a less rich benefit plan to avoid the 85 percent rate increase.

In the previous 3 years valuations, it was assumed that all conversions would be done before 2016. However, in 2016, during the second 36 percent rate increase implementation, there was just some convergence. Those convergence pushed up the margin by about 3.7 percent.

The progress -- the progress funded status has been positive -- has been more than 100 percent and the margin has been positive since 2013, after the implementation of the stabilization plan. But in the last 2 years, there's a decrease in both -- in both the funded status and the margin.

The major drivers of the higher than expected claim costs, but remain in the negative investment return in fiscal year to 2014-15. The margin would be roughly 10 percent higher if the investment returns were as expected. But overall, the margin of 9.59 percent as of 2016 as close to the Board approved 10 percent required margin, and also is consistent with the goal of the stabilization plan.

That completes my presentation, and I'm happy to answer any questions you may have.

CHAIRPERSON COSTIGAN: Hang on a second.

Ms. Hollinger.

VICE CHAIRPERSON HOLLINGER: My only -- my question to you -- I just want to understand like you're showing basically that, you know, we're overfunded right now, correct?

SENIOR LIFE ACTUARY HU: Yes.

VICE CHAIRPERSON HOLLINGER: So I don't know in the insurance world for every dollar of liability that I have to pay out, I have to have a dollar in reserve. So when you're -- I want to understand you're basing the funded status on what -- on our liabilities for every dollar we're projected actuarially to pay out?

SENIOR LIFE ACTUARY HU: Do you mean like you want to understand like for each dollar, how much we're going to pay for the claim cost, how much we have --

VICE CHAIRPERSON HOLLINGER: We have in reserve, correct.

SENIOR LIFE ACTUARY HU: -- in reserve?

Currently, we are overfunded, so --

VICE CHAIRPERSON HOLLINGER: Right.

SENIOR LIFE ACTUARY HU: The funded status is 106 percent. So it remains if we have to pay a dollar for claim costs, we'll probably have -- yeah, we'll have probably 6 more cents.

VICE CHAIRPERSON HOLLINGER: Got it. Okay. Thank you.

CHAIRPERSON COSTIGAN: Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: This goes to the presentation on funded status on page 2 of the agenda item. Present value of future premiums we essentially treat as a negative liability, because the liabilities are 1 plus 2, minus 3. So why do we show it above the valuations and not show it as an asset of the fund?

SENIOR LIFE ACTUARY HU: This is how it works. So we treat premiums as cash flow -- cash inflow. We treat benefits and expenses as cash outflow.

So we tackle that every year, and the discounted back to the current to see how much it's worth. So if we have more cash inflow than cash outflow, we have a positive margin.

COMMITTEE MEMBER JELINCIC: Okay. And -- but if it is a positive, why is it being included above in the liability valuation, rather than being added back down in the -- in the assets?

SENIOR LIFE ACTUARY HU: In this calculation, the assets is not a proper included in the liability calculation, it's just used as denominator for calculation to -- as -- for the margin as a percentage of the assets, or to use -- to use a calculator for the funded status, to use the liability over assets. So probably that's different from the pension funded status calculation. I'm not too sure how pension --

CHAIRPERSON COSTIGAN: Yes, Mr. Jelincic

COMMITTEE MEMBER JELINCIC: Yeah, I would -- rather than have the staff try and educate me here, I'd like permission to talk to them off line and --

CHAIRPERSON COSTIGAN: So actually, I think what we're going to do would be both you and Ms. Hollinger, who's writing me a note. There is a little confusion, so there's some stuff that we would just like -- and understand, you know this stuff inside and out, so we're struggling looking at charts and going -- I was just leaning over to Mr. Gillihan just talking about how impressive our staff actually is and the ability to present this.

So I think we probably need more of an understanding to -- and we've got a couple more questions. Again, the same question I've asked before, will we be seeing an action item in February or does this continue to be informational?

SENIOR LIFE ACTUARY HU: This is continued to be informational.

CHAIRPERSON COSTIGAN: Okay. So there's not an action to be taken.

So, Mr. Jelincic and Ms. Hollinger, the answer would be, yes, we'd like for you to meet with them sometime over the next couple weeks, just answer their questions. We're going to go to Ms. Yee in a second, but then potentially put this back on February just as a follow-up information item.

SENIOR LIFE ACTUARY HU: Sure.

CHAIRPERSON COSTIGAN: So Controller Yee.

COMMITTEE MEMBER YEE: Thank you. Two questions. Let's assume going forward that we might experience another margin drop, I'm just trying to get an understanding about at what margin level we would actually consider a premium increase? I know you're not suggesting one now, but if it should continue to drop, I mean, I guess --

SENIOR LIFE ACTUARY HU: So next year when we provide the valuation result, we will probably listen to the ideas, recommendations from the Board. Overall, it's always better to action earlier -- take actions earlier than later, if you see a drop in the margin --

COMMITTEE MEMBER YEE: Right, um-hmm.

SENIOR LIFE ACTUARY HU: -- because it's always easier to -- probably to pull the time back to stabilization than later when you have worse experiences.

COMMITTEE MEMBER YEE: Right. Okay. So you're just going to monitor it and see whether --

SENIOR LIFE ACTUARY HU: Yeah. Currently, in the industry you'll see the rate increase non-stopping -- it's basically like every year. As probably you can see from the news, they actually recommended to the commissioners in different states, he would like to probably see long-term care probably rate increase to -- similar to health insurance products to have annual increase -- small, small annual increase every year.

COMMITTEE MEMBER YEE: Right. Okay. Good. And then the second question really relates to the discount rate and the -- how do we review that? Is that part of the fund's ALM process or is that a separate process?

SENIOR LIFE ACTUARY HU: That's -- I'm not too clear about -- it is separate, right -- is a separate process.

COMMITTEE MEMBER YEE: And how often do we --

SENIOR LIFE ACTUARY HU: Every 3 years. I think it got delayed because they wanted to probably wait until the rate increase be finished, because the -- they allowed benefit change during the rate increase activity. So the liability impacts the asset structure. So we want to see what options -- what actions the participants have taken during this rate increase. So we have a clear projection of future benefits and the liabilities.

COMMITTEE MEMBER YEE: I got. Okay. That makes sense. Great. Thank you.

CHAIRPERSON COSTIGAN: Anything else, Ms. Yee?

COMMITTEE MEMBER YEE: No, that's it. Thank you.

CHAIRPERSON COSTIGAN: Any other questions?

Okay. We'll see you guys back in February. Please meet with Mr. Jelincic and Ms. Hollinger.

So here's what I'd like to do before we move to Item 9, which is our next item, is that right, Ms. Eason?

CHIEF FINANCIAL OFFICER EASON: Yes.

CHAIRPERSON COSTIGAN: I'd like to take a 15 minute break. Let's get the room reset, because I don't want to disrupt the flow for the next 2 hours. I'm being optimistic on 2 hours or less. So we're going to -- we'll reconvene at 2:30.

Thank you.

(Off record: 2:14 p.m.)

(Thereupon a recess was taken.)

(On record: 2:29 p.m.)

(Thereupon an overhead presentation was Presented as follows.)

CHAIRPERSON COSTIGAN: Please take your seats. Mr. Jelincic, if you're in the back come on back out. I'm going to give everybody a couple minutes to gather before we get started.

All right. We're going to wait one minute. Mr. Jelincic is just going to grab something.

No, she's coming.

So we're just going to wait for Mr. Jelincic and then we'll get started.

Okay. All right. Ms. Eason, we are going to get started with a workshop. So first, before we begin, I just want to thank staff, the consultants, the stakeholders. I know this has been a robust process getting ready for this workshop. I know we're going to try and cover a substantial amount of information. So if you have not signed up to speak, please do. I think we've got a pretty big list right now. And at this point, I intend to just keep it at 3 minutes. If anybody would like longer, please signal, wave, or text me before we get to public comment.

But right now, since we adopted a new regulation today, the new regulation is 3 minutes. So with that --

COMMITTEE MEMBER JELINCIC: We just adopted sending it to OAL.

CHAIRPERSON COSTIGAN: Oh, we adopted sending it to OAL. Okay. Ms. Eason, you're up.

CHIEF FINANCIAL OFFICER EASON: Thank you. Good afternoon, Mr. Chair, Committee and Board members. I'm going to turnover the presentation to Marcie Frost, CEO, to have some opening remarks.

CHAIRPERSON COSTIGAN: Thank you.

Ms. Frost.

CHIEF EXECUTIVE OFFICER FROST: Thank you, Cheryl. Thank you, Mr. Chair, members of the Committee, and of the Board. I'd like to take just a few minutes or moments to introduce the presentation today. And I know you're very familiar with our team who's gathered here at the table, but you will be hearing directly from our Chief Financial -- excuse me, Financial Officer, our Chief Investment Officer, Todd Tauzer who is representing the actuaries. You'll have Brad Pacheco. Wylie Tollette, who is the Chief Operating Investment Officer. So we've gathered your professional team to be able to deliver information to you for your consideration.

So I think it's also important that we recognize that the environment that we're working in today is very different than the environment that created the asset liability management process, and that was nearly 2 years ago.

Time does fly. I was wasn't here during its creation, but I do know that we have a very disciplined process to review the demographic and the economic assumptions that are really the underpinnings of this system.

We have a structured timeline that sets forth the reviews and analysis that are important considerations as we look at asset allocation, and discount rate changes. And it was established through what I would consider very significant stakeholder input and collaboration with all of our stakeholders.

We should all really appreciate the fact that we have this process in place. It was an achievement by CalPERS and I think one that is definitely a best practice for all pension systems in the United States.

One of the factors that our ALM process requires us to do is recognize with changing conditions happen. And as fiduciaries, and as administrators of the system, we are required to review and, at times, act upon those changing conditions.

That's really why we're here today. What you have heard over the course of several months from the team here, your professional staff, and your own independent consultants is that conditions have, in fact, changed.

Our plan dynamics, including our negative cash flow position, our lower funded status, and growing pension outflows, combined with an expected low return environment over the next 10 years, has raised the question as to whether we need to consider changes sooner than our process would allow for, or could allow for.

Your team believes the answer to that question is yes. And you will hear from them today their professional recommendation that will insure the long-term sustainability of the fund

The difficulty about this issue is not the data itself, or the data that you've already seen and the data that will be presented to you today. It's the clear fact that changes to our assumptions means impacts to people's lives. These are the lives of some of our active members. They're the bottom line of the cities, and the counties, and the special districts we serve, and ultimately the taxpayers.

As you directed last month, we have continued to talk to our employer communities. We've continued to talk to the associations that represent our active and our retired members. And their feedback is reflected in the materials that you'll see today.

And we believe it's very important to have this high level of transparency, since the decision before you is an impactful one. All of this work is important, and the Board, the CalPERS steam, and all of our stakeholders should be applauded for the willingness to really tackle this tough issue.

Delivering pensions is a shared responsibility with one common purpose, to serve the members and protect the fund. That must remain our guide. This will not be the last time we address our challenges. We fully expect that we will face similar dynamics in the new year, as we start looking at the data, around the new -- around the ALM cycle itself. But we do believe we need to start that now.

Our team is looking forward to the discussion today, and finding the best solutions for our members and for the fund.

Mr. Chair, we have structured the presentation into 2 parts today. The first part will be delivered by your independent consultants. We've asked them to present additional data, and expand on their comments related to the market environment over the next 10 to 20 years.

Then our team will present some impact and cost data, in addition to a staff recommendation that they will -- that you all asked be brought back to this committee.

And finally, it will be important that we give sufficient time and opportunity to comments from our stakeholders who are gathered here with us today.

Thank you.

CHAIRPERSON COSTIGAN: Thank you, Ms. Frost.

So we are going to start with Ms. Eason.

CHIEF FINANCIAL OFFICER EASON: Yes. So I will kick off the workshop, and then I'll be passing it on to the members that are here today.

But I just wanted to again reiterate that, as Marcie mentioned earlier, recognizing the environment we are operating today is different than 2 years ago during our ALM process. And just to remind everyone that there are a number of important steps that the Board has taken already to secure the CalPERS future through managing funding risks, stakeholder outreach and engagement.

One, of course, being, which is already mentioned here today, is the asset liability management review cycle, which takes an holistic view of -- an integrated view of our assets and liabilities. And as well you will recall the implementation of the new Treasury Management

Program that helps to identify and mitigate risks early to avoid future liquidity problems and strengthens the internal controls around cash flow.

We also have the funding levels, risk levels, and risk report, as well as annual annualized valuation reports, which provides detailed information to employers to better inform our contracting agencies on their budget and funding decisions. And there was also the PEPRA that came into effect in 2013 recognizing that that will take time to realize savings. And so that's really what we're here to talk about today is that the -- what we need to do today.

But, of course, all of these measures were to ensure our overall goal, which is aimed to sustain the fund at an acceptable level of risk over the long term. And so with that, I will turn the presentation over to Ted.

CHAIRPERSON COSTIGAN: Thank you.

Mr. Eliopoulos.

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CHIEF INVESTMENT OFFICER ELIOPOULOS: All right. Thank you, Cheryl. Thank you, Mr. Chairman, members of the Committee. I'm going to spend a minute or so on the "why no"? -- chart before you. And then I'll be turning over the presentation following that to Wilshire and associates, to Andrew Junkin and Steve Foresti who, as Marcie related, will cover the capital market assumptions work they've been doing on behalf of the Committee.

After that, we'll turn it down to Allan Emkin to present information on PCA's independent views with respect to market outlook as well. Following that, the presentation will come back to us here and Wylie will be covering a chart on the next page on market conditions.

So the why now question, I'm not going to read the familiar bullet points now that are before you. We've been talking about the challenging outlook for future returns for about 2 years now in the Investment Committee pretty regularly, and in other forums as well.

Over the course of those 2 years, we've seen the total systems funded status come to a point of 68 percent funded over that 2-year period. And really the bottom line is that as our CalPERS system continues to mature, the need to bring in additional cash to close the growing gap between benefits going out and contributions coming in is placing mounting and additional pressure on the investment portfolio at a time when we're facing the prospect of a lower return environment, and a asset allocation mix that has a degree and a higher degree of volatility than perhaps we'd like.

So that's the rationale and with that to cover some of the metrics around the outlook for future returns, I'll turn to Wilshire and Associates first.

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MR. FORESTI: Thank you, Ted. Good afternoon, committee members. Mr. Chair, I'll do the best I can to reward your optimism of keeping things to 2 hours.

(Laughter.)

MR. FORESTI: I just had 3 slides I wanted to step through to frame the return outlook from our perspective, which I think is -- is very consistent with what see across the industry from other advisors.

Some of these charts, in particular on this first page are charts I've shared with your Investment Committee recently. And the chart at the top right here just shows over the very long term Wilshire's return assumptions for stocks, U.S. equities, and bonds. And so the top line would be our equity forecast through time. The green line at the bottom would be our U.S. core bond forecast. And then I've just drawn a 60/40 stock bond portfolio in the middle of that.

And this is essentially to highlight a couple of points. And I think they're both important points. One is that through time, these return expectations have been coming down and some what secular manner.

And the second point is that revealed here just through the stock and bond assumptions there's relationship between the assumptions, that while we employ different models to come up with these forward-looking assumptions anchored together in the very important way buy economic conditions and whether that's by looking through the cash environment or through inflation there very strong relationship in looking forward across different at classes.

The bottom chart I think is one of the -- and probably the most important on that I want to share with you today. The bottom chart, I think is one of the -- and probably the most important one that I want to share with you today. And this is very simple. This is not a forward-looking assumption. This is simply looking at a market signal, in this case it would be the blue line, that runs all the way from the left side of the chart to the right side of the chart, which is simply the yield on the Barclays, I guess now Bloomberg, aggregate index.

