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, APRIL 16, 2019

2:00 P.M.

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

A P P E A R A N C E S

COMMITTEE MEMBERS:

Ms. Theresa Taylor, Chairperson

Mr. David Miller, Vice Chairperson

Ms. Margaret Brown

Mr. Henry Jones

Ms. Fiona Ma, represented by Mr. Matthew Saha

Mr. Jason Perez

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

BOARD MEMBERS:

Ms. Dana Hollinger

Mr. Eraina Ortega

Mr. Ramon Rubalcava

Mr. Bill Slaton

STAFF:

Ms. Marcie Frost, Chief Executive Officer

Mr. Michael Cohen, Chief Financial Officer

Mr. Matthew Jacobs, General Counsel

Mr. Scott Terando, Chief Actuary

Mr. Dan Bienvenue, Interim Chief Operating Investment Officer

Mr. Matt Flynn, Investment Director

Mr. Forrest Grimes, Chief Risk Officer

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

STAFF:

Ms. Jennifer Harris, Chief, Financial Planning, Policy and Budgeting Division

Ms. Renee Ostrander, Chief, Employer Account Management Division

Ms. Nina Ramsey, Associate Pension Actuary

Mr. Kurt Schneider, Supervising Pension Actuary

Ms. LaRiesha Simmons, Committee Secretary

Ms. Emily Zhong, Health Actuary

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 TAYLOR: Calling the Finance and Administration Committee meeting to order.

Our first order of business is to call the roll.

COMMITTEE SECRETARY SIMMONS: Theresa Taylor?

CHAIRPERSON TAYLOR: Here.

COMMITTEE SECRETARY SIMMONS: David Miller?

VICE CHAIRPERSON MILLER: Here.

COMMITTEE SECRETARY SIMMONS: Margaret Brown?

COMMITTEE MEMBER BROWN: Here.

COMMITTEE SECRETARY SIMMONS: Henry Jones?

CHAIRPERSON TAYLOR: He's here somewhere.

COMMITTEE SECRETARY SIMMONS: Matthew Saha for Fiona Ma?

ACTING COMMITTEE MEMBER SAHA: Here.

COMMITTEE SECRETARY SIMMONS: Jason Perez?

COMMITTEE MEMBER PEREZ: Here.

COMMITTEE SECRETARY SIMMONS: And Karen Greene-Ross for Betty Yee.

ACTING COMMITTEE MEMBER GREENE-ROSS: Here.

CHAIRPERSON TAYLOR: All right. And let the record note that Erin -- Eraina -- I can't say your name. I'm sorry.

BOARD MEMBER ORTEGA: Eraina.

CHAIRPERSON TAYLOR: Eraina is here, Bill is here, Dana is here, and Ramon are here as well.

Let's move on to the approval of the April 16th 2019 Finance and Administration Committee timed agenda.

COMMITTEE MEMBER BROWN: Move approval.

VICE CHAIRPERSON MILLER: Second.

CHAIRPERSON TAYLOR: It's been moved by Ms. Brown, seconded by Mr. Miller.

All those in favor?

(Ayes.)

CHAIRPERSON TAYLOR: All those opposed?

Okay. Motion to approve the minutes has passed.

And, Mr. Cohen, we are moving to the Executive Report.

CHIEF FINANCIAL OFFICER COHEN: Good afternoon, Madam Chair, just in the interests of time. I'll defer any comments and turn it back to you for questions. I'm happy to comment on anything any of the Board members have questions on.

CHAIRPERSON TAYLOR: Okay. Does anybody have questions? We don't have an executive report at this time.

All right. We will move on to the action consent items, which is moval -- approval of the February 21st Finance and Administration Committee Meeting minutes.

VICE CHAIRPERSON MILLER: So moved.

CHAIRPERSON TAYLOR: So it's been moved by Mr. Miller.

COMMITTEE MEMBER PEREZ: Second.

CHAIRPERSON TAYLOR: Seconded by Mr. Perez.

All those in favor?

(Ayes.)

CHAIRPERSON TAYLOR: All those opposed?

All right. We have approved the meeting minutes for February 21st, 2019.

Actually, I'm going to move that we move the rest of the action consent items. I apologize.

VICE CHAIRPERSON MILLER: So moved.

CHAIRPERSON TAYLOR: All right. It's been moved.

I need a second.

COMMITTEE MEMBER BROWN: Second. But I have a comment.

CHAIRPERSON TAYLOR: Okay.

COMMITTEE MEMBER BROWN: I'd like 4b to be pulled separately and get a roll call vote on 4b.

CHAIRPERSON TAYLOR: Okay. We're going to pull 4b out. So I would like to get -- I'm sorry, we're going to have to get a motion to pass C and D on the action consent items.

VICE CHAIRPERSON MILLER: Moved

COMMITTEE MEMBER BROWN: Second.

CHAIRPERSON TAYLOR: I've got it moved by Mr. Miller, second by Ms. Brown.

All those in favor?

(Ayes.)

CHAIRPERSON TAYLOR: All those opposed?

All right. Motion passes.

We're pulling out 4b to talk about. Ms. Brown.

COMMITTEE MEMBER BROWN: No. I just want a separate roll call vote on the item.

CHAIRPERSON TAYLOR: Okay. So you don't want to talk about it.

COMMITTEE MEMBER BROWN: No.

CHAIRPERSON TAYLOR: Okay. So on 4b, I need to move 4b as an action consent item.

COMMITTEE MEMBER BROWN: Move approval.

VICE CHAIRPERSON MILLER: Second.

CHAIRPERSON TAYLOR: Moved by Ms. Brown, seconded by Mr. Miller.

And can we have a roll call vote on that.

Okay.

MS. HOPPER: That was on 4b?

CHAIRPERSON TAYLOR: 4b. All right.

(Thereupon an electronic vote was taken.)

CHAIRPERSON TAYLOR: All right. The motion passes. Thank you very much.

And we're going to move on to -- I have no requests to pull anything off information consent.

So we're going to move on to action agenda items. First, the annual budget proposal, first reading.

Mr. Cohen.

CHIEF FINANCIAL OFFICER COHEN: I'll have Jennifer Harris, the lead of our Budget Division join me.

(Thereupon an overhead presentation was presented as follows.)

CHIEF FINANCIAL OFFICER COHEN: This is the first reading of the organization's budget for the upcoming fiscal year 2019-20.

As is practice with CalPERS, we'll do a first reading now and then revisit it in May with any changes that the Committee gives us direction on.

But let me go ahead and turn it over to Jennifer. And Dan from Investment Office is here as well.

FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: Good afternoon, Madam Chair and members of the Committee. Jennifer Harris with CalPERS Financial Office. I'll be walking you through the 2019-20 proposed budge, the first reading. I'd like to begin with an update on the current year.

CHAIRPERSON TAYLOR: Okay.

FINANCIAL PLANNING, POLICY & BUDGETING DIVISION

CHIEF HARRIS: CalPERS 2018-19 total authorized budget is 1,698,000,000. As of December 31st, 2018, 750.4 million, or 44.2 percent, was expended. Based on analysis of resource utilization, CalPERS forecasts that it will end the 2018-19 fiscal year with a 26.8 million in unexpended funds. 15 million of this results from vacancy related salary savings, and other 5 million results from savings in various operations, equipment, and expense line items, or OE&E, both of which are in the administrative operating cost budget.

CalPERS also estimates another 5 million in savings resulting from third-party administration fees. This is based on actual enrollment data, which identifies few enrollments and higher -- higher fee health plans than previously estimated.

Moving on to the 2019-20 fiscal year.

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FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: The total proposed budge is 1,898,000,000. This is a 199.4 million increase over the 2018-19 budget. As the slide shows, it's a 205.6 million increase in operating costs, offset by a 6.2 million decrease in enterprise projects.

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FINANCIAL PLANNING, POLICY & BUDGETING DIVISION

CHIEF HARRIS: The major highlights of the 2019-20 budget include funding for Board approved salary increases for Investment Officer classifications, and funding for compensation and benefit increases negotiated through the State's collective bargaining process.

There are also funds built in for new investment trading platforms and management systems, as well as funds for higher external investment management fees based on asset allocation strategies for Pillars 1 and 2, and asset class market assumptions.

There are no new positions proposed in the 2018, '19, '20 budget, but we'd like to point out that the budget does display the implementation of the new California Employers Pension Prefunding Trust Program, which was authorized by Senate Bill 1413 statues of 2018.

I'll now go through each line item in the budget.

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FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: Beginning with the administrative operating costs. Administrative operating costs include personal services expenditures, which are salaries, wages, and benefits for staff, as well as OE&E expenses for each branch within CalPERS.

The 2019-20 proposed administrative operating cost budget is 530.3 million. This is a 32.2 million, or six and a half percent increase, as compared to 2018-19. Personal services expenditures are increasing 32.2 million. And again, this is the result of those Board-approved salary increases for investment classifications, which added 6.3 million, as well as the general salary and benefit increases negotiated through the State's collective bargaining processes, which added another 20 million.