The line that's superimposed on top of it, the red line, is simply the 10-year subsequent return to that yield. And what I'm hoping to demonstrate through this exhibit is how strong a relationship the yield -- and I'll call it a going in yield -- the yield to maturity of a core fixed -- high quality core fixed income index, in this case, is to the subsequent return.

It is essentially the return destiny. There is some wiggle room around that, but it sets the frame. And you'll see a very strong relationship between the chart at the bottom and the return expectations that I just discussed at the top right.

Now, this is just fixed income. There's certainly other asset classes within many portfolios, and riskier asset classes within the CalPERS portfolio that have less -- certainty is probably too strong a word, but we would have less confidence in the future expectations. There's more variability around that expectation.

And I want to spend a minute. So this was looking backwards over a very long period of time. On the next slide, I wanted to zoom in a bit on more of the recent history.

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MR. FORESTI: And there's 2 charts here. The one at the top right again looks at the yield environment. The line here is again looking just at yields through the last 3 years. And I selected 3 years here, because it's somewhat consistent with your ALM cycle, and the return environment, and how that may have changed since the last ALM cycle that CalPERS has been through.

And you can see that through this period of time yields have been in a fairly narrow range from 2 and half percent. They have wandered down a bit, but essentially moved between 2 and 2 and a half percent. You can see very recently, and this is charted through the end of November of this year, an increase in yields. And that's essentially a move we've seen post-U.S. election.

The red shaded area is the forward looking break-even inflation rate. And it shows again what market expectations are glimpsed through bond yields for inflation. And inflation is a very important input to many forward-looking models. A similar relationship with yields, but a bit more dramatic in terms of the dip from 3 years ago, where the break-even rate was a bit over 2 percent. It came down and stayed in the 1 and a half or so range for some time. And commensurate with yields recently, you can see an uptick in the market expectation on that 10-year break-even rate recently.

The more important chart I wanted to focus on here, because I think it speaks importantly to some of the riskier asset classes in terms of where assumptions were 3 years ago to where they may be today. And specifically here, I'm looking at information on the S&P 500 index. There's 2 lines that I have charted here.

The -- I think it's dark blue. The blue line is the price, or the index value, for the S&P 500. And I've set up the chart, where the other line is the earnings per share -- operating earnings per share on a 12-month backward looking basis. And I've set the charts up, even those are graphed on both the left and the right access, to start at the same point on the left.

And what I'm highlighting here is through this period of time, this nearly 3-year period of time, prices on equities have advanced at a much more rapid rate than earnings. And if you think about price earnings, multiples or valuation levels, the price has increased 19 percent over this period of time -- again, this is through the end of November -- versus the EPS number, which has had a bit of an earnings recession here until recently where it's picked up, have increased by just under 2 percent.

The consequence of that is expansion in PE multiples, which essentially challenge the future return environment. Because if you think about the potential drivers of equity returns, there' growth, which would be in the form of at what rate will -- can earnings grow in the future, and then there's how much is the market willing to pay for each dollar of earnings?

Well, that PE expansion is essentially one of those drivers that, I won't say, has been exhausted, but there are limits to how high that can go. So that challenges the environment forward looking for equities versus how things may have looked 3 years ago.

I just want to wrap things up by decomposing looking at asset classes from cash --

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MR. FORESTI: -- to core bonds, to equities, and compare our 10-year forward assumptions, which are the ones that we contribute to your asset liability process. And when we put forecasts together for the CalPERS portfolio, it's the 10-year forward assumptions that we're looking at side by side with, what we refer to as, equilibrium assumptions. And these would be over the very long term, in fact, in an unspecified period of time, which just suggests that over the long run inflation will increase at a certain rate, cash will deliver a real rate of return above inflation.

On the left side of this exhibit, I have our nominal expectations again for 10 years versus equilibrium, and I show the differences. And you can see for most asset classes, the net shortfall to the equilibrium figures are somewhere in the 2 to 2 and a half percent range.

Moving to the right side of this chart would be decomposing those into building block components, where I'm starting with inflate -- what do you receive from inflation on an expectational basis, what does cash add to that, what do core bonds add to that, what do equities add to that?

And the purpose of this is to get an understanding of what is driving in a 10-year outlook versus and equilibrium outlook those muted or depressed forward expectations.

And if you look at the third column that shows the net, you can see that the culprits here are essentially a low inflation environment, and indeed a negative expected return on cash. And if you think about cash as the risk free asset, risk taking in the portfolio is designed to layer incremental returns on top of that cash rate.

From our perspective, those incremental returns and the premia received for taking those risks is not materially different than it has been historically, somewhere in a, you know, 0 to 50 basis points versus the equilibrium contributions. So to us -- and I'm going to end by going back to the first slide, the yield environment essentially suggests what is available by taking a moderate amount of risk.

And if we think about the yield environment against the discount rate, as those start to separate, that essentially sets the table for how much risk may be required in other elements of the portfolio. And by other, I mean outside of core fixed income and asset classes that are driven, not so much by growth, but by income and are more predictable in terms of their return environment.

I'll pause there. Happy to take any questions. I don't know if we're going to -- if Allan is going to make his comments, and then we can circle back, but --

CHAIRPERSON COSTIGAN: If it's okay with the Committee members, I would like to go through the presentations first and then questions.

Okay. Thank you.

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MR. EMKIN: Good afternoon, Mr. Chairman, members. Allan Emkin, PCA.

The real test is can I figure out the clicker.

Yes.

--o0o--

MR. EMKIN: I consider that a small victory.

At your last meeting, the issue of a portfolio's ability to generate a return of 7 and a half percent was raised. And so I made a decision, let's try to figure out what it would take to accomplish that objective.

We used PCA's capital market assumptions, which are not that dissimilar from Wilshire's, and are pretty consistent with the broad industry. But it's important to be humble. If we really had the ability to see into the future, as much as I enjoy coming to Sacramento on a regular basis, I would be doing something else.

We don't have that ability. What we use is pretty wide industry practices that are generally accepted and most people think they're reasonable with a large dose of humility.

As I'll show you on the next slide, the ability to generate a 7 and a half rate of return using our assumptions would require a portfolio that for all intents and purposes, given your size, is completely unimplementable. I wish it was, but it's not, because it would require that a disproportionate percent of the portfolio, as I'll show you, would be in the liquid markets. And that's just not practical and reasonable or prudent.

--o0o--

MR. EMKIN: This is similar to charts you've seen before. Going left to right it shows various asset allocations that will generate various levels of return from low risk to high risk. And the arrow points to what it would take to generate a return, in this case, of 7.6 percent at the lowest level of risk. And what it would require -- once again remember I said it was unrealistic -- half of the portfolio would have to be in real estate, and 40 percent would have to be in private equity.

And effectively, to get any kind of return at all, there can be no cash in the portfolio, and no fixed income. That's just because in today's environment, those assets are considered to be suboptimal. The machine, which looks for risk and return, rejects those asset classes, because they don't generate enough return for the risk they create. And as you can see, the range of outcomes, if you get left to right, gets broader and broader and broader.

--o0o--

MR. EMKIN: So the next task was, given your strategic asset allocation and your interim asset allocation, what would they generate, and then looking at the likelihood of getting certain levels of return. So using our numbers, the strategic would generate 6.8 percent annualized that's compounded. The interim 6.4, cause it's a slightly less risky portfolio.

Well, what's the likelihood of getting to 7 percent?

It's basically at 48 percent, or right in 50/50 for the strategic, and it's less than 45 for the interim. And to get more than a 50 percent probability, you'd have to get a return a little bit more than 6 and a half percent to get to the likelihood of more than half the time you're going to get that number.

So to generate the kind of return that you would like to get would require a level of uncertainty, and an asset allocation that, in our opinion, is unimplementable.

Thank you, Mr. Chairman.

CHAIRPERSON COSTIGAN: Thank you.

Mr. Eliopoulos.

CHIEF INVESTMENT OFFICER ELIOPOULOS: I think Wylie will be covering this next page, and we'll see if he can catch up with the clicker.

--o0o--

CHIEF INVESTMENT OFFICER ELIOPOULOS: And, Mr. Chair, after this is done, if you want to take questions --

CHAIRPERSON COSTIGAN: We'll take questions.

CHIEF INVESTMENT OFFICER ELIOPOULOS: -- on the investment portion, this will conclude the investment portion of the presentation.

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE:

Great. Thank you, Mr. Chairman and Finance Committee. This slide sort of brings home some of the information that Wilshire and PCA just discussed, specific to CalPERS capital market assumptions. And this chart illustrates how CalPERS and many other pensions derive their long term expected rates of return.

At the last ALM, which you can see on the left-hand side of the slide, you can see that our 10-year estimates of return were of 7.1 percent were offset by higher years 11 through 30 returns of 8.05.

During the mid-cycle ALM review, we first became aware of reduced -- or steadily reducing capital market assumptions over the last several years, culminating in August with the capital market assumptions you see on the right side of the slide, which is showing a 10-year return of 6.2, and a years 11 through 30 return of 7.83.

As a result, particularly when you incorporate our consistent negative cash flow position, the probability of hitting 7.5 has fallen actually to between 14 and 19 percent over the next 10 years.

So I think with that, I will turn it back to Ted.

CHIEF INVESTMENT OFFICER ELIOPOULOS: Mr. Chair, that's our -- that concludes our presentation.

CHAIRPERSON COSTIGAN: So we have a few questions. So I'd like you all to lay the table a little bit more. So Wylie I appreciate -- I mean, the risk we're running is, 1, is you have to safeguard the portfolio and we have to pay the benefits. We're facing a negative cash flow.

But just on the investment side, touch a little bit. I mean, as I was reading on CNBC, I mean, we're about to hit Dow 20,000, and there's all this excitement. Yet, there's still a lot of uncertainty. And then when you look at our portfolio, it's not just U.S. domestics. And so maybe you can just broaden a little bit about, for folks that are watching in the room, is you look at Dow 20,000, why aren't we jumping up and down about that aspect of, well, all things are good because look where the Dow is?

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE: I'll take a first crack at that, and then I would invite my investment colleagues to add color to my answer.

Two quick thoughts. First off, most of the discussion today, in fact almost all of it, really is focused on what we can expect from the current asset allocation. Really not planning to discuss altering that asset allocation until the next ALM cycle. So we're really just talking about what the current level of risk in our portfolio is expected to deliver. That current level of risk is about somewhere between 12 and a half and 13 percent.

At the last asset liability management exercise in 2013/2014, that level of risk was right around 11 and change. So the overall level of risk of volatility has increased slightly from the last ALM. And the expected level of return from that same portfolio has fallen a built.

The second thing about the recent market run-up -- and, in fact, I think the NASDAQ actually hit a new record today -- is that when prices go up, as they have quite dramatically recently in the stock market, the forward-looking expectations tend to go down, because you're starting from a higher base.

So remember that our capital market assumptions are always forward looking, so we have to look at where we're starting. And right now, we're starting at a fairly elevated level, as Mr. Foresti's presentation talked about.

Earnings essentially have to catch up to support continued growth in that stock market, or the price earnings ratio of the stock market would really have to become even more elevated than it is today for that to continue.

CHAIRPERSON COSTIGAN: All right. And then, Mr. Emkin, if you could just expand a little bit, because I think you went over it a little quickly. In order to achieve the 7 and a half percent, what your materials show is that the 2 assets that we would have to hold would be real estate and private equity, which are not issues where we can raise cash very quickly from.

MR. EMKIN: That's correct. And the size of those markets wouldn't allow you to have those exposures under any circumstance.

CHAIRPERSON COSTIGAN: And part the issues in 2008 was -- and I'm not going to say the -- it's an -- I had to write it down, illiquidity, because I want to use a different world. But it was an liquidity issue, is that folks had to raise cash. So you sold, drove price down, sold continued to drive. But in order to achieve the rate with our current allocation, almost two-thirds of the portfolio would have to be walled off and we wouldn't be able to touch. And then on top of that, we're still running the negative cash flow.

MR. EMKIN: That's correct. That's why I stated it's unimplementable.

CHAIRPERSON COSTIGAN: Yeah. Great.

Okay. So questions.

Mr. -- or actually why don't we start with the Committee first. So it's Ms. Yee. I'm sorry.

Controller Yee.

COMMITTEE MEMBER YEE: Great. Thank you. I wonder if you could comment more with respect to -- give us more of a flavor with respect to the impact on the fact that we're selling off assets to make up the difference between employer contributions and the investment earnings, and what the sale means with respect to volatility and lower prices?

I mean, this -- I think oftentimes, you know, the observation about, you know, what's happening here is, you though, why aren't we more aggressive, why are we being so conservative?

And yet, you know, we're really kind of put in this position of where, you know, we're losing some leverage and position with respect to getting in on, I guess, more advantageous prices.

So could you comment on that a little bit more?

CHIEF INVESTMENT OFFICER ELIOPOULOS: I'll jump in and then certainly Allan or Wilshire and Wylie is going to pull up a chart to make this point even more acute.

But you're exactly right, it produces a strain on an investment portfolio, you know, meant to be for the very long term. You have to -- you have to be able to survive that long term without selling assets in order to achieve that risk premium that you're hoping to take, and having to sell assets during the course of a down market is a big threat to portfolio to achieve the hope for return premia in the risk assets over the long term.

In terms of some of the percentages, I'll turn to Wylie on this chart to walk you through some of the work we've done looking at the probabilities of hitting different return targets, given the negative cash flow that we have.

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE: Yeah. Thank you for your questions, Controller Yee. I thought this chart might be helpful in answering your question. This is essentially your Investment staff ran a series of Monte Carlo simulations, which is a mathematical algorithm, basically samples thousands of potential market environments and then looks at the results set that occurs when that's undertaken, given the current capital market assumptions.

And what you can see here is both our current interim asset allocation, as well as the strategic asset allocation, which has a higher equity component to it.

You can see the somewhat dramatic impact that negative cash flows actually have on the probability of achieving certain return levels. For example, the interim asset allocation using Wilshire's current capital market assumptions, the probability of hitting 7.5 percent is 14 percent, when you include cash flows.

If we didn't -- were not cash flow negative, that probably increases to 34 percent. So it's quite a dramatic effect. Basically, negative cash flow makes any investor and pension -- and calPERS is no exception to that, path dependent.

Whereas, if we're able to retain assets and ride out the bumps, we can maintain a higher level of risk without suffering the impact on return.

COMMITTEE MEMBER YEE: Okay. Thank you.

Thank you, Mr. Chair.

CHAIRPERSON COSTIGAN: All right. We're going to go -- we're going to do Committee first, if that's okay. We'll continue. So Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: A number of questions and observations. You know, we talk about being cash flow negative and that obviously is not particularly helpful, but I will point out that as a percent, we were much more cash flow negative when we were making 30 percent a year, and nobody seemed to get terribly excited about it.

If we are long-term investors, I think we ride out the ups and downs. But, Steve, I want to go back to -- well, it's 90 -- it's 275 of the iPad. And let me see if I can get rid of this. And it looks like it's page 1 of 3 in attachment 3.

We talk about the bond yield. Going forward, do you really believe that this bond yield is going to stay here forever or is it an anomaly? You know, my guess is we're going to see higher rates in the future, but what's your confidence level that we're going to stay there?