Year over year, OE&E expenses are going down a net $700,000, which are reductions in various line items in the expense categories. CalPERS doesn't have included in general expenses and OE&E $1 million proposed for a new fiduciary insurance policy.

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FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: The total budget holds authorized positions at 2,875. This includes 12.5 positions in the position pool. These are positions that will be available for redirection throughout the organization should critical resource needs arise. There's also no funding in the budget for permanent authorized positions in the blanket.

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FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: As your budget materials indicate, there's some information related to Social Security

Administration. Since 1955, CalPERS has been the State's designated Social Security Administrator. In general, CalPERS has responsibility for overseeing contracts between the Social Security Administration and about 2,300 public employers statewide.

Expenses related to this responsibility are included in the administrative budget, and are funded with residual interest sitting in the Old Age Survivors Insurance Revolving Fund, or the OASI Fund. Beginning in 2019-20, there will be insufficient reserves in this fund to cover administrative expenses. Pursuant to current Government Code statutory authority, CalPERS will begin assessing an administrative fee to those public employers who offer Social Security benefits to their employees.

CalPERS is currently working with the Department of Finance as required by Government Code on the related fee structure.

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FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: The next line in our budget is investment operating costs. These are expenses specifically related to investment activities. This includes consultants to inform the Board of new initiatives, as well as to implement new technology strategies within the Investment Office.

There are also funds for external legal, audit, and appraisal services related to asset valuations, funds for custody and management, as well as data and analytic software. Also included in this line item are funds to implement or improve data platforms and investment strategies.

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FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: The 2019-20 proposed budget includes 120.4 million for investment operating costs. This is a 27 million, or 28.9 percent, increase over 2018-19. Major increases include 3.1 million for consultants. This include Board consultants, as well as technology consultants to help implement some new strategies.

There's 3.8 million included for master custodian fees, and 4.9 million included for new data and analytic software and subscriptions related to internalizing more investment functions within the Investment Office.

Finally, there's $14 million proposed for new trading and portfolio management systems that will provide better access to data and increased fund performance.

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FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: Also included in our budget is a line item for investment external management fees. These fees represent amounts that CalPERS pays to external advisors with whom it contracts to manage specific portfolios. CalPERS estimates these fees based on diversification strategies and market class assumptions.

Total fees in 2019-20 are estimated at 899.8 million. This is a one 132.8 million increase over 2018-19.

With me today is Dan Bienvenue from the Investment Office, and he's going to provide a little bit more information related to the increases in investment operating costs and investment external management fees.

INTERIM CHIEF OPERATING INVESTMENT OFFICER BIENVENUE: Thanks, Jennifer. Dan Bienvenue, CalPERS team member.

So really quickly, the two areas where you see the increases for the Investment Office are on operating expenses and then management fees. Regarding operating expenses, there are three main drives of that. The first is technology and data. That has to do with some of the strategies that we've internalized. We need to get a better sort of data platform to really know the data around our positions and our holdings, and then technology to access that data. And those are both implementation costs and then actual software costs.

The next one is enhanced risk and attribution software. We feel like we've got a pretty good handle on what goes on on the public assets. We're enhancing our capabilities, both in private assets and then how it comes together and how it aligns with the liabilities. So that's another category of costs.

And then finally, there's just kind of some standard contract step-ups, so step-ups around the Board consultants and step-ups around custodial fees, with assumptions based on AUM. And, you know, these are kind of part of the existing contract that was already approved.

Regarding management fees, and that, of course, is the lion's share of the cost. The management fees come -- the assumptions -- and these are -- these are proposed budgeting. This is what we -- these are projected management expenses. They come from two things. First of all, assumptions around performance, that's both absolute performance and relative performance. We're assuming that we're going to pay on a higher AUM. That would be base fees. And then we're also assuming that we're going to pay some performance fees.

In this space, of course, paying fees is a good thing, because that means assets under management is going up, right, assets are going up, and then also performance is positive. So that's the -- this is based on projections. And management fees candidly, they defy a budgeting process, but we still try to budget and project them for you.

The other thing that's driving the management fee increases is around the migration of private assets. Note importantly this is for an increase in private equity and real assets projected with private equity projected as Pillars 1 and 2. This does not include anything for Pillars 3 and 4. Anything for Pillars 3 and 4, as agreed, would come back to this -- to the Board for approval.

But these -- what we are still projecting increases in our private assets, of Pillars 1 and 2 on private equity, and then an increase in real assets.

The -- these increases seem large. And I thought it made sense to just give a little bit of context though for history just to -- just to share, because I know there's been a quite a bit of turnover both on our team as well as -- as well as on the Board.

If you look from several years ago on assets in the $200 billion range, we had expenses in the 1.5 to 2 billion dollar range. So much higher than where we are here. After several years of really focusing on costs -- and of course that cost focus continues. And for some members of the Board that have been around, they recall a lot of this real focus on cost.

We've really driven a lot of these fees down. We've gotten about $500 million, half a billion dollars, in annualized run rate savings, plus another about half a billion dollars in one-time savings that have taken us from that sort of $1.8 billion of expenses down to where we are now.

This is a focus that remains in place. We will continue to drive that. But I thought it was also finally worth mentioning that if you compare us to our peers through, you know, an organization like the CEM survey, CalPERS costs on the investment side are in the low 30s of basis points relative to our peers. And those are like size and like complexity. They're more in like the mid-40s of basis points.

So certainly these are big numbers. This remains something that we're very focused on. But I do think both relative to our history and relative to our -- you know, to our peers, we are relatively low cost and it was worth providing that context.

But from there I'll turn it back to Jennifer and we'll take questions when appropriate.

FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: Thank you, Dan.

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FINANCIAL PLANNING, POLICY & BUDGETING DIVISION

CHIEF HARRIS: Our next category of expenditures are third-party administrator fees. These are amounts that CalPERS pays to external administrators to support the delivery of health and pension programs. These fees paid -- these fees paid covered administration, record keeping, and communication with participants.

And the programs included include our Health Programs, our Long-Term Care Program, the Supplemental Employment Program, our Income Program, and the two new programs which are the California Employers Retirement Benefit Trust Program, and the California Employers Pension Prefunding Trust Program.

Year over year, this budget is increasing 13.6 million. These costs are being driven by health plan rate increases that are negotiated through the contracts. On average, there's a five percent annual fee administrative increase built into the 5-year contracts that were negotiated last fall.

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FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: Oh, I'll also note, as I've indicated before, the display of the new California Employers Prefunding Pension Trust Program, this was authorized by Senate Bill 1413 statutes of 2018. The amounts in the budget are funded by a general fund appropriation that was authorized by Senate Bill 1413.

Next up are enterprise project costs. Enterprise projects are technology projects that CalPERS undertakes to improve services, enhance services to members, and to stay current with industry trends and practices.

Year over year, CalPERS is requesting a 3.4 million -- or, I'm sorry, in 2019, CalPERS is requesting 3.4 million for two ongoing and one new technology project. This includes 2.9 million for the final phase of the Actuarial Valuation System redesign effort, and 236,000 to continue work on the previously approved new Human Resources Management Project.

Finally, CalPERS requests $174,000 to begin an implementation effort of a new electronic member payment system. This new system will enable members and beneficiaries to make credit and debit card payments online. CalPERS estimates there will be a reduction in workload related to the receipt of about 34,000 paper checks each year, as well as improved collections. This program should be implemented in the spring of 2020.

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FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: Our final item in the budget are headquarters building costs. The headquarters building budget reflects amounts to operate, maintain, and improve the Lincoln Plaza buildings, as well as costs for regional offices, the offsite emergency operations center, warehouses, and parking space.

Year over year, the headquarters building budget is increasing a net $300,000. This reflects some increases in operating costs, which are driven by union contract wage increases for our janitorial, engineering and security staff, offset by non-operating costs decreases for one-time expenses that were in the 2018-19 budget.

This concludes my presentation, and I'm happy to take any questions.

CHAIRPERSON TAYLOR: Thank you for your presentation.

I'm going to start with Mr. Perez.

You're on.

COMMITTEE MEMBER PEREZ: Hi. In regards to the Social Security Administration and the fees that are going to be -- the admin fees that are going to be needed, is that something that we can get from the general fund as opposed to hitting the cities with those?

FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: The way the current statute reads is that CalPERS is authorized to assess an administrative fee. There is nothing, or no mechanism, in statute currently that authorized a general fund appropriation.

COMMITTEE MEMBER PEREZ: Thank you.

CHAIRPERSON TAYLOR: So -- and that's your only question, Mr. Perez?

COMMITTEE MEMBER PEREZ: Yes.

CHAIRPERSON TAYLOR: Okay. I'm going to follow on that, because I thought that was curious myself. So there used to be a fund -- let me go back to the page, because I wrote down notes on it. There used to be a fund from Social Security, the Old Age and Survivors Insurance Fund, right, that's where we were getting that administrative fee before?

FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: Well, between 1955 and 1987, CalPERS would collect the contributions from employers and deposit them into the Old Age and Survivors Insurance Revolving Fund. Then CalPERS would remit those taxes to the IRS.

While the funds sat there, they were earning interest. And per statute, CalPERS was able to use those funds to cover the administrative expenses.