MR. FORESTI: No, I don't -- a little close to the mic there. No, I do not think the yield is going to stay there forever. But the thing that's important about, and the reason this chart reveals such a tight relationship, is -- let's think for a moment if yields were to rise going forward. The bonds you have are priced to give you, let's call it, 3 percent. As yields go up, and the portfolio kicks off cash flows, those rising yields will lower your principal, but that's okay, because the bonds your holding are going to mature at the rate, assuming they pay, which these are high quality bonds.

The problem is whatever direction yields go, pushes the return in the opposite direction of what the principal gain or loss is.

So if yields are on the rise, you take a principle hit for the bonds you own. Good news is, as you're reinvesting capital that's coming in, you're getting a higher than forward why vine capital. The that's coming in you're getting a higher than forward return on those subsequent years. The way that nets out the reason this relationship shows so strongly, is those 2 things balance themselves out. You have a portfolio. All the bonds you're holding are this neighborhood of, you know, high 2's to 3 percent return.

So it's only irrelevant, almost, what happens to yields from this point forward. That will change what your expectation might be a year or 2 years from now, but if yields went up, again, you would have had a negative return over the next 2 years that will then be buffered by a higher return over the next 8.

And that's essentially why the going-in yield is your return destiny when it comes to high quality bonds of this maturity range.

COMMITTEE MEMBER JELINCIC: So if we had held less bonds, we would be expecting less capital losses.

MR. FORESTI: It -- I mean, it completely depends, number one, on what happens to yields in that less part of the portfolio.

COMMITTEE MEMBER JELINCIC: Okay. Assuming a yields rose.

MR. FORESTI: That assumes that other asset classes are going to appreciate in that environment. If yields rose because there's a spike in inflation, it's probably not great news for equities. It's probably not great news in the short term for other assets as well. So there's just so many variables in that question.

We know what will happen to bonds, because there's such a direct relationship as yields move. But what pushed those yields has all sorts of knock-on effects to other investments in the portfolio.

COMMITTEE MEMBER JELINCIC: Allan, you showed us your chart with unconstrained allocation. I've seen that chart or variations of it for 20 years, and you've produced them for 20 years, but in an unconstrained environment, doesn't it always default to 100 percent real estate and 100 percent private equity?

MR. EMKIN: Mr. Jelincic, the answer to that is yes. And if you go to portfolio 1, it's 100 percent cash. And if you go to the far extreme, it's 100 percent private equity. And it is illogical. No one would ever invest this fund or any other fund's assets in that manner.

It's just a tool. And the tool is to say that at various levels of risk, you have various levels of return, and how comfortable are you, as decision makers, with a range of outcomes. And that's really the key is the range of outcomes, not the specific number. And to get a specific rate of return, what level of dispersion or risk are you willing to accept because that has an impact on funding levels, contribution levels, et cetera.

COMMITTEE MEMBER JELINCIC: Fair enough.

Steve, back to you. On the following page, there has been some discussion about whether PEs are actually moving around as much as they have on the -- because the question of what it -- what are we reporting as earnings to the change in accounting? Have you done any work at that on that subject, and do you have anything you can share on it?

MR. FORESTI: I think that's a -- that's a good point. I mean these are accounting figures. I've reported them here as trailing, based on operating earnings. I think one of the ways to smooth this out would be a CAPE Shiller PE which normalizes and looks at earnings over a 10-year period, inflation adjusted.

And if you look at Shiller PE ratios today versus historically, they are also at very historically high levels. And if you -- I did it with bond yields against subsequent returns. But if you put together a chart of a Shiller PE, and subsequent returns, you see the same sort of pattern, not with as strong a relationship as we see on bond yields, but with a very strong relationship between the price you pay against earnings.

And that smooths out over 10 years, so these accounting artifacts that might hit a number this quarter versus last quarter versus last year are diversified through that data set. So when normalizing for those things, you -- it leads to very similar results.

COMMITTEE MEMBER JELINCIC: Okay. And I want to comment on the fact that we are an international investor, and I think we ought to be, because we don't know, you know, what's going to go on in the U.S. versus the rest of the world.

But we do need to acknowledge that that's a decision we made that we are going to put more of our assets into international than our liabilities, which were all dollars, so -- and, you know, higher PEs really come because people are valuing earnings more, or they're expecting more earnings in the future. And again, it's called decision making in a condition of uncertainty for a reason. Thank you.

CHAIRPERSON COSTIGAN: Mr. Jones.

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

Yeah. I have a couple of questions. One deals with inflation, and the other deals with interest rates.

The Federal Open Market Committee, as you know, have raised interest rates a quarter of a percent. What impact -- and they anticipate raising them again, maybe 2 or 3 times next year. What impact will that have on your projections, positive or negative, or -- and to what degree that any of that information has been included into your projections?

MR. FORESTI: It's not directly included in terms of if X, then Y, meaning if they do 3 increases next year versus 5, but it is included in the general risk around the assumptions. So with each assumption we have, there's variability. To Mr. Jelincic's point, none of this is --

these are all probabilistic outcomes. I think to the extent that the Fed moves, based on what's priced into markets, which, you know, they last moved last December. At that time, there was speculation that there'd be 2 or 3 or even 4 increases in 2016. It didn't materialize. We saw one increase this -- just a week ago.

The risk is if the Fed gets ahead of what's priced into markets and what the expectations are of markets, we saw a form of that in the temper tantrum of a few years ago. But they seem very keen on telegraphing, being clear to markets on what their expected moves are.

But that's a difficult call to make, and it's -- I guess it's priced in the uncertainty around the assumptions.

COMMITTEE MEMBER JONES: So the bottom line, if the Fed does increase 3 times next year, the impact on our potential return is negative or positive?

MR. FORESTI: If rates generally move up, what ends up happening to the assets you have invested over that period of time, big question mark. That's a short-term return. It depends how markets react. It depends what's going on in the environment.

In terms of what that might mean for the future -- and I'll actually -- because maybe it's a great way to highlight the point, the third slide that I had at the bottom. I didn't touch on this in the remarks I made earlier, but I did want to just give a glimpse of how quickly some of these things get moved.

Now, this was an unusual period of time. We update our assumptions on a quarterly basis, so the last formal assumptions we struck were in September of this year.

I thought it would be instructive to just put together what things might have looked at if we ran all our models as of the end of November. And because break-even inflation had increased by 30 or so basis points, and because yields had increased so much, that pushed up the forward expectation on returns.

If the scenario, Mr. Jones, that you're painting materializes and not only does the Fed's fund rate go up, but yields on fixed income instruments gradually rise. Then that -- it pushes the forward expectation up, but think about in the short-term as yields are going up, then the return, because of a small principle hit, depending on the maturity of the bonds, will have a lower return than the 3 or 4 percent that's priced in.

But to answer your question 9 months from now, if yields are a little bit higher, or forward expectations on fixed Income would be a little bit higher.

COMMITTEE MEMBER JONES: Okay. And the other question is dealing with inflation. Because when we go through our asset allocation process, and we come down to the bottom line, and I think I remember a line that has inflation. And so my question is what is that number? And number 2, also at the Fed, they talked about inflation going up to about 2 percent or something. So the question is, what impact that's going to have, if that's true, compared to what we are projecting in our numbers here.

CHIEF INVESTMENT OFFICER ELIOPOULOS: Well, I'll pause just for second if you want to comment on the inflation projection as part of your capital market assumptions, then I can turn to the CalPERS one.

MR. FORESTI: Sure. Sure. So we, with very few exceptions, rely very heavily on that break-even rate that I described. During the financial crisis, we stepped out of that model. But that's the only time we've stepped away from relying on that rate. And the reason is it's priced out of tens of billions of dollars of bonds being priced, and it's a spread that shows what markets are pricing in.

There has been a need. So part of the bond yield increase we've seen since early November 60 or 65 basis points. Half of that is from an inflation expectation picking up. The other half is in the form of a real yield, which one can make an argument is because there's growth expectations have increased.

What happens with inflation over the short run is very different than what we're forecasting here. There might be some volatility, but -- so our glimpse right now, and this -- you know, when we strike the assumptions at the end of this year, things are looking much more like 1.90, closer to 2 percent, then 1.65. That then pushes through some of the other models. How it hits the liability in some of the other work, I'll leave that to Wylie and Ted to talk about.

CHIEF INVESTMENT OFFICER ELIOPOULOS: Great. Thank you.

So the number for CalPERS set at the last ALM was 2.75, which is a number that both the Actuarial Office really sets, as part of its experience study, for the long term, which, you know, closely matches the equilibrium number that Wilshire has there. And we also adopted that as inflation assumption for the 10-year investment outlook as well.

So you contrast that 2.75 to the 2 percent break-even now, and there's a decent gap. So I would expect that it to be a discussion point during the ALM process. I know the actuaries are working quite a bit about it -- on that number as part of their experience study.

COMMITTEE MEMBER JONES: Okay. And the 2.7, when you say -- is that the 10 year and not the 30 year.

CHIEF INVESTMENT OFFICER ELIOPOULOS: Yeah.

COMMITTEE MEMBER JONES: So it the same number used for 30?

CHIEF INVESTMENT OFFICER ELIOPOULOS: We use the same number for both.

COMMITTEE MEMBER JONES: Thirty years. Okay. Thank you.

CHAIRPERSON COSTIGAN: Ms. Hollinger.

VICE CHAIRPERSON HOLLINGER: Thank you. I appreciate all this. I think my fellow Board members when you're looking at inflation, I think the other thing you have to look at in terms of -- is that, yes, we're cash flow negative $5 billion a year, but that's going up a billion dollars a year.

So we -- our burn rate on our portfolio with the maturing population that we have, we're in a hole. So I really think the emphasis, and I've said this before, has to be on principal protection, less risk to the portfolio. And I'd like you to speak to even though we could talk about interest rates going up, that -- of the fact that our expenses are going up with our maturing population, and how that plays out.

CHIEF INVESTMENT OFFICER ELIOPOULOS: The very next chart really speaks to your point, so I might pivot to Cheryl to talk about that increasing gap.

CHIEF FINANCIAL OFFICER EASON: Thank you. And I think you've covered this slide very nicely Ms. Hollinger, but I will -- I will add to it, because really an important discussion and plays into the environment that we're dealing with is the risks associated with the maturing of the plan, which I think you've just -- you've articulated.

And part of that risk that you see with the maturing of the plan is this negative cash flow environment. And this is -- this is data that illustrates. This is based on actual data, and then we've taken that and we've projected that out.

And as Ms. Hollinger pointed out, we have this gap that continues to grow between the very top of those stacked bars, which is really the anticipated benefit payouts, versus the current contributions that are coming in which is the blue bar portion.

That gap requires additional cash flow, or this liquidity, from the investments that we've been talking about. So real data that we use that is -- that is in our system is that for -- as an example, that CalPERS paid approximately 19 billion in pension benefits last year, and we've collected 14 billion in contributions.

So that's the $5 billion shortfall that was just mentioned, and that is the cash flow negative. And then as you look at that growing to -- up to 35 billion in total contributions being paid out versus closer to about a $23 billion collection. That increases that gap. And what we've done -- what we have added to the chart was that if we were to look at a assumed rate of return of 7.25, and 7, so we've modeled those 2 numbers. And that's the orange, the 2 colors of orange on that chart, you'll notice that what happens is those additional contributions helps to reduce the reliance on the investment returns. It reduces that because of the increase in the contribution. So setting -- offsetting some of the otherwise required investment returns, and then lessening the gap between the benefits paid and the contributions received.

CHAIRPERSON COSTIGAN: Hang on a second. We've got other folks, unless Ms. Taylor you would be next. Can I stay with the Committee or would you like me to come to you.

BOARD MEMBER TAYLOR: You can stay with the committee.

CHAIRPERSON COSTIGAN: Okay. Then we'll go to Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: On this chart, investments used, is that principal that is being used?

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE: (Nods head.)

COMMITTEE MEMBER JELINCIC: So where does investment income show in this chart?

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE: That's a good questions, Mr. Jelincic. Investment income, the reinvestment of the dividends that we earn on our stock portfolio, and the reinvestment of the interest that we earn on our fixed income portfolio, that is included in the return expectations for both of those asset classes.

So if we were to cease to reinvest dividends and interest, that would make cash available. However, it would also have an offsetting effect on the expected return from those asset classes.

So what that gap represents is actually us having to sell investments to fund the gap. That's not sort of -- the cash that our stock portfolio generates essentially is reinvested and is included in the capital market expectations that reinvestment is assumed.

COMMITTEE MEMBER JELINCIC: And on this chart, it does not show up?

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE: It's -- that's right.

COMMITTEE MEMBER JELINCIC: Okay.

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE:

That is pure principal sales that we would have to undertake.

COMMITTEE MEMBER JELINCIC: I was just trying to understand what I looked at.

CHAIRPERSON COSTIGAN: Mr. Jones.

COMMITTEE MEMBER JONES: Yeah. Thank you. On that chart also just make sure I understand, I'm looking at the bottom where it says additional 7.2, and additional 7. You're really talking about the net difference between those 2 numbers, not additional, twice, right?

CHIEF FINANCIAL OFFICER EASON: Yes, that's correct.

COMMITTEE MEMBER JONES: Okay. Thanks

CHAIRPERSON COSTIGAN: Okay. Ms. Taylor.

I'm sorry, please push your microphone.

My mistake.

Ms. Taylor.

BOARD MEMBER TAYLOR: Thank you. So I appreciate this. This really clarifies a lot. And I, too, want to make sure that we are funded for the future 60, 100 years in the future making sure that our members and our employers can afford it. That's the main thing. We have to think about that impact.

But also, I had a couple of questions, because in the previous report -- actuarial reporting, if you go to attachment 8 --

BOARD MEMBER MATHUR: Which agenda item?

BOARD MEMBER TAYLOR: I'm sorry. Actuarial reporting number 8, attachment 5. I apologize.

CHAIRPERSON COSTIGAN: And back to the prior presentation.

BOARD MEMBER TAYLOR: And the reason I bring it up is because what I'm trying to figure out is why we're in this hole of so much cash going out? Is it -- and you talk about the maturity of the fund, but I see here that we had closed off the classic employees fund, which creates an underfunding, right?

CHAIRPERSON COSTIGAN: Ms. Taylor, I think Ms Eason is looking. Page site again.

BOARD MEMBER TAYLOR: So it's on Agenda number 8 -- Agenda Item number 8, attachment number 5.

CHAIRPERSON COSTIGAN: All right. If you're on your iPad, what page would that be, bottom right-hand corner? Is she on the though iPad?

CHAIRPERSON COSTIGAN: I am.

BOARD MEMBER TAYLOR: Oh, she is.

It's on -- you can start on page 1 of 9. It talks about -- it's page on 14.

CHAIRPERSON COSTIGAN: It's page 104 of the iPad.

BOARD MEMBER TAYLOR: Yeah, page 104. I'm, sorry of the iPad.

CHAIRPERSON COSTIGAN: In its item.

CHIEF INVESTMENT OFFICER ELIOPOULOS: I think what we're struggling with is we have 8a, 8b, 8c.

CHAIRPERSON COSTIGAN: So it's Item 8a.

BOARD MEMBER TAYLOR: It's 8a, attachment 5.

CHAIRPERSON COSTIGAN: Five, but it's listed as Agenda Item 5a from May 20th, 2014. That's the document you're referring to, right?

BOARD MEMBER TAYLOR: Right, right, right.

CHAIRPERSON COSTIGAN: Okay.

BOARD MEMBER TAYLOR: So I'm just trying to figure out does that closing of the classic fund have an impact also on our status as more cash flows? I'm sorry, less cash coming in to paying out?

SENIOR PENSION ACTUARY TAUZER: Good afternoon. Todd Tauzer, CalPERS staff. So certainly with the turnover of members from the classic side of things to the PEPRA side of things, we do see in the very long term an improvement in some of the risk factors that we've been talking about. We actually have a slide coming up. I think it may be next.