CHAIRPERSON TAYLOR: Okay.

FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: But since 1987, there was a change in federal law, where CalPERS no longer collects those contributions. There remitted directly to the IRS from the State Controller's office.

So there has been residual interest for several careers that has covered these expenses. But in 19-20, there won't be enough reserves to continue to use that fund source.

CHAIRPERSON TAYLOR: So -- in 2020, you mean?

FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: 19 -- 2019-20.

CHAIRPERSON TAYLOR: I got you.

FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: Yes.

CHAIRPERSON TAYLOR: Okay. The tax year -- or the year 19-20.

So since the Controller's office does it now, what are we asking for the fees for?

FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: CalPERS currently has a team who is involved in setting up what are called 218 contracts. So when a new employer decides to enter into agreement with the Social Security Administration to offer Social Security benefits to their employees, there are some contracts that have to be set up.

There's also regular ongoing reporting and monitoring that goes back to the IR -- Social Security Administration. So CalPERS staff are overseeing all of those contracts monitoring and reporting.

CHAIRPERSON TAYLOR: Okay. So we do the background stuff. The Controller actually collects the funds from the employers and remits it to the IRS, correct --

FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: Correct.

CHAIRPERSON TAYLOR: -- so that it goes into the trust fund.

FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: Nothing hits the trust fund any longer. It goes directly to the IRS now.

CHAIRPERSON TAYLOR: Well, I assume eventually it hits the trust fund, the Social Security Trust Fund.

FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: I'm going to call up Renee Ostrander.

CHIEF EXECUTIVE OFFICER FROST: It would hit the Social -- it does not hit the pension trust fund here.

CHAIRPERSON TAYLOR: No, no, no. I don't mean our trust fund.

CHIEF EXECUTIVE OFFICER FROST: Right. Right.

CHAIRPERSON TAYLOR: It's Social Security, federal trust fund.

CHIEF EXECUTIVE OFFICER FROST: But CalPERS is the administrator of the OASI Program for the State of

California.

CHAIRPERSON TAYLOR: Okay. Okay. So we do all of that work, the Controller remits it. Okay. That's where I was. So if we were to charge that fee, and it comes from all the employers, is that to our local agencies and our States agencies? Is that who's paying that fee, and does that get passed onto the employees?

CHIEF FINANCIAL OFFICER COHEN: And it's probably worth a little bit of context here. The amount of fee we're looking at is, at most, kind of a few thousand dollars per government agency that has, you know, over 1,000 employees. So we're not talking a big dollar amount. But no, we wouldn't expect anything to be passed on to employees.

The interesting angle on this is we would be charging a fee both on existing contract entities with CalPERS, as well as all other local government agencies in the state, whether they have an existing relationship with CalPERS or not.

CHAIRPERSON TAYLOR: Or not. So you have to do it regardless.

CHIEF FINANCIAL OFFICER COHEN: That's right.

CHAIRPERSON TAYLOR: Oh, interesting.

CHIEF FINANCIAL OFFICER COHEN: And so we've basically been living off of the interest from the old way of doing this for the last 20, 30 years, and that money has finally run out. And we have a team of, what, 5 individuals who sort of comply with the federal rules in administering this.

CHAIRPERSON TAYLOR: So basically we get -- we have to have a fee for the job that we do. The Controller gets a fee for taking it out of the paycheck. That's interesting. Just kind of a double dip there.

EMPLOYER ACCOUNT MANAGEMENT DIVISION CHIEF OSTRANDER: Renee Ostrander, CalPERS team member. So let me -- let me help kind of jump in.

So this has to do with the administration that needs to be done by the coordinator. So it does not have to do with the actual collection of taxes. So there is -- there's the collection of taxes --

CHAIRPERSON TAYLOR: Right.

EMPLOYER ACCOUNT MANAGEMENT DIVISION CHIEF OSTRANDER: -- that happens at each agency, and those agencies, whether it's a State agency, or a city, or a district, whoever has what's called a 218 agreement, which just means that the agency has coordinated to provide Social Security benefits to its members, which they don't have to do. But if they've so chosen that, then they would submit those taxes that are collected, along with their portion, the employer's portion. And those are submitted directly from the agency to the IRS. IRS is the collection arm for State Social Security -- or for, excuse me, the Social Security Administration.

CHAIRPERSON TAYLOR: So then I'm misinformed. I was trying to figure out how this was working. So I thought the State Controller was getting those funds. So you're saying each agency submits to the IRS already.

EMPLOYER ACCOUNT MANAGEMENT DIVISION CHIEF OSTRANDER: Well, if we're talking about State departments, that's a little bit different. But each agency, not State agency, but each entity, so city, district, county, State, each of those agencies send that directly to the IRS.

CHAIRPERSON TAYLOR: Okay.

EMPLOYER ACCOUNT MANAGEMENT DIVISION CHIEF OSTRANDER: And we used to be involved.

CHAIRPERSON TAYLOR: But the State of California is different. I got that.

EMPLOYER ACCOUNT MANAGEMENT DIVISION CHIEF OSTRANDER: Yeah.

CHAIRPERSON TAYLOR: Okay.

CHIEF FINANCIAL OFFICER COHEN: And basically, in this case, the Controller's office is acting as the HR sort of function for --

CHAIRPERSON TAYLOR: Agency for the State.

EMPLOYER ACCOUNT MANAGEMENT DIVISION CHIEF OSTRANDER: Correct.

CHIEF FINANCIAL OFFICER COHEN: -- for the State of California.

CHAIRPERSON TAYLOR: Gotcha. Okay. Margaret, go ahead.

COMMITTEE MEMBER BROWN: Thank you.

Can you tell me why our presentation changed from the 23-page one that's in our Board books to this 12-page one, because I could not -- I don't know if you noticed, we were -- some of us were lost up here. It's a different presentation than what we got. Mine is shorter. Mine is 23 pages.

CHIEF FINANCIAL OFFICER COHEN: The PowerPoint and -- I think all the information in the PowerPoint is included in the 23-page document. We're sorry for any confusion.

COMMITTEE MEMBER BROWN: Yeah, it's just I'm trying to figure what page is this on, because -- so let me -- bear with me --

CHIEF FINANCIAL OFFICER COHEN: Sure.

COMMITTEE MEMBER BROWN: -- while I find my bearings, so -- because my notes are on different pages. So on page 5 of your handout of the PowerPoint, you talk about $1 million for fiduciary insurance. That's an increase? It includes -- the very last bullet at the bottom. OE&E includes $1 million for fiduciary insurance. Does that benefit the Board members? Does that protect the Board members? And I think -- I have problem with the -- I might have a 1090 problem with this. If this fiduciary insurance protects Board members from suit or from a clawback inn the event we are sued.

CHIEF RISK OFFICER GRIMES: Forrest Grimes, CalPERS team member.

Ms. Brown, it would protect both CalPERS and Board members through a vehicle called the Waiver of Recourse, which is kind of a little bit technical I think to get into at this point. But that's how the Board members and actual staff members would be protected.

COMMITTEE MEMBER BROWN: Right. So I have a concern that this -- if we vote to include this in the budget and we -- CalPERS Pays for this and it actually protects Board members individually, that we could have a 1090 conflict. And I'd like to see that get a -- either an attorney general opinion or an opinion on that, other than our own counsel, because it also protects you. So I have a concern about that.

CHIEF FINANCIAL OFFICER COHEN: I think it would work in a very similar way that you've scene, in terms of the personal protection you end up paying writing a check for some of the health care programs directly as sort of an exhibition that you're acknowledging the risk and sort of covering your own -- your own cost, in terms of the organization's fiduciary insurance. More broadly, we would expect a similar process by which Board members would have to make their own payments.

COMMITTEE MEMBER BROWN: And that the payment should be -- have some nexus to the actual value we're receiving. That it shouldn't be some nominal fee. It actually should be -- there should be a nexus, the fee we pay to the benefit we receive, is that correct, Mr. Cohen?

CHIEF FINANCIAL OFFICER COHEN: In terms of -- there does seem to be an industry practice by which the fee is somewhat distant from whether or not a benefit actually is received, but it's certainly something that the insurance industry kind of sets the -- what they view as an appropriate rate for this waiver of recourse.

CHAIRPERSON TAYLOR: So there's no 1090 issue here is what you're basically saying?

CHIEF FINANCIAL OFFICER COHEN: Not that I'm aware of, no.

CHAIRPERSON TAYLOR: Okay.

COMMITTEE MEMBER BROWN: I'd just like us to take a look at that. If no one else is concerned, I just -- I think I have a concern. Because the price we pay is so little for the amount of insurance coverage we get, I have a concern that the value we receive --

CHAIRPERSON TAYLOR: Go ahead, Mr. Jacobs.

GENERAL COUNSEL JACOBS: No, I understand your point. We have taken a look at the 1090 issue, and we've also consulted with fiduciary counsel on it. And we've -- we do have an opinion from her that this does not present a 1090 issue.

COMMITTEE MEMBER BROWN: Great. If we could get that in writing, that would be phenomenal.