BOARD MEMBER TAYLOR: It's number 6?

SENIOR PENSION ACTUARY TAUZER: So here we have a slide -- yeah, 6 of 41, where we're talking about looking at a sensitivity to a poor return, whether that poor return happened right now, 5 years from now, 10 years from now and then going on out into the future from there.

And so what we're seeing is as we continue to see this impact from the Baby Boomers, as we continue to see these challenges that we've talked about, we see our sensitivity to poor investment returns increasing, meaning over the next 10 or 15 to 20 years, the same negative investment return over time would increase our contribution rates by more.

BOARD MEMBER TAYLOR: Right, because we've closed that one --

SENIOR PENSION ACTUARY TAUZER: Well, it's mainly due to the fact that we have this big increase in retirees as compared to actives and our sensitivity there.

But as you're mentioning, over the longer period of time, the effects of PEPRA do kick in. So you can see at 2040, 2045, 2050 on that slide that our sensitivity starts to come back down. So in the very long term, you do see that that beneficial impact of PEPRA helping contribution rates.

But even if you look at 2060, compared to 2015, especially for the safety side, you still see us being a little bit more sensitive than we are today. So it's a very long-term path, when you're just talking about the impact of PEPRA.

BOARD MEMBER TAYLOR: Okay. And I actually was trying to get to whether or not -- because it costs more to fund a closed fund than it does --

SENIOR PENSION ACTUARY TAUZER: Well, so it's not actually the fund isn't closed itself, it's really that individual plan within the fund. Many of those plans have been closed off, and then we have to introduce new plans for their new members on the PEPRA side.

So as a whole, we don't have to view an employer per se as a closed employer, who won't be funding their plans anymore, but we do. So we more are just looking at this long-term impact from PEPRA as the real significant effect of PEPRA.

BOARD MEMBER TAYLOR: Okay. And then I just had a -- I count a process. In September, I just -- it's a question about September we did the interim ALM. And I think, I can't remember who mentioned it now, you mentioned our regular strategic ALM had a return of 6.8. When did the interim it was at 6.4. So -- and we did that before now, when we're talking about reducing the rate. So did that have an impact on needing to reduce the rate?

CHIEF INVESTMENT OFFICER ELIOPOULOS: No. No impact.

BOARD MEMBER TAYLOR: It didn't have an impact.

CHIEF INVESTMENT OFFICER ELIOPOULOS: None.

BOARD MEMBER TAYLOR: Okay. All right. And then hold on, I think I had one other question.

Okay. No that was it, those 3 questions. Thank you.

CHAIRPERSON COSTIGAN: All right Todd, would you like to do your presentation? Are you next?

SENIOR PENSION ACTUARY TAUZER: Yes.

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SENIOR PENSION ACTUARY TAUZER: So moving on from here, I'm going to just take a little time to talk about the impacts. As Theresa just mentioned, it's important to see the full picture. So we're going to focus on 3 topics. First the funded status. And then, of course, any change in assumptions, especially when you're going more conservative, is going to have an impact on 2 aspects of the cost, the 2 sides as we say, the normal cost and the unfunded liability.

Just as a quick reminder, the normal cost is a forward-looking measure. It's saying for everyone to earn their next year's service, what will it cost those people. Whereas, the accrued liability from the past that we need to sure is fully funded.

So the normal cost is more of a permanent measure continuing to go forward. We will see the increase in that cost on the accrued liability side. Especially for assumption changes, we pay it off over 20 years, and then it's gone. So it's not permanent, in that sense of the term.

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SENIOR PENSION ACTUARY TAUZER: So here we just present the PERF funded status as a whole. And again, we're looking at 2015 and then a projected 2016 measure. And we see going from 7.5 to 7 percent, that in both cases the fund, in general, decreases by about 4.5 percent in funded status.

What's important to remember is that's the immediate impact of funded status. But as we look at the long-term impact of a change like this, it's a much different picture. Even though you drop when you decrease the funded status, you increase additional contributions coming into the plan, so you catch up in the long-term much faster in terms of funded status.

So in a 10 to 20 year horizon, CalPERS would be, on average, much higher funded with dropping the discount rate as opposed to no action.

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SENIOR PENSION ACTUARY TAUZER: So the next few slides are meant to give you an understanding of the possible costs to plans and to members, of course. So we did -- we looked at estimated costs across all of our public agencies. We also, on the side, looked, of course, as State and schools, and we have more detailed slides on the appendix for State and schools.

But for public agencies, we did basically a distribution of where they'd fall in estimated costs. And for these slides, I'm going to focus at the 7 percent level. You can also see the 7.25 is basically half of the impact.

So this is miscellaneous plans. And you can see it's pretty clear that most plans at the 7 percent level fall between 1 to 3 percent increase on the normal Cost. Again, normal cost is the permanent increase that we're looking at long term.

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SENIOR PENSION ACTUARY TAUZER: The next slide is just the exact same thing for safety. And the costs are because they, in general, have much higher benefit formulas. It's reflected in the costs and the costs are basically double. Most plans falling in the 2 to 5 percent range of normal cost for public agencies.

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SENIOR PENSION ACTUARY TAUZER: Moving on to the unfunded liability side of things. For unfunded liability, it's a little more tricky like we mentioned before. It's paid off over 20 years. But in addition to paying it off over 20 years, we do, what we call, a ramp up. We ramp the costs in over 5 years. So just to be clear on that, in year 1 you see one-fifth of the estimated cost, year 2 you see two-fifths, and then you get up to year 5, and then it stabilizes at that point, and then falls off at the end of 20 years.

So what we've presented here is we really wanted to look what's the more significant long-lasting cost. So we looked at the 5th year, once the ramp-up is done, what's the impact to the current unfunded liability payments that people have.

The other thing I want to mention is that we've been moving away in our valuation reports from percentage of payroll, because as Theresa mentioned, some plans have been closed off, other plans are PEPRA, and are growing at a much more rapid pace. So payroll isn't the best -- projecting payroll forward isn't the best measure of looking at percentage of costs.

So here, we've looked at, in general, what's the current unfunded liability payment for most plans, and what's the increase on that payment caused by this assumption change? So it's a relative increase based on the current payment.

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SENIOR PENSION ACTUARY TAUZER: So for miscellaneous, you can see most plans fall just right about in the 30 to 40 percent range on their current payment. So what that means is if a plan is currently paying 1 million in unfunded liability, you would see -- once you get through the 5 years of ramping up, they'd be paying 1.3 to 1.4 million on their unfunded liability. So that relative increase.

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SENIOR PENSION ACTUARY TAUZER: On the safety side, we actually see, unlike normal costs, because we're looking at a slightly different measure here, you see basically the same distribution, a 30 to 40 percent is the median increase.

Just a reminder that if you have a larger base unfunded liability, when you're looking at a relative increases, the same relative increase is a more -- is in absolute dollars a greater amount, if that makes sense.

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SENIOR PENSION ACTUARY TAUZER: So moving on from just the general distribution, we took it -- we decided to for normal costs kind of dig a little deeper.

And so we looked at, first of all, have a few samples of classic plans. And then we also wanted to look at PEPRA, because, of course, for PEPRA it affects the members as well as the employers.

So here's some -- a couple of examples, Miscellaneous A and B, and Safety A and B of basically the classic normal cost change of a discount rate change. And you can see for both miscellaneous plans, the change is just right, about 2 percent.

Here, we're talking total normal costs across a classic plan. And for safety, you can see it's just under 4 percent. So again, almost double.

But on the pages we did a little more analysis for PEPRA, because it affects members, as well as employers. So we looked at all of the PEPRA plans in the public agency pool and we did an average.

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SENIOR PENSION ACTUARY TAUZER: And what we saw was for employees, miscellaneous employees, that going down to 7 percent, on average, would cause a contribution increase of about 0.75 of a percent.

And, of course, does the employer side as well, that's about 1 percent. So when you add the 2 together, you're having just a little bit less of an increase than you saw in the classic side, generally because the benefit formulas are more modest.

And then -- so for safety as well, you can see the employee going up by about 1.75 percent. And then, of course, you'd add the employer to that.

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SENIOR PENSION ACTUARY TAUZER: So this is just to give a more rounded view of what the cost would be split out for PEPRA between the employees and the employers. And this is actually the last slide I have for costs. So if there are any clarifying questions on costs, I'd be happy to answer them.

CHAIRPERSON COSTIGAN: So, first, any Committee members have questions?

Mr. Juarez you're not on the Committee.

Shaking your head at me.

Ms. Taylor.

BOARD MEMBER TAYLOR: So I'm just trying to clarify, the normal cost for the classic employees is higher when you lower the rate of return than the normal cost comparison, because the plans are more generous. So I'm trying to figure out who this classic employees are. Are they the all classic employees?

SENIOR PENSION ACTUARY TAUZER: So really for classic, we're talking about employer, but I could just say total normal costs. The total normal cost for the plan is a bit higher -- the increase is more --

BOARD MEMBER TAYLOR: Is more.

SENIOR PENSION ACTUARY TAUZER: -- when you lower the discount rate and for PEPRA.

BOARD MEMBER TAYLOR: So a portion of say municipalities and cities and counties who have classic employees before PEPRA, a portion of that is going to be paid for by the employer at a higher rate, so -- and is it -- when that normal cost happens, is that immediate?

SENIOR PENSION ACTUARY TAUZER: Yes.

BOARD MEMBER TAYLOR: That's immediate. So there's no ramp-up for the employers or employees who have to do normal costs.

SENIOR PENSION ACTUARY TAUZER: Correct, yes.

BOARD MEMBER TAYLOR: At all?

SENIOR PENSION ACTUARY TAUZER: There's no ramp up.

BOARD MEMBER TAYLOR: Okay. So that makes it -- that's where it gets a little rough, I think, for our employers and our employees.

And that -- oh, my whole iPad went away for a moment. So then my other questions is, is that all classic employees, like State employees, as well as municipalities or is that --

SENIOR PENSION ACTUARY TAUZER: Generally, for most classic employees, there's certain statutes that's going to determine the classic employee's contribution towards the normal costs. So for State employees, most State employees are at 8 percent. And really for public agency, it varies. Most are between 7 to 8 percent for miscellaneous. And I meant miscellaneous when I said the State employees as well. And the safety has their own stipulations as well.

BOARD MEMBER TAYLOR: I think it's 11 percent.

SENIOR PENSION ACTUARY TAUZER: So really for -- it's only once you get to PEPRA that you get into this calculation, what's the total normal cost, what's 50 percent of the total normal cost, and how do we split it between employer and employee?

BOARD MEMBER TAYLOR: Right. I think my concern is I think the State of California has made it clear that they can afford to put the money, but I'm not sure about our cities, counties, and municipalities when it comes to the normal cost sharing. So that's just all I was concerned about that.

Thank you.

CHAIRPERSON COSTIGAN: Okay. Any further questions?

Ms. Eason, before we go to public comment, is there any other staff presentation?

CHIEF FINANCIAL OFFICER EASON: I think I would just -- I would want to talk just to remind ourselves now that we've gone through all of the impacts that remind ourselves of the benefits of the reducing of the assumed rate of return, we believe that it looks to strengthening the long-term sustainability to pay the promised benefits. These additional contributions would help offset the growing pension payments and reducing the impact of the negative cash flow environment that we -- that you saw in that particular chart that I showed earlier.

And when we look at the long-term, it reduces the chances of falling below a 50 -- or 60 percent funded status that we believe would weaken the sustainability of the fund. And as well, lastly, we would look to improve the likelihood of earning the assumed rate of return at a -- if we assumed a lower rate of return.

So I think with that, we could move to public comment.

CHAIRPERSON COSTIGAN: Okay. So what I would ask is various folks signed up to talk with various people. So I need at least -- I'm going to bring you all up in groups of 4. So I need 4 seats, please. Because as I read in my notes, I'm going to try to accommodate how people wanted to speak in their flow.

So we're going to start with Jai, Dennis Meyers, Ingram and Carrillo.

I'm sorry, oh, you had more presentations?
I may have misunderstood.
Mr. Eliopoulos.
CHIEF INVESTMENT OFFICER ELIOPOULOS: Did you want to take public comment before hearing from Ms. Eason on a potential recommendation.
CHAIRPERSON COSTIGAN: I want to hear from public comment, because there are questions. So I say yes.
So I need 4 seats, please.
And it's my understanding.
Okay. We're going to have a little change up here. You all don't need to move.
So we'll go to -- you have a comment, Mr. Juarez?
ACTING BOARD MEMBER JUAREZ: Yeah. I'm just trying to understand how we're going to process this?
CHAIRPERSON COSTIGAN: We're going to change it up now.
ACTING BOARD MEMBER JUAREZ: Okay. All right. Well, maybe you solve my dilemma.
CHAIRPERSON COSTIGAN: I'm the last to know what's going on around here.
(Laughter.)
CHAIRPERSON COSTIGAN: We're going to have staff make a recommendation, unless anybody -- I assume. I will look at the 4 of you. Do you want to wait and comment

after the staff recommendation? See, you guys are killing us.

See. Not you, Cheryl. You don't get an opinion on that.

(Laughter.)

ACTING BOARD MEMBER JUAREZ: You want to dance?

(Laughter.)

CHAIRPERSON COSTIGAN: You don't have to comment. So we're going to go -- so any questions before?

Looking left, looking right.

Ms. Eason.

CHIEF FINANCIAL OFFICER EASON: Thank you, Mr. Chair. So as you recall that the staff was -- or last month, the team was asked to bring back additional information, which we've now done, and recommendations. Based on the information the team and your independent consultants just presented, the collective team sitting before you recommends that we lower the fund's discount rate to 7 percent over 3 years.

Based on modeling, stakeholder input, and achieving the goal to ensure the long-term sustainability of the fund, we believe a phased-in approach to lower the rate is the best course of action.

Based on a very thoughtful and thorough analysis, we recommend the Committee adopt the following reduction schedule:

For fiscal year 2017-18, 7.375 percent; for fiscal year '18-'19, 7.25 percent; for fiscal year '19-'20, 7 percent.

We believe this schedule will give our employers time to plan their budgets, and also minimize the impact to them, as well as to those active members under PEPRA who will see their contributions rise as we lower the rate.

We also recommend that we separate the State and school employers and Calculate the school's employer contributions on the same timeline as our local public agencies.

Traditionally, we have recommended the change to valuations, so that it impacts all of our employers for the same contribution here, which would be 2018-'19, due to the 2-year lag for public agencies.

However, the State has requested an accelerated implementation, and that would -- they would then see their rate impacted in 2017-'18.

If the Committee were to approve this recommendation, we would implement these changes while still preserving our asset allocation management -- oh, sorry, asset liability management review that would start next month and conclude in February 2018.

And that is a recommendation by the team.

CHAIRPERSON COSTIGAN: So -- okay. So let me go through it again, and then we will hear public comment, and then we'll take comments from the Board.

So Ms. Eason, what is -- it is my understanding that you recommend that we lower the fund's discount rate to 7 percent over the next 3 years. That the schedule is as follows: That beginning in fiscal year '17-'18, the rate would be 7.375. And 7 -- excuse me, in '18-'19, the rate would be 7.25; and in fiscal year '19-'20, the rate would be 7.0.

CHIEF FINANCIAL OFFICER EASON: That's correct.

CHAIRPERSON COSTIGAN: So I just want to make sure. Any questions on that move?

Mr. Slaton.

COMMITTEE MEMBER SLATON: Just to clarify. And that would -- the dates you just gave would be for State, and for schools and local government it would lag by a year.