GENERAL COUNSEL JACOBS: I do not currently have it writing, but I can -- I can ask her about -- to provide it.

CHAIRPERSON TAYLOR: They had a conversation about it.

COMMITTEE MEMBER BROWN: Great.

CHAIRPERSON TAYLOR: So if we could -- Mr. Cohen, if we could have that as Committee direction.

COMMITTEE MEMBER BROWN: A few more -- a few more items on budget now. Something simpler for you. And maybe it's for Mr. Bienvenue. I've been working on that name.

We -- so it's page 15 on my slide. Let me see what page it is on your slide. The increase in the cost for -- maybe it's not detailed in here. It's on page 15 of my detailed slide, where we talk about the increase in external management fees. And you sort of explained it the AUM is going up, and the value is going up, so the increase is a good thing. Except when I look at the external management performance fees on real estate, it's going up 74 percent.

Now, if 74 percent is on a very small amount of money, that's fine. But it's 74 percent on a large amount of money. So can you kind of explain to me why it's going up that dramatically.

INTERIM CHIEF OPERATING INVESTMENT OFFICER BIENVENUE: So it has to do with assumptions around the previous valuations and then the projected valuations. We -- again, we make projections around what we think the valuations will be, and then what the resultant management fees, performance fees will be based on that. And that set of projections leads us to that number. If we were going to -- to go deeper, I would have -- I would have to dig much deeper into the numbers.

COMMITTEE MEMBER BROWN: So I'll just -- a couple more just technical questions. So performance fees. This is the 2 percent or are performance fess the carry?

INTERIM CHIEF OPERATING INVESTMENT OFFICER BIENVENUE: The carry.

COMMITTEE MEMBER BROWN: The carry. Great.

And so according to this either we're -- we don't pay carry until the asset is sold or transferred, is that correct?

CHAIRPERSON TAYLOR: On real estate?

INTERIM CHIEF OPERATING INVESTMENT OFFICER BIENVENUE: Let me see if I can get Matt Flynn who knows --

COMMITTEE MEMBER BROWN: On real assets.

INTERIM CHIEF OPERATING INVESTMENT OFFICER BIENVENUE: -- knows these a little deeper than me to describe exactly when we pay the carry.

COMMITTEE MEMBER BROWN: I'm just wondering, because I think if you pay carry, it's because the asset was sold. And so we are selling a lot of assets or are we just increasing the number in case we sell the assets? Help me understand.

INVESTMENT DIRECTOR FLYNN: Good question. Matt Flynn, CalPERS team member. Real assets has a, I'll call it, lumpy performance payout process. It's paid out over typically a 5- or an 8-year cycle. And valuations across the real assets portfolio have been going up over that period of time. And the real assets team is projecting, based on those valua -- inflated valuations, that we would be paying our strategic partners a performance fee. Keep in mind, strategic partners do get paid on unrealized gains, but that's the nature of our long-term relationship with those entities.

COMMITTEE MEMBER BROWN: I did not realize we paid carry on unrealized gains. I thought we only paid it on assets that were sold, so this --

INTERIM CHIEF OPERATING INVESTMENT OFFICER BIENVENUE: This is the reason for that sort of 5- to 8-year crystallization cycle is that we don't want to give an incentive to a manager to dispose of an asset.

COMMITTEE MEMBER BROWN: Because he wants to get paid.

INTERIM CHIEF OPERATING INVESTMENT OFFICER BIENVENUE: So that they can collect their carry, we would rather hold onto the good assets. And that's why we crystallize over an extended period of time. But there is an alignment of interests component here and that's the rationale for that.

COMMITTEE MEMBER BROWN: And so it might be helpful for those of us who are new on this Committee to maybe get multiple years of changes, so I could see the increase, because I -- we're seeing increase, right, this last fiscal year to this fiscal year. So I'd like to know if it's gone up 75 percent a year for the last five years or maybe we've had some dips as well, right, because we think it's going to go down and then up? I would assume that's --

INVESTMENT DIRECTOR FLYNN: It's a volatile process.

COMMITTEE MEMBER BROWN: Excellent.

INVESTMENT DIRECTOR FLYNN: Your intuition is exactly correct. Based on valuations, based on which particular strategic manager is in a payout cycle and who's not, the valuations or the payouts do change.

As far as the data, we absolutely have that data. And if so directed, we could provide it.

COMMITTEE MEMBER BROWN: It just might be helpful to see it in a little bar graph. I don't know if anybody else wants to see it, but I like trends, right, where are we going? And if we're making more money, I'm perfectly happy with that. Seventy-four percent was a big jump. Is that big jump for you? Is that an anomaly for real assets?