CHAIRPERSON COSTIGAN: I'm going to continue reading my notes but, I just want to --

COMMITTEE MEMBER SLATON: Okay.

CHAIRPERSON COSTIGAN: And that we separate the State and school employers, and calculate the school employers contributions on the same timelines as our local public agencies.

Everybody good?

And that the staff is recommending to change valuations, so that it impacts all employers for the same contribution year, which would be the 2018-19 fiscal year due to the 2 year lag for public agencies. And that the State has requested an accelerated implementation, and that the State rate would be impacted in 2017-'18.

CHIEF FINANCIAL OFFICER EASON: Correct.

CHAIRPERSON COSTIGAN: Make sure everybody is writing down notes, because we're going to have comment on it. Okay. Mr. Juarez, Mr. Jones, any other questions?

No, just on --

ACTING BOARD MEMBER JUAREZ: No, I'm fine. I want to go through public testimony.

CHAIRPERSON COSTIGAN: Okay. Jai, you're up first. Three minutes, please.

Hang on a second you mic is not on. Can we turn his mic on, please?

MR. SOOKPRASERT: I'm on. Mr. Chairman and members --

CHAIRPERSON COSTIGAN: Okay. Go ahead. Sorry.

MR. SOOKPRASERT: Mr. Chairman and members, Jai Sookprasert with the California School Employees Association. I have 3 basic comments. And I want to frame them in the vein that we understand you're struggling to try to find stability in the system.

But my first point would be that a proposal to a 7 percent rate, even as phased in is very aggressive.

We understand that the current 10-year investment projection falls short of the 7 and a half percent that you currently have. But the same studies that you've highlighted recently here, and the consultants who looked over these earnings over a 30-year period, we would note -- had pointed out that the earnings would be 7.83 percent.

So the move to 7 percent will establish this system as the most conservative pension plan in the nation among the 120 plus plans in your peer groups.

Despite being the largest, and arguably the most capable of outperforming its peer group, CalPERS will be adopting the lowest discount rate in the nation, which, as you had explored briefly, there's some sense of irony that the market currently is teetering on 20,000 -- at the 20,000 mark.

My next point is as you well know, nobody has a crystal ball to project the future. We believe this action you are about to take will have a major impact on employees and employers to contribute more towards pension.

I want to be clear that nobody wants to ensure the pension plan solvency more than the retirees and employees who relied on these benefits.

Since the Great Recession, our members have barely scratched their ways out of the recession levels due to furloughs, pay cuts, and years without raises. And as you well know, many public employees rely on CalPERS for their sole retirement, because they don't receive Social Security.

With the average pension only around $31,000, and for schools it's $17,000. That's not a lot to live on in California.

And in conclusion, while we're not convinced that the data provided -- that's provided merits the reduction to 7 percent, we understand the need to protect again the market slow down and to increase cash flow. We want to emphasize, however, this action will be a major pension reform that will have significant impact on our members.

Thank you.

CHAIRPERSON COSTIGAN: Thank you.

Now, is it Mr. Meyers.

MR. MEYERS: Yes.

CHAIRPERSON COSTIGAN: Okay. Please.

MR. MEYERS. Thank you. Dennis Meyers with California School Board Association. Thank you, Mr.

Chairman and members.

Knowing exactly what you have to do and your role in protecting the fund, not only, but over the long term, my comments mainly just are to let you know about the impact on our side. So we represent school boards. We're adopting budgets all the time.

There is, you know, no real windfall to Proposition 98. We are right now, Prop 98, about where we pre-recession. And although folks probably at the capital, maybe even in the Governor's office, and probably the public think that Prop 98 and Prop 30 and Prop 55 have resulted in a huge windfall. That's really where we are.

And because of the distribution effects of the local control funding formula, there are plenty of school districts that -- although, all school districts and county offices went down about the same. Growth out of the recession, because of distribution effects, there are a lot of school districts that are not back to where they were before pre-recession.

So as we look at what we know right now, which is about a $6 billion dollars increase in employer contributions from the CalPERS and CalSTRS systems, just without talking about what you're about to do, that eats up all of the growth that maybe 150 or 200 school districts are seeing right now.

So just to let you know that that is the impact. You have to do what you have to do. And we're not commenting negatively on that. We just want you to know about what that means. So that means that, you know, $6 billion in costs, which we assume will be about, you know, at least with your action, maybe increased another half a billion or so.

That means that that's money off of the table. It's money that's not being able to be used to decrease achievement gaps, or buy textbooks, or technology, or all of those things that we need to do to move our student population forward.

So one is just that we would, you know, ask you to work with us to convince other decision makers outside of this room about what we need to do the job just in the public education system.

Problem 98 is about $70 billion, that's K14. And when I'm talk about right now is really the K-12 system, thing that we're dealing with, increased health care costs, increased costs to technology, increased costs with our State standards. All of those things factor into this, which means many districts are moving backwards just to stay where they are.

So thank you for your work. Thank you for staff reaching out to the employer side. We really appreciate that. And you have to do what you have to do. And we will factor ways to do this, but I think some districts are going to be really -- you're going to hear more from school districts as this kind of hits the news about what the impact is going to be them over the next 3, 5, 10 years. It will be serious, but we can use your help to communicate that out.

So thank you.

CHAIRPERSON COSTIGAN: Thank you.

Jai, don't go anywhere. You guys. Jai, just sit in case -- we're going to come back to the panel, if there are questions.

Dr. Ingram.

DR. INGRAM: Yes. Thank you. I'm Ruben Ingram. I'm the Executive Director of School Employers Association of California. If you're not familiar with us, we represent mostly superintendents. All of our board, our practicing superintendents, all of my department heads and myself are former superintendents.

We work with school districts to help them protect their fiscal security, and we also help them to support competitive salaries and benefits. And that's what this discussion is all about, I think, sort of thing.

So I'd just like to say a couple of things. It's along the line of what Dennis said. You know that we operate in a zero sum budgeting environment, so any increase that we -- that come to us have to come out of something else. And that has an impact on our educational programs, and certainly at the bargaining table.

As a matter of State law, we have to have our budgets adopted projections for 3 years in advance. And so therefore, any escalation in rates is going to create some obstacles and things to overcome, in terms of providing a stable and educational -- in our programs.

With that said, we certainly understand your need for fiscal security, because that's what we deal with at the school district level, our fiscal surety, and setting realistic expectations, both with the fund and for our districts. If the Committee votes to decrease the discount rate, the SEAC members have made their requests clear.

We need an incrementally phased-in plan and sufficiently lead time to implement the changes. So with this recommendation that we've heard today, it's something that fits with what our members have been asking for. A phased-in adjustment to the discount rate is unanimously supported by our members. There can be no question that without such a phase-in, our school districts might not be able to meet their near-term financial obligations.

So today's proposal of a phase in and subject to additional smoothing, which I understand will certainly help our districts. What we need is predictable, stable contribution rates. And the delayed schedule of adjustments that were mentioned today will also help our districts manage this.

So our position at that point is that if you adopt this recommendation today, it'snot something that we want to see happen, but if you give us plenty of lead time, like I hear you're doing, then we'll be able to work with it, I believe.

Thank you.

CHAIRPERSON COSTIGAN: Thank you, Dr. Ingram.

Mr. Carrillo.

Mr. CARRILLO: Yes. Good afternoon, Mr. Chair and members of the Committee. Hi. My name is Ivan Carrillo. I'm with the Association of California School Administrators. I want to begin by emphasizing that the viability of the CalPERS fund is of the utmost importance to ACSA and that we recognize the pressing need to act.

We appreciate staff's recommended proposal, because it moves the system towards full funding while addressing some concerns that have been raised by our members. With that said, ACSA prefers that no action be taken today, and that a vote wait until February, so our members have the opportunity to review, assess the impact, and provide input on the most recent proposal.

From the input we've gathered, our members have expressed 3 main concerns. First, that no change be made for the 2017-18 year that would impact the LEA's budgets, because it would leave districts no time to prepare for increased contributions.

Secondly, some members have expressed that if a reduction to the discount rate were to happen, that it be phased over a several year period to soften the blow.

And lastly, our members have raised concerns about any reduction to the discount rate, because of the costs pressures it would put on LEA's budgets.

I want to thank staff for being responsive to the concerns that we've raised. The proposal in front of you moves in the right direction. We recognize the difficult decision you have and the urgency to act, but ultimately request further time to be able so our members can review the proposal.

Thank you.

CHAIRPERSON COSTIGAN: Thank you. Any questions for any of these?

Seeing none, thanks for being here.

Okay. The next group, because you guys have asked to go in a specific order will be Dane Hutchings, Phil Wright, Ms. Milstein and Sara Lamnin.

And the order you want to go into is Hutchings, Wright, Milstein and Lamnin. That's correct.

Dane, good to see you.

And again, do your 3 minutes, but don't get up in cases there are questions.

Dane, your threw me off. You're supposed to be on the left.

MR. HUTCHINGS: You want me over here?

CHAIRPERSON COSTIGAN: No, that's fine. Go ahead no. You're first up. Go ahead.

MR. HUTCHINGS: Good afternoon, members. Dane Hutchings with the League of California Cities. I want first take a moment to thank CalPERS staff on their consistent outreach to our organization. It is very important that public employers be a part of this discussion. And it is our hope that we can continue to work with the executive staff as well as our employee stakeholders, and this body to ensure that we have a sustainable fund.

The League has not taken a formal position on this new proposed action, but we want to weigh in from the public employers perspective here today. There is little doubt that the State of the pension fund is concerning. Projections that staff has shared are sobering, specifically that if we do not act, there is a 47 percent likelihood that the pension fund will fall below 50 percent funded.

Moreover, we have cities large and small where nearly 60 percent of their total payroll for police and fire are going to pay retiree benefits. So we believe that this more than a financial stability issue. This is a public safety issue, and a governance issue, and it is not sustainable.

And while we do not believe that lowering the discount rate is a silver bullet that will solve all of the issues the fund faces, we do believe it is a step in the right direction, in spite of the strains it will put on our budgets.

The economic rebound has had an uneven -- has been uneven throughout the State. Many cities continue to struggle, and the significant portions of receive growth are being used to offset increasing costs for pension and OPEB liabilities.

Staffing levels have also been reduced constricting our ability to deliver services. And we have also asked our employees to share more of the burden with some already contributing 12 to 14 percent of their income.

We appreciate the intent of the phase-in reduction from 7.5 to 7 percent over the next 3 years, with an 8-year smoothing period. However, this deal does not solve the long-term viability of the pension fund. We do have concerns, since only half of our cities responded to the survey that was given by CalPERS last month, that some cities may be facing hardships dealing with the increased contributions.

We encourage the Board and -- in those instances to work with those communities as they make the adjustment. You will hear from several city officials today of who have their own unique perspective reflective of their city. But one common theme you will hear today is that it isn't a matter of should we reduce the discounted rate, but rather by how much and what length of time.

You will also hear -- excuse me, what you will also here is that challenger -- that the changing discount rate by itself will not cure the challenges to the sustainability of the fund. This -- the agreement made in PEPRA was a start to the discussion of how to ensure a sustainable pension system. But for many of our city managers and fiscal officers, we believe that further reforms to the system must be needed. We encourage the Board to rise to the challenge with a more meaningful solution.

And with that I'm happy to answer any of your questions.

Thank you.

CHAIRPERSON COSTIGAN: Thank you.

Mr. Wright.

MR. WRIGHT: Thank you, Mr. Chairman and members of the Committee. My name is Phil Wright. I'm the Assistant City Manager for the City of West Sacramento. I'm the chief negotiate for the city, and I'm also the finance director, so I get to see this from both sides.

From the city's perspective, this is clearly a step in the right direction. The sustainability of the plan is critical to our employees, and is critical to the city, and obviously critical to this Committee.

It is helpful, but it is not enough. We need a more holistic approach. I was looking at the chart earlier today on contribution and benefit payments. And even with this change in the assumed rate of return, there's still a gap. And so we need to address the gap and we encourage this Committee and obviously the Governor and the legislature to look at a more holistic approach.

I don't want this Committee to think that our city, and I think many others, have not done everything they can to help with this situation. We have done everything we can. We've reduced staff by 25 percent. Our employees are paying all of their PERS. We have less people obviously paying into the system, and it's a higher percentage of payroll.

And despite the coming out of the recession, and having a little bit more money in the budget every year, I get to tell my boss every year that that money simply going to PERS, because we have not had any increases in our income that has been greater than the increases in our PERS.

So the result of that is that we have not been -- our police, for example, are down 12 police officers. Our fire are down 11. Firefighters are miscellaneous are down even greater numbers. And despite this increase in revenue, we have not been able to fill those positions.

This change will obviously be very difficult for us. This will continue our inability to fill those positions. But despite that, our counsel believes in fiscal responsibility, and we think this step needs to be taken, but it needs to be taken with other steps.

We need a more holistic approach. We need to solve the problem. And I've been able to be successful with our labor unions, because they see the same issue. We all are in the same boat here. We all want this to be sustainable, and we're working hard, and we've done everything we can, but we really need holistic approach to solve the problem in the long run.

Thank you for this opportunity.

CHAIRPERSON COSTIGAN: Thank you. Milstein or stan?

MS. MILSTEIN: Stein. Leyne Milstein.

CHAIRPERSON COSTIGAN: Okay. I'm sorry. They --

MS. MILSTEIN: Good afternoon. I'm Leyne Milstein, the director of finance for the City of Sacramento. Thank you for the opportunity to share my thoughts with you today. We share your concerns and appreciate the efforts that have been made to acknowledge, Educate, and respond to the reality that a 7 and a half percent interest earnings assumption is likely a thing of the past. And that lowering this rate is both a reasonable and responsible action to safeguard the sustainability of our pension funds.

I know that just getting to this point hasn't been easy. However, I think it's important that we consider this as just a next step in what is really a lot more work to be done, to ensure the sustainability of this fund over the long term. We cannot stop now.

We must continue to consider options and opportunities to reduce the growth of unfunded liabilities. In addition, while the implementation of PEPRA will aid in reducing costs, we cannot continue to assume that the employers can continue to pay for the cost increases associated with what I believe is really a very generous retirement benefit.

While we are seeing economic recovery from many local governments, revenues are not growing faster than expense are currently growing. And I'll give you a sense, because staff talked about it in the perspective of percentage increases.

We forecast already that the changes that have been made to PERS rates over the last couple of years will cost the City of Sacramento by fiscal year '22-'23 an additional $32 million. That's 10 percent of employee services right now. So that's the equivalent of a 10 percent raise for all of our employees.

We estimate that the cost increase associated with these changes will result in an additional $6 million in costs. That's a 1 percent cost just for our general funded employee organizations. So just a little perspective.

As I stated earlier, lowering the discount rate is a necessary action. However, we must all acknowledge the reality that some employers are not going to be financially capable of paying these costs, and continuing to deliver programs and services, and salary and wage increases that are expected by our employees.

Yes, we understand that this starts with our responsibility to continue to negotiate with our employee groups. However, we will look to members of this Committee, the PERS Board and staff, our employee groups and our legislators to continue to be transparent with these realities, to educate our members and employers, and to consider all options to ensure long-term sustainability of the pension fund.

Thank you.

CHAIRPERSON COSTIGAN: Thank you. Ms. Lamnin.

HAYWARD CITY MAYOR LAMNIN: Hi. My name is Sara Lamnin. I'm Mayor Pro Tem for the City of Hayward. I'm a past SEIU member. I've been a California taxpayer for nearly 30 years. I was elected 2 and a half years ago with strong labor support.

And I'm currently Chair of the League of California Cities Governance, Transparency, and Labor Relations Policy Committee. That committee is committed to supporting workers and their ability to care for their families.

So I understand political pressure, and I applaud your effort and the staff's effort to serve members in a sustainable way. And it seems to be consensus that there is a funding gap. What I am here today to underscore is that there were many factors that led to that funding gap, some of which were made at the statewide level. And yet, only one solution, over the last few years is being proposed, and that, of course, is the rate of return, the discount rate, which, as was just articulated well by my colleagues, translates to more cost to jurisdictions, as well as was articulated by some of you. Thank you for that.

In Hayward, under the current assumptions and maintaining our status quo, our employee costs go up three to seven million dollars per year every year, without really any impact on our unfunded status. Our employer rate is anywhere from 43 to 46 percent on safety, and about 26 percent for miscellaneous.

Our employees give. They are already contributing 15 percent some of them. And that's -- and then on top of that to health care costs as well. Our council contributes and our city has cut positions, about 200 of them in fact.

So it is time for a broader collaborative conversation at a statewide level for a diverse set of solutions that is as diverse as our municipal employee pool.

Thank you.

CHAIRPERSON COSTIGAN: Thank you.

Any questions for this group?

Okay. Thank you.

Okay. Next, we're going to have Marcia Fritz. Faith Conley, Dillon Gibbons, and Al Darby. I believe that's -- and then we'll have -- we have, I think, 2 more after that.

Ms. Fritz, we'll have you go first.

MS. FRITZ: Yeah. I'm Marcia Fritz. I'm the President of the California Foundation for Fiscal Responsibility. And I'm also a former member of the Governmental Accounting Standards Board task force that developed GASB 68, which is the new accounting standards for pensions.

That whole project started with a letter that I sent to GASB, I don't know, mid decade ago about all of the different ways CalPERS was able to manipulate the accounting standards that were very broad at that point, and very permissive in order to encourage benefits that we couldn't afford. And GASB agreed with me, and that's why they appointed me to both their advisory committee and their task force.

We struggled with discount rates. Finally, GASB -- you know, should we -- should we measure our liabilities using a bond rate like the private companies do? Should we use our anticipated rate?

Finally, GASB said we don't care what rate you use, but if you're off the mark any year, if you use a 7 and a half percent, and you actually make 5 percent on an accounting standard, you recognize that difference over five years no smoothing. The only time you smooth is when you change your overall assumption and your whole liability is revalued and that change is recognized over the remaining service life of the employees.

The whole idea was you would catch up on an accounting standard that basis overall doesn't matter what you assume. So the struggle here is the amortization of the difference. You're smoothing. Smoothing smothers. Smoothing smothers the next generation that has to pay for it. We've seen what smoothing has done. We went from a fiscal surplus in 1999 to, what, about 63 percent funded. Now smoothing smothers.

All I would suggest is that you follow more closely the GASB -- whatever you do, follow more closely your funding according to what GASB adopted. It's sound. And your responsibility as a Board is not to put your employers on an easy payment man. It's to sustain those -- sustain the pension.

And when you smooth too much, you delay action, you're smothering. Smoothing is Smothering.

That's all I have to say.

CHAIRPERSON COSTIGAN: Thank you.

Mr. Darby.

MR. DARBY: Al Darby, vice president, Retired Public Employees Association.

Our view is sort of forward looking. Lowering the discount rate improves cash flow when fully phased in and employers/employee contributions increase, that helps the cash flow.

The problem here is getting the fund back to 80 percent funded. The only way we're going to do that is find our way back to fiscal year '13-'14 in which the returns were in the, I believe, 13 percent and 18 percent range.

In view of the fact that the new Republican administration has declared that substantial business favorable tax cuts, regulation relaxation, more defense spending, more domestic spending for infrastructure, that's its immediate goal. And the Republican Congress will probably concur. It's quite possible the current slow growth in the economy could increase to 3 to 4 percent, which is the rate that that new administration is anticipating.

If employment remains strong, inflation remains low, Federal Reserve continues measured increases in interest at 25 basis points, construction remains strong, it can be expected that domestic public equity and some global equity will significantly benefit, resulting in continuing gains in those financial markets.

The other point here is that just over the last 8 weeks, 6 weeks, the market has almost reached 20,000. That isn't based on anything new in terms of earnings and so forth. It's based on psychology more than anything else. And I think that it's taking a look at what this new administration is anticipating, in terms of economic growth. And that psychology and perhaps the growth will substantiate and support that continued growth in the equities market.

CalPERS appears to be equivocal in the commitment to long-term investing. Long-term investors must stay the course by holding their equity assets, and increasing them when prudent to receive maximum benefits from upside moves in the equity market.

Expanding equity holdings at this point seems to be dictated even more by the fact that private equity isn't interested in concurring with our disclosure of fees. So where are you going to put the money? The best place to put it is probably in other public equities.

This should bring us to the 80 percent funding level a lot faster. The announced the economic policy of the new administration's positive stock market reaction, pretend better public equity performance over the near term.

This would suggest and perhaps dictate re-risking the CalPERS portfolio in the year of equities in order to find that sweet spot that we had in '13-'14.

The economy is stronger now. Economists say it is much stronger now, because stronger not in a 2007 situation when we had no income verification housing --

CHAIRPERSON COSTIGAN: Mr. Darby, you can wrap up. You gone over you time, bur wrap-up.

MR. DARBY: I think that basically what I'm saying is that it's quite possible that the new administration and the new economic outlook and the probable favorable business climate could easily improve the equities market greatly.

Thank you.

CHAIRPERSON COSTIGAN: Thank you, Mr. Darby.

Ms. Faith -- or Ms. Conley.

Oh, you want to go Mr. Gibbons?

MR. GIBBONS: Chair and members of the Committee. Dillon Gibbons with the California Special Districts Association. Last year, when we were discussing the risk mitigation strategies with our members, the most common response was that our members believed CalPERS needs to take action to mitigate the risk in fund.

CSDA members strive to take a fiscally prudent approach to their CalPERS liabilities, in order to minimize the 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 employer contributions are needed to ensure the health of the fund, they understand.

Given the option of a one-time reduction in the discount rate versus a phased-in approach, CSDA members have indicated their preference of the phased-in approach.

Additionally, while CalPERS adopted a new risk mitigation strategy last year, the proposal from staff today provides greater certainty and predictability, witch is something CSDA members have indicated is of great importance. Rate predictability allows our members to plan future budgets with great accuracy. For these reasons, CSDA supports the phased in rate reduction over a one-time reduction.

CHAIRPERSON COSTIGAN: Thank you.

Ms. Conley.

MS. CONLEY. Thank you. Faith Conley here today with the California State Association of Counties. CSAC -- I'll keep it brief since a lot of my comments have already been covered by CSDA as well as the League.

We agree with our fellow public agencies that the most important thing is to ensure fund sustainability, which accordingly should result in a reduction of the discount rate.

In fact, CSAC has long urged for a reduction in the discount rate ever since it was back at 7.75. We believe that -- while albeit costly, the approach to mitigating risk now is better than a drastic increase in employer and employee contributions in the future, as we keep seeing -- as the market continues to produce less than a desired outcome.

In accordance to the survey that CalPERS sent out, we only had one county that responded with some trepidation with regards to a one-time increase in employer contributions. When the proposal was put forward to do a phased-in approach, that trepidation did go down, along with other counties replying to me today that they did appreciate CalPERS staff proposing something that would give them more predictability and when a rate increase would come, when the discount rate would lower by each Percentage, et cetera. So I do want to thank the Committee for that.

The phased-in process helps ease that concern, not only because it will help us budget, but also helps us budget, since there are a lot of other issues that we deal with in our budgets. We, as counties, provide public safety services. We are in -- we're asking for more transportation money right now. So there are a lot of already existing big pressures in our budgets. And although we agree that this will create cost increases that will also put pressures on those budgets. The phased-in approach helps us to predict that over the next several years.

So I just wanted to thank you, Chairman Costigan, as well as CalPERS staff for including us in the process. We do appreciate the proposal and we ask that the Committee move forward on it today.

CHAIRPERSON COSTIGAN: Any questions of this group?

Okay. Thank you, all.

I think we have one more speaker. If anybody else wants to speak, please let the staff in back know.

Mr. Stern. I think that is the last.

MR. STERN: Good afternoon. Eric Stern with the California Department of Finance. Thank you for this opportunity to address the Board.

I want to first echo the League's comments and thank the staff for all the outreach, especially the actuarial staff. That's really helped us understand the potential cost increases, particular in the last -- kind of the last few days.

We're here to support the staff recommendation for -- to lower the discount rate to 7 percent using a 3-step process. I just want to point out though, I wouldn't characterize it though as we've requested to accelerate the State's payment though.

Under existing Board policy, actuarial policies, whenever the Board adopts an assumption change, the State's contribution rates are immediately reflected in the next fiscal year. So we're not requesting any sort of accelerated process. In fact, I would say it just would follow the normal process.

But we do support the phased-in 3-step approach. We think it strikes a really healthy balance between adjusting assumptions, and providing the State government and local governments, and school districts, as well as employees with a known schedule that can be budgeted appropriate.

These costs -- these costs do have very real and significant budget pressures. You know, as we look at the system, it's been around for almost 85 years now. Hopefully, these are medium-term short-term pressures that are going to be sort of absorbed over the next 20 years.

And we look at the next 85 years, it would be far worse to have a massively underfunded pension system going into the next century.

Ultimately, we're here to provide and protect and ensure retirement security for all of our public employees. And if the experts tell us that our assumptions are off, it's -- and retirement security is at risk, it's our obligation to fix it, not just the Board's responsibility but the employers, and the employees as well. So the State of California is prepared to do its share and build these additional costs into the Governor's budget of January 10

And just to sort of comment on a nuance Ms. Taylor said. It's not that we can afford those costs. The full phase-in plan for the State is going the cost probably an additional $2 billion, a billion of it general fund.

The State doesn't have a billion dollars of general fund that we can just put into the pension fund easily. There are significant trade-offs and budget pressures that come with that, in terms of expanding programs, new programs growth, things like that.

But Governor Brown, since he took office, has really prioritized paying down our debts and liabilities. And I think this is consistent with that approach. So in order to sort of uphold and pay for the promises we've made to our employees in the past. We support lowering the discount rate and increasing our contributions in the long term.

Thank you.

CHAIRPERSON COSTIGAN: Thank you, Mr. Stern. Don't go yet. Any questions for Department of Finance before -- Okay. Thank you, Mr. Stern.

Okay. We do have some questions from Board -- from Committee members, and -- but I'll first go to Mr. Juarez.

ACTING BOARD MEMBER JUAREZ: Yeah, a question of staff or 2 questions of staff. First, I want to be clear on -- or I want to get a better understanding about the cash flow issue that we're likely to face under -- whether it will continue to exist in any form under the proposed reduction in discount rate. In particular, will we totally obliterate it or we'll just reduce it over time.

CHIEF FINANCIAL OFFICER EASON: Thank you. So just on -- refer back to it was slide page 5 of 41 of the slide deck, what we'd be looking at is it would help to reduce the pressures of the cash flow, but it does not completely take away those pressures.

ACTING BOARD MEMBER JUAREZ: Okay. And that's over what period? Have you looked at it over the long term or is it just over a suggested period?

SENIOR PENSION ACTUARY TAUZER: So if you look at this slide here, page 5 of 41 in the presentation, as you saw, we presented with moving the discount rate to 7.25 or even to 7.0 how that increases the contributions over time. Over the longer term, then just looking at 2023, 2024, unfortunately, it doesn't miraculously help that gap go away.

In fact, I just -- I think it's important to note that many mature pension funds out there, once you get to the mature side of things, it's very common to have a negative cash flow. It's not an uncommon thing. It does mean that you're facing some headwinds, when you're trying to fund it, but it doesn't mean we're in some kind of abnormal situation. And you would expect that negative cash flow to continue going into the future. It just wouldn't be as big of a gap.

ACTING BOARD MEMBER JUAREZ: And do we alter our assets mix to reflect the need for liquidity in order to address the shortfall?

CHIEF INVESTMENT OFFICER ELIOPOULOS: Well, yes, you know, and the asset mix is established during the ALM period. And we do set a allocation for liquidity as part of that process, as well as the ranges in order to accommodate market fluctuations.

It will certainly be something that we discuss during the next ALM cycle that's going to kick off just this January.

ACTING BOARD MEMBER JUAREZ: Okay.

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE: I would also just quickly add that we also look carefully at the liquidity of other asset classes, global equity, fixed income for example to ensure that we, if needed, can liquidate those to pay benefits.

SENIOR PENSION ACTUARY TAUZER: Also, if I might add one more to what we were talking about Ms. Taylor earlier, the long-term effect of PEPRA going out 20, 30, 40 years you do see. So in the mid-range term, so to speak, you see that gap widening. But you do see some relief in the end due to PEPRA, once you have not only PEPRA members go into active retirement, but then retire and start receiving those benefits on the cash flow side of things.

ACTING BOARD MEMBER JUAREZ: Okay. How does the staff respond to the statement that CalPERS will be an outlier by taking this position relative to its peer group? Is that an issue that you are concerned about, or do you see it as a leader versus laggard issue? What would be your response to those that have raised that issue?

CHIEF FINANCIAL OFFICER EASON: We've included in the appendix some information on a recent 2016 NASRA survey. And I think I would just point out that the current median assumed rate of return is 7.5 percent. And when this particular survey was done in 2012, when we -- when CalPERS had adopted their 7.5 percent, I would say that CalPERS was a leader at that time.

You can see, based on the current survey, we're really currently at that median assumed rate of return. And based on that same return -- or same survey, I should say, there are approximately, based on the latest survey, of the, I believe it was, 127 plans that participated, there are approximately about 30 plans that are about at 7.5 and below that. So we certainly are not the first plan that would go below 7.5 percent.

ACTING BOARD MEMBER JUAREZ: Okay. So let me just say that on behalf of Treasurer John Chiang that the office recognizes both the gravity and the difficulty associated with trying to address this issue. I think that with the changes that are being suggested from the November meeting relative to the implementation, the delayed implementation, and also putting school districts a little bit further back in the queue, I think the Treasurer sees that as a very positive development, and wants to acknowledge the efforts of staff and others in that regard.

Clearly, he also understands the additional increased burden that will place on State and local employers, and the employees that they have, but recognizes that if what we're doing is providing for the long-term security and keeping to the promise that has been made to those beneficiaries, that that's a good thing.

Clearly, retirement security will be one of those issues -- one of those major public policy issues that will confront us, not only as a State, but also as a nation over the next couple of years. And securing the long-term viability, I think, of the State pension's largest fund -- the largest State pension fund, I think is a very positive step.

But it's incumbent on us to look -- to complement that for the over 7 million people in the private sector who have no security -- retirement security options available to them at this point. And that's why the Treasurer believes it's vitally important that we implement and pursue the Secure Choice Program that will provide that type of retirement security to those folks, so that when we look out 30 years, it's not just public employees who are securing a reasonable retirement, but those people in the private sector as well.

I do want to acknowledge the work of the Chair of this Committee, who has been working, I think, feverishly to get to a result, also, the work of the Governor's office, the stakeholders who have been involved in trying to reach a compromise. And I think we heard it in terms of the comments that were made today, recognizing that it's not a -- it wasn't their first choice, but it's one that, given especially the delayed implementation, one that they can try to make work.

So with all of that, I know that tomorrow I'll look forward to, hopefully, if it gets out of committee supporting the staff's proposed recommendation on this issue.

CHAIRPERSON COSTIGAN: Thank you very much, Mr. Juarez.

Mr. Gillihan.

COMMITTEE MEMBER GILLIHAN: Thank you, Mr. Chair. So not to echo -- repeat my comments from last month, but we sit here today at 68 percent funded. And unfunded pension is nothing more than a hollow promise to our employees that are -- spend their careers working with the promise of a pension when they retire.

Our members simply deserve better. And the recommendation before us gives us a chance to be a leader in the nation in responsible pension funding. And I think from a reputational perspective that's something that it's time for this system to take the lead on.

And so with that, Mr. Chair, I'd like to move staff recommendation.

VICE CHAIRPERSON HOLLINGER: Second.

CHAIRPERSON COSTIGAN: Thank you, Mr. Gillihan. It has been moved and seconded by Ms. Hollinger, but we still have some questions before us.

Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: I think there's a couple of important things that we need to remember. And that is that we don't set the benefits. You know, so -- you know, that just a reality. That's not our function.

It's also important to recognize that changing the discount rate does not change the cost of pensions one iota. The checks we're going to write are the checks we're going to write.

What changing the discount rate does is it changes our estimates of the cost. It changes our estimate of how much is unfunded, and how much we need to collect now, so that we have the earnings we need going forward to pay the benefits.

We adopted an asset allocation. We to date we've been unwilling to explain why we adopted it, but we adopted an asset allocation. That asset allocation has a expected return of about 6 and quarter percent. Our discount rate is really our expected return. If we are not willing to live with that discount rate, then we need to look at the asset allocation.

We have an obligation to act as prudent persons acting in the capacity -- in like capacity and familiar with those matters used in the conduct of an enterprise of like character with like aims.

The discount rate is our expected return. The expect return on the portfolio that we've adopted as an asset allocation is 6 and a quarter. I, therefore, move to amend the recommendation to adopt a 6 and a quarter percent discount rate.

CHAIRPERSON COSTIGAN: Mr. Jelincic, while I appreciate the passion, and I appreciate your insights, as you know I do. I do value you know more about investments than I will. I believe that today's staff recommendation is an interim action in order to help us have the debate that you want to have, I believe in 2018, when we begin addressing the ALM. And moving as quickly -- and while I agree with you, I do believe the rate is higher than I would like to see, it is a move forward to do something today. It is to get staff ready -- or in a position, along with employers and the employer community -- employee community to look at what an ALM will be.

And you are entirely accurate, as I have learned, the risk that we're taking with a high rate, a discount rate, all the inverness. But I would say, I appreciate. I would ask that you withdraw the motion at this time, and let us move forward with the staff recommendation, otherwise I will call for a second.

COMMITTEE MEMBER JELINCIC: I will not withdraw my motion.

CHAIRPERSON COSTIGAN: All right. Thank you, Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: We made a decision that 6 and a half is the reality.

CHAIRPERSON COSTIGAN: Okay. So we have a substitute motions in front of us.

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE: Mr. Chairman?

CHAIRPERSON COSTIGAN: Oh, I'm sorry.

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE: Yeah, just a quick clarification, Mr. Jelincic is accurate based on the 10-year return assumption. Again, using Wilshire's current capital market assumptions. That has to be averaged in over the long term with a longer rate for years 11 through 30. So you see that on the slide in front of you.

That's essentially how we are able to -- how the math helps support a 7 percent discount rate.

CHAIRPERSON COSTIGAN: Thank you. Ms. Hollinger, I just want to make sure. Mr. Jacobs, I'm not always the best -- Mr. Jacobs. Before I do my next statement, because I'm not always good on Robert's Rules.

GENERAL COUNSEL JACOBS: Do you have a second?

CHAIRPERSON COSTIGAN: We don't have a second yet. Wait a second, Ms. Hollinger.

Do we have a -- do we take questions prior to a second or can I take questions before it's seconded?

There's been no second.

COMMITTEE MEMBER JELINCIC: There has to be a second to have discussion on it.

CHAIRPERSON COSTIGAN: Is there a second on the motion?

Is there a second on the motion?

VICE CHAIRPERSON HOLLINGER: I need to ask Matt a questions because I might second it.

CHAIRPERSON COSTIGAN: Ms. Hollinger.

VICE CHAIRPERSON HOLLINGER: Yes. Mr. Jacobs, if --

CHAIRPERSON COSTIGAN: It's a point of order. So you're raising a point of order.

VICE CHAIRPERSON HOLLINGER: Okay. I'm raising a point of order. I believe what -- based on our current 10-year asset allocation that what Mr. Jelincic says is true, so how does that correspond with my fiduciary duty, in terms of if our current asset allocation nears 1 return and here I'm asked to -- I just want some input from you. Yet, I recognize that to move forward, the burden on our employers and employees, so could you please speak to that?

CHIEF INVESTMENT OFFICER ELIOPOULOS: Mr. Jacobs, IF I could?

GENERAL COUNSEL JACOBS: Please.

CHIEF INVESTMENT OFFICER ELIOPOULOS: And Mr. Chair, if I could just underscore what Mr. Tollette said, because I think it's very important to the math of the setting of the discount rate, the capital market assumptions really cover the years 1 through 10. So that 6.25 number for the investment portfolio and the investment outlook is 10 years, and the work of the full team, including the Actuarial Office, is to look over the long period of time, years, you know, 11 through 30 and 60. And when you blend those 2 time periods together, that's exactly how we arrived at this 7 percent number, and why we're recommending that we take that move now given the outlook today, and I think that might help with the fiduciary discussion as well.

CHAIRPERSON COSTIGAN: Mr. Jacobs.

GENERAL COUNSEL JACOBS: Do you still --

VICE CHAIRPERSON HOLLINGER: No.

CHAIRPERSON COSTIGAN: I don't believe, since we don't have a second. Thank you.

So there's a motion before us.

Is there a second?

All right. Mr. Jelincic, the motions fails for lack of a second.

So we back --

COMMITTEE MEMBER JELINCIC: Thank you.

CHAIRPERSON COSTIGAN: Thank you.

We are back on the underlying motion.

Ms. Yee.

COMMITTEE MEMBER YEE: Thank you, Mr. Chairman.

First of all, I want to just say that I know this has been a difficult series of conversations and meetings, but I want to thank the staff of the stakeholder for just hanging in there and getting us to the place where we are today.

Clearly, I think we're all doing this because we honor the service and contributions of our public sector workforce. And the move here today is really an attempt to preserve the benefits that have been, frankly, won by our public sector workforce.

I wanted to make a couple comments, because I'm already anticipating the headlines tomorrow. And the first comment is that, you know, I know we have the NASRA survey, but I think it's really important to not read too much into that, because we really don't know a whole lot about the underlying assumptions about what other plans' discount rates are.

There are a lot of variables. And I think we -- I don't -- I don't have any sense of the funded status of the plans. I don't know what the asset allocations look like. And so, I mean, it's a number basically. And whether you want to place us or peg us, CalPERS, as having the most conservative discount rate, I will likely -- I think it's likely that we can assume that we probably have some of the richest benefits as well. And we do that because we honor our public sector workers.

Secondly, I wanted to just express my appreciation to the public sector -- the local agencies, the employers who came forward today. I think the phase-in plan is taking into consideration the need to plan, the need to budget. I also want to applaud a number of the local employers who have come forward already on their own in preparation for this eventuality.

Our actuaries have been very, very engaged with them and really providing a lot of technical assistance. And I assume that that will continue once action is taken in this regard.

But the other thing I want to say is there will be headlines tomorrow about how we weren't aggressive enough. And I think this is really a balance to Mr. Jelincic's point. We do preserve the ALM process going forward. So this is not the end of the conversation. Hopefully, we can continue to focus on what we have to do to certainly do our part to ensure robust investment earnings going forward. We're not losing our focus on that, even with this action. And so this is really an opportunity to help stabilize the fund, given all of the factors that we heard about today.

I also want to applaud the comments that were made by some of our speakers about how this is really a symptom of a larger problem. And that is the changing nature of our economy, both here in the U.S. and globally, that fact that, you know, there are a lot of issues that we haven't grappled with with respect to the nature of our economy going forward; with the respect to the nature of work and our economy and what that means for workers considers going forward; the nature of how -- I mean, some work that we're doing in our office about how our tax structure needs to better support economic development and sustain economic growth.

So there are a whole variety of policy issues that can influence what this landscape looks like going forward. And we're not abandoning any of that. I think all of us are committed to working on all of that. And I want to do that in partnership with our -- obviously, our local governments as well.

But I need to just say I appreciate the work of the administration on this. Frankly, I don't that we would be here but for the commitment of the administration to look at doing its part relative to the State contribution.

We are not doing this to bankrupt anybody. As I said, this is really, I think, the most honorable thing we can do to recognize the service and contributions of our public sector workforce.

And so with that, I look forward to the ongoing conversation that I agree with Mr. Gillihan, this is really an action we can take today to really lead -- have CalPERS be in the lead with respect to recognizing just the position that we're in, and we're not the only ones in this position.

And so I don't want there to be any mistake about it, that, you know, this will be watched around the world, and that our actions going forward and we'll continue to be watched and this is really just the beginning of a large conversation about what we need to do to honor our commitment to the workers who serve our local communities and our State every day.

Thank you, Mr. Chairman. With that, I do intend to support the motion.

CHAIRPERSON COSTIGAN: Thank you, Madam Controller.

Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: I want to agree with something Betty said. And that is the comparing our discount rates to others really is kind of a non-starter, unless we know what their liabilities are.

You know, it's not an apples-to-apples comparison. So I think that we should not get hung up on that.

I will say if you look at the motion itself, it says that our expected return next year is 73/8th, and then 7¼ quarter, and then 7, but we're not looking at changing the asset allocation, which is what drives the change.

I think -- I understand the reason is to help scale it in, make it easier for the employers. But I think a much cleaner way to do that, quite frankly, would be to say, okay, we think we can do 7, and adopt that as our discount rate, and then build a ramp up into the rates, but acknowledge up front that we think we can -- 7 is our discount rate.

CHAIRPERSON COSTIGAN: Thank you, Mr. Jelincic.

We're going to do Committee members, and then I'll come to you all, if that's okay.

Mr. Slaton.

COMMITTEE MEMBER SLATON: Thank you, Mr. Chair.

I'll also want to thank the staff, the stakeholders who joined with us in discussing this and trying to understand it and understand what the -- what the need to do.

I also want to thank the fellow Board members. You know, this is -- when we take all of this together we're a family, and we're a family that believes in public service, and in serving those who serve others.

And this is a difficult conversation. It's a very easy conversation if you're going to give raises, and you're going to lower contribution rates. It's very easy to do. This is not easy.

I'm reminded when I joined this Board in the summer of 2012, one of the first Board meetings that I was at Dan Dunmoyer, who represented -- who was gubernatorial appointee, who represented the insurance industry, made a comment that has stuck with me.

And he said, you know, at some point in time, there's -- pretty soon, there's a 22 year old female who's going to join as a safety officer for a local agency, and we make a promise for that person that is a solemn promise. And I'm worried that we're not going to be able to keep it. And that has stayed with me as I've taken my seat to represent the employer, local government employers.

And so I think that, you know, my own finance background would tell me that we need to go lower and we need to go faster. But the fact is we live in a real world, and we live with jurisdictions and employees and employers who have a commitment to serve their publics. And we need to understand that and appreciate that.

So I think this is a reasonable compromise to try to get to a better position, to make sure this fund is sustainable, because at the end of the day, we have to deliver on that promise.

And the last thing I would say is that this also is a move, although I think it's a small move, but it's a move toward intergenerational equity, because we really need to do everything we can not to place this burden on the next generation, on our children and our grandchildren. And this is part of a step to try to rectify that as well.

So I'll be supporting the motion.

CHAIRPERSON COSTIGAN: Thank you. We have 5 more Board members that would like to speak.

Do you need a break?

THE COURT REPORTER: (Shakes head.)

CHAIRPERSON COSTIGAN: Okay. We're going to go probably another 30? We're good. Okay.

Because we still have to wrap-up.

Ms. Mathur.

BOARD MEMBER MATHUR: Thank you, Mr. Chair.

CHAIRPERSON COSTIGAN: Oh, I'm sorry, Ms. Mathur. My apologies. Mr. Jones chimed in. We'll come back to.

(Laughter.)

CHAIRPERSON COSTIGAN: Committee first. He's over here signaling at me.

I'm sorry.

(Laughter.)

COMMITTEE MEMBER JONES: I' just following your rules.

(Laughter.)

CHAIRPERSON COSTIGAN: I'm sorry. I can't see beyond the coke bottle.

COMMITTEE MEMBER JONES: I just want to, first of all, applaud the staff and the stakeholders for working together to reach this point. And just listening to the public speakers, it's evidence that we're -- a lot of dialogue and exchange of information and a clear understanding as to what the problem is.

And we can't solve problems if we have different views of what the problems are. So I think that was fundamental in getting to this point is having that kind of dialogue and having everyone have a common understanding of what problem we're trying to solve.

And I think that that came together, because I'm just remembering many of the comments from that stakeholders, because as a fiduciary our duty is to sustain the system so that we can pay those promised benefits for generations to come. And that's our promise to our members.

And also, I recall in the Constitution it also imposes upon us to also be mindful of the impact of our agencies and our employers. And I think that part of the recommendations that came forward today attempts to address that impact on our agencies, so that it's not all done at one time, and it allows some kind of phase-in to allow planning at these different agencies. As the school guy indicated that they have to prepare a 3-year budget. So it's good to know what's going to happen in the next 2 to 3 years.

And I also, based on information that was provided, not just today, but over the last several months about our income contribution and payout gap. You know, we're running a deficit on $5 billion and all the information we see and projected in the future, it's going to get worse. And as we all know that the longer we wait, then the bigger the problem becomes. So I think this is a smart move to start addressing it at this time.

Also, the data shows that the fund has a potential of dropping to a less than 50 percent funded. And all the data that you guys have presented to us and I've read that when you drop to a level of 50 percent, it's a point of no return as we know a pension system today.

Yet, you may come -- you know, you may return, but it won't be the same. So I think this also, based on the information, and these steps that we're taking today will hopefully avoid us reaching into that no return zone.

So with that, I will support the staff recommendation because the, not only our staff, but economists and other financial experts have all indicated that we're in low growth environment. And it's to be expected to remain that way for the next 5 to 10 years.

And it's very different than just a few years ago. So I support the staff's recommendation, Mr. Chairman.

CHAIRPERSON COSTIGAN: Thank you, Mr. Jones

Ms. Hollinger.

VICE CHAIRPERSON HOLLINGER: Thank you.

I just wanted to thank staff as well, and I wanted to thank our stakeholders and everyone who came together. It takes big people to look in the mirror, address a problem, and to come to terms with it.

And I also recognize that everybody, all our budgets are strained. And even though maybe I personally would like to see a lower assumption, I realize it would be too much of a strain on budgets.

But I also worry because in the insurance industry, if we didn't take a direction the catch-up premium to catch up would be -- would really hurt and probably something we couldn't afford. So I really support this motion. I support a movement in the right direction.

And similar to Mr. Slaton, when I started on this Board, I think we were 78 or 80 percent funded. So I do worry about intergenerational equity, and the young people that are working hard and contributing, and I want the fund to be there for the benefit of everyone.

CHAIRPERSON COSTIGAN: Ms. Mathur.

BOARD MEMBER MATHUR: Are you sure?

(Laughter.)

CHAIRPERSON COSTIGAN: I'm sure now.

COMMITTEE MEMBER FECKNER: You better hurry.

(Laughter.)

CHAIRPERSON COSTIGAN: Or I'll call on Rob.

BOARD MEMBER MATHUR: So it's clear to me that we're at this very painfully unique period -- moment in time, where we had, you know, one economic downturn in 2002, and then a fiscal crisis in 2008, and now we're facing a period of persistent low growth.

All of these combined have brought -- sort of really brought us where we are today. And in this period of persistent -- what was projected to be persistent low growth, taking on more investment risk is not going to generate the kind of returns that we need. There's not enough risk for us to take on. And if we did take on extraordinary amounts of risk, then that amplifies our risk of underfunding -- of significant underfunding, and -- if there's a major downturn.

So it is clear to me that that is not the answer. That increase -- juicing up the risk is not the answer to solving this problem.

We have been entrusted by employers to deliver the pension promises that they make to their employees. And we've been entrusted by employees to ensure that they have -- that they receive their promised benefits when they retire. And I see that really as a sacred trust that we hold as a Board.

And so I think we've arrived -- that we've arrived at a very sensible recommendation that strikes just the right balance and is a very prudent step. And so I support the recommendation as it's been laid out by the staff.

CHAIRPERSON COSTIGAN: Thank you, Ms. Mathur.

Mr. Bilbrey.

BOARD MEMBER BILBREY: Thank you, Mr. Chair.

So I won't belabor the point, because all of my fellow Board members have probably stated most of what I would say. But what I do want to say is, number one, I do want to echo about the thankfulness of the staff and all those who have participated in coming to a common ground. It's one -- probably one of the first times in a long time that it seems that everybody, not -- while not perfectly happy has actually come to a consensus on something that is so difficult for us to deal with.

What's more difficult is that I will make a decision that I have to face my fellow workers who some paycheck to paycheck, but do count on me to make a decision for them for their future and for their retirement.

And so they expect and know the decisions we make are going to be in their best interests. And they'll understand once you discuss with them and make sure they understand what we're doing here, that that little extra that they may end up having to pay in the long run will benefit them when it's time for them to retire and have their retirement from all the years of service that they're putting in, whether it be a school district or a public agency.

But it's difficult. It is extremely difficult, because I get to see them face to face on a regular basis. And I know how much it will mean to them to pay that little extra out, where it may be not put some food on the table as opposed to paying more out their paycheck. But it's necessary, it's needed, and our retirement is so important to so many.

And so I support the motion as well.

CHAIRPERSON COSTIGAN: Thank you, Mr. Bilbrey.

Mr. Lind, and then we'll be going to Mr. Feckner.

BOARD MEMBER LIND: I didn't want to be the only Board member not to opine, if I can stop coughing for long enough.

Just echo what everybody said around the work that's been done around this and the outreach and a difficult decision. You know, I come from the private sector. And a small segment of the private sector where we still have defined benefit pensions plans. And private sector pension plans are facing this same reality, but even worse in dealing with it.

We do need to have a broader discussion in this

State and in the country around retirement security. I think several of my fellow Board members have talked about that.

As the Controller said, we're going to be criticized for making this decision, not making a much bigger step. But I think a lot of that criticism is going to continue to come from people that want to undermine, particularly public employee pension plans, but all defined benefit pension plans.

So at CalPERS, you know, we've already said as part of our Pension Beliefs, that we're leaders in protecting defined benefit pension plans. And I think this difficult step that we're proposing today, which I'll be supporting tomorrow, reflects that leadership role that we have.

Thanks.

CHAIRPERSON COSTIGAN: Thank you.

Mr. Feckner.

PRESIDENT FECKNER: Thank you, Mr. Chair.

I, first of all, also wanted to thank staff for all their hard work and especially note that Ms. Frost has only been here 2 and a half months, and she's still here.

(Laughter.)

PRESIDENT FECKNER: So that's even a better sign. But I want to thank you all for the hard work. It was certainly a very arduous task that you took on, especially meeting with all the stakeholders. Sometimes that's even harder than crunching the numbers. I understand that. It's personalities et cetera.

But when you have this many groups together, whether it be labor, whether it be employers, the administration, the staff or the Board, a group of basically 5 groups and none of them like it, I think we've probably hit our right nerve.

It's a little bit of pain for everyone. We can all live with it, but nobody is thrilled about it. I certainly hope that the Board passes this tomorrow. I'm sure the Committee will pass it today, and we can move forward making sure this System stays strong.

So thank you very much for all the hard work, everyone.

CHAIRPERSON COSTIGAN: Okay. Any other questions?

All right. I do -- before we take a final vote, I do want to thank all the participants. I know this has been very difficult. This is something we've all been working on for over 2 years. I really want to thank Cheryl, Ted, your staff, Todd, and please tell Scott thank you very much. I know to the local government and to the employee groups, this was very difficult.

But not to belabor the point, this is about the long-term future and sustainability of the fund. We are going to continue to have a robust discussion. This is just a start. We are going to go through the ALM process. We are 14 months from that. We are certainly hoping, as Al said that we have a robust year. I certainly hope my 401 hopes that.

But we're going to go back and revisit this. And today, our experts, I want to Wilshire, PCA, everyone else we've spoken to. It has really been amazing work, a very collaborative process. It doesn't stop here, and I just want to make that clear, that today is just -- Mr. Jelincic, as you raised, this is just step 1. And Mr. Slaton I think you'll need to -- I'm going to come to you in a moment. But we have a motion before us, I will go through it one more time just to make sure we're all on the same page.

The staff has recommended, Mr. Gillihan has moved and Ms. Hollinger has seconded the following, that beginning in fiscal year '17-'18, we will reduce the discount rate to 7.375, in fiscal year '18-'19 to 7.25, and in fiscal year '19-'20, we will take the rate down to 7.0.

I also note that Finance and the Governor's office did not ask for the acceleration of the implementation. That is just by operation of law that will take effect for 2017-18.

Okay. And then I'm going -- I've got people handing me notes and pointing at me -- that is -- that if the changed evaluation that it will impact all employers for the same contribution year, which will be 2018-19, fiscal year, due to the two year lag for public agencies. And that -- I think that's -- is that the motion? And that's State and school employers, and calculate that school employer contributions on the same timeline as our local public agencies, is that correct?

CHIEF FINANCIAL OFFICER EASON: That's correct.

CHAIRPERSON COSTIGAN: All right. And then he may have left. I do want to thank Allan Milligan.

Where is Mr. Milligan?

Without all of your hard work -- I didn't see you. You look so casual. Thank you for dressing up.

(Laughter.)

CHAIRPERSON COSTIGAN: Mr. Milligan and his staff I appreciate that.

So with that, it has been moved. It has seconded.

All those in favor?

(Ayes.)

CHAIRPERSON COSTIGAN: Opposed?

(No.)

CHAIRPERSON COSTIGAN: Please note Mr. Jelincic as a no vote. The motion passes.

Mr. Slaton, you are next.

COMMITTEE MEMBER SLATON: Thank you, Mr. Chair.

Well, given today's action and the data that's been presented by the staff and consultants, I'd like to make a motion to revisit our Risk Mitigation Policy, not today. We've set forth a path to reduce the rate over next 3 years, so I would ask that the staff -- the motion is that the staff bring the Risk Mitigation Policy back to the full Board in February for action with the following proposed changes:

To suspend the policy for the next 3 years, to take effect again in fiscal year 21-22, and to reduce the threshold trigger from 4 percent to 2 percent.

While we have a good path forward, I believe we need a more aggressive policy in the future to do more risk reduction and lowering the threshold will help move in that direction. And because we are implementing already reductions, I think it's prudent to let the Risk Mitigation Policy in a -- be in abeyance for that period of time.

So I would introduce that as a motion to take that to the full Board in February.

BOARD MEMBER TAYLOR: Second.

CHAIRPERSON COSTIGAN: Can I get -- well, just --

VICE CHAIRPERSON HOLLINGER: Second.

CHAIRPERSON COSTIGAN: Ms. Taylor, you're not -- Ms. Taylor, you're not on the Committee.

BOARD MEMBER TAYLOR: I know. I know.

CHAIRPERSON COSTIGAN: Hang on. Hang on. Can I get -- there's a little confusion Mr. Gillihan raised.

Is this your -- is this -- Ms. Eason, this is your -- who's issue is this? I just want to make sure our dates. Can we go through the dates very quickly.

Mr. Gillihan, did you want to --

VICE CHAIRPERSON HOLLINGER: I want to talk.

CHAIRPERSON COSTIGAN: Hang on. We just have a question.

COMMITTEE MEMBER GILLIHAN: If we were delaying the process by 3 years, so if we're stating in '17-'18, '18-'19, '19-'20, then wouldn't we -- the new policy kick back in in 2021?

COMMITTEE MEMBER SLATON: Well, except that the delay of locals and schools, so you have to take one more year for that. But I'm open to it being 20 -- if we're on the same process of risk mitigation, but I don't think we can treat them differently. I think the Risk Mitigation Policy acts on everybody at the same time, even though it takes effect later, is that correct?

SENIOR PENSION ACTUARY TAUZER: Yes, that's correct. And you're correct that because of the split out between State and schools and public agency, the total time in which we will be reducing -- the total time in which this would affect the contribution rates based on the valuation would be 4 years.

COMMITTEE MEMBER SLATON: So let me ask the question just to make sure, because I think Mr. Gillihan has raised a good point. For states, if the application of a discount rate reduction due to the Risk Mitigation Policy that would happen at different time periods for the 2 groups, is that correct?

SENIOR PENSION ACTUARY TAUZER: In terms of the Risk Mitigation Policy itself, it would affect the whole -- PERF-wide fund at the same time.

COMMITTEE MEMBER SLATON: It would, but the impact of that reduction would be in 2 steps.

SENIOR PENSION ACTUARY TAUZER: The impact for State and schools would be one year earlier than the impact for public agency, because of the different lag.

COMMITTEE MEMBER SLATON: Then I think your point is correct.

COMMITTEE MEMBER GILLIHAN: That's the point I'm trying to make.

COMMITTEE MEMBER SLATON: Then it should 2021, and it would take effect for schools, and if we keep the same logic that we used for this one for schools and local agencies, in 2122.

SENIOR PENSION ACTUARY TAUZER: So just to clarify, we have a valuation date that we use, and then you go from the valuation date 1 year forward for State and schools, and 2 years forward for public agency.

So the upcoming valuation date would actually be a 6/30/16 valuation date, because we're looking back at past data, which would separates for State and schools normally for '17-'18 and for public agencies for '18-'19.

So if we're talking about that valuation date, based on the recommendation, that 6/30/16 valuation date would be where we'd reflect the initial change for the State and for the public agency. And then the schools valuation date would be 6/30/17, because you only have a one year lag for the schools, so that it's hitting contribution rates at the same time.

COMMITTEE MEMBER SLATON: So the intent of the motion is that it not hit at the same time in the same year that it's dropping from 7¼ to 7. That's the objective.

CHAIRPERSON COSTIGAN: So there's what I think we're going to do. We're going to recess for 10 minutes to give the court reporter -- we've been going two hours and 40 minutes.

So let's take a short break. And make sure we're -- we know --

COMMITTEE MEMBER SLATON: That we've got the math right.

CHAIRPERSON COSTIGAN: -- what the math is, okay, because this is very important. So we're going to recess for 10 minutes.

Wait a second.

GENERAL COUNSEL JACOBS: My suggestion would just be that the motion --

CHAIRPERSON COSTIGAN: Hang on. Hey, hey, hey. People, please.

Yes, Mr. Jacobs.

GENERAL COUNSEL JACOBS: The motion can be made and you can figure out the specifics of it. We're not deciding it today. It's just a motion to put it on the calendar in February.

So we've got the concept that can be placed on the calendar for February, and we can work out the details between now and then and discuss it in February.

CHAIRPERSON COSTIGAN: Okay. All right.

GENERAL COUNSEL JACOBS: That was my just a suggestion.

CHAIRPERSON COSTIGAN: Can we take a seat, please?

Okay. The staff -- the motion is to put on the -- Mr. Feckner is not here, but to put on the full Board of Administration in February a delay, Mr. Slaton.

COMMITTEE MEMBER SLATON: To suspend the policy, so that the -- any impact of a risk mitigation happens subs -- in the year following the year of the reduction to 7 percent.

CHAIRPERSON COSTIGAN: And take it from 4 percent to 2 percent.

COMMITTEE MEMBER SLATON: And then take it from 4 to 2. Those are the 2 components.

VICE CHAIRPERSON HOLLINGER: Second.

CHAIRPERSON COSTIGAN: Mr. Jelincic, you wanted to speak.

COMMITTEE MEMBER JELINCIC: Yeah, I was just going to say since the policy can't kick in until at least next June, I don't see any particular need to get it on the agenda earlier. And so I think we ought to direct staff to bring it back at some point, but not necessarily say February.

CHAIRPERSON COSTIGAN: Mr. Juarez.

ACTING BOARD MEMBER JUAREZ: Yeah, I just want a clarification. So does the motion preclude staff coming back with any adjustments or alterations to what's being proposed, so that we're going to dictate that this is the only thing staff can come back with in terms of this particular issue?

COMMITTEE MEMBER SLATON: Well --

CHAIRPERSON COSTIGAN: Mr. Slaton.

COMMITTEE MEMBER SLATON: -- this is the issue and then we would wrestle with it as a Board as to whether we want to modify it, we like it, we don't like it, et cetera. But we're in the mode here of trying to get everything aligned, and I don't want to leave this unaligned with the action we just took today.

ACTING BOARD MEMBER JUAREZ: And to that point, I would only ask that if the staff has any difference in terms of how they would approach it, that they offer that as part of the --

COMMITTEE MEMBER SLATON: Of course.

ACTING BOARD MEMBER JUAREZ: -- review in February or whenever it comes forward.

CHAIRPERSON COSTIGAN: Thank you, Mr. Juarez.

All right. So it has been moved and seconded by the Committee -- or actually to put this on the full Board agenda for February.

Any further discussion?

Okay. All in favor?

(Ayes.)

CHAIRPERSON COSTIGAN: Opposed?

Motion carries.

All right. We are almost done. Ms. Eason, I think we've covered with Mr. Hoffner the direction for February. Is there anything we left hanging with you?

CHIEF FINANCIAL OFFICER EASON: Yes, I believe that we -- there are 2 items -- other items coming forward in February. One was asking for the Responsible Contractor Policy should be brought back to the Finance and Administration Committee in February, and also I think additional discussion on the long-term care valuation report as an information item in February as well.

CHAIRPERSON COSTIGAN: I believe that's it. Are there Board members with anything else?

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE:

Chairman Costigan, Wylie Tollette, Investment Office staff. Just to be clear, I think the Responsible Contractor Policy is under the jurisdiction of the Investment Committee, so I think what's actually coming back is the potential contract -- implications on CalPERS contracting of the elements of the Responsible Contractor Policy.

CHAIRPERSON COSTIGAN: That's correct. It is a -- it is just an informational item for us to have a discussion about whether the program should be -- I believe Ms. Weir yesterday had just talked about we are the gold standard. And I think part of that is to have that discussion with Mr. Juarez and his folks.

CHIEF OPERATING INVESTMENT OFFICER TOLLETTE: Yes.

CHAIRPERSON COSTIGAN: So anything else, Ms. Eason?

CHIEF FINANCIAL OFFICER EASON: No, that's all I have.

CHAIRPERSON COSTIGAN: Anything else from the Board members?

Anything else, anybody

All right. Than you all. We are adjourned.

(Thereupon the California Public Employees' Retirement System, Board of Administration, Finance & Administration Committee meeting adjourned at 5:08 p.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 22nd day of December,

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