INVESTMENT DIRECTOR FLYNN: Last year was an anomaly to below. So what you're seeing is the peak-to-trough change from an extremely low year, where we actually had some clawback type of activity, to a projected high period. And you're just seeing that peak-to-trough change being excessive, which it is. But if you look at it over time, I think as to your point, you'll see that it is a much tighter bandwidth.

COMMITTEE MEMBER BROWN: That would be awesome.

And then one more question on global equity on the base fees. We're going up 36 percent. So, Dan, this is going to be you. And so why is it going -- and is that a normal increase, or is that standard, or why is it going up by 36 percent?

INTERIM CHIEF OPERATING INVESTMENT OFFICER BIENVENUE: Yeah. What you'll see there is about a 30 some million dollar increase on the base fees, and then an offsetting decrease on the performance fees. What we've done over the past several years is migrate to a place where we put more of it in base and less in performance. We've done that, because we found that we would actually get similar investment performance and higher fees with the base performance calculation as opposed to just going with the base. And then really the incentive is that we'll terminate you if we don't like the way the performance is going.

COMMITTEE MEMBER BROWN: Okay. Thank you very much.

INTERIM CHIEF OPERATING INVESTMENT OFFICER BIENVENUE: So that's been an intentional migration over the past several years.

COMMITTEE MEMBER BROWN: Thank you.

CHAIRPERSON TAYLOR: Thank you.

Mr. Jones.

COMMITTEE MEMBER JONES: Yeah. Thank you, Madam Chair. Apologize. I came in a little late, so I don't know if you addressed this question earlier. But I'm looking at -- on the iPad, because I don't see it on the hand out. And I'm on the page 10 of 23. And several years ago, we adopted a policy on putting a vacancy credit in the budget. There was a policy decision by the Finance Committee. And I see that it's been removed, so I don't remember that policy change coming back to the Board.

CHIEF FINANCIAL OFFICER COHEN: I think both Jennifer and I have -- are new on the organization's budget, and so we sort of took a fresh look at some of the practices and -- in terms of budgeting these things, you'll notice one of the things you might have also missed is there's no longer any permanent positions in the temporary health blanket. So that's been something that was going on a long time, and we sort of put an emphasis on getting rid of.

We also sort of felt like the forced vacancy savings rate was not a -- sort of an accurate way of projecting expenses within the organization's individual divisions. So we made some methodological changes in terms of budgeting, and sort of budgeting individual employees at their -- the mid-step of their classification, which is more aligned with State budgeting practice.

But if it's -- if it's something that the Committee wants to direct us to go back and sort of have this vacancy rate, certainly something we could do before May. I just -- we just as a group didn't see it having much value and it was causing confusion within the organization, giving the sense that we -- the organization didn't want divisions to actually fill their vacancies.

So right now, what we've tried to move to is here is all of your funding for your staff. Go fill your vacancies. That's what you're budgeted for. And don't arbitrarily hold positions vacant on the expectation that you have to meet a certain criteria.

But we can certainly respond to the Committee's direction.

COMMITTEE MEMBER JONES: Yeah, and I -- right, and I think -- I appreciate the comment. That's why when we discussed it, the credit for the vacancy was put at the fund level rather than individual offices, because there's no way to know where vacancies are going to occur throughout the organization, but we know they're going to occur. And a matter of fact your -- another page -- I don't remember what page it is, but your unexpended amount is $26 million.

CHIEF FINANCIAL OFFICER COHEN: Correct.

COMMITTEE MEMBER JONES: So where is that money coming from? Probably from vacant positions. So therefore, we need to continue -- I believe the policy of putting that credit in. Because if you don't put the credit in, that money is free to be invested somewhere. So if -- I would suggest, because it was a policy decision, I think it should be returned to the Committee if the Committee wants to change it.

CHIEF FINANCIAL OFFICER COHEN: Sure. And I'll --

COMMITTEE MEMBER JONES: And so we know there's going to be salary savings. We just don't know where.

CHIEF FINANCIAL OFFICER COHEN: Right.

COMMITTEE MEMBER JONES: That's why when we discussed this when it was implemented, we put the savings at the bottom of the budget, so that it's less money needed somewhere in the budget. We just don't know where until the end of the year.

CHIEF FINANCIAL OFFICER COHEN: Sure. Understood. And you're right, the current year savings is largely from personnel savings.

COMMITTEE MEMBER JONES: Right, exactly.

CHIEF FINANCIAL OFFICER COHEN: In an organization that's so heavy in its staffing, you know, most of the savings are going to come from their.

COMMITTEE MEMBER JONES: Exactly.

CHIEF FINANCIAL OFFICER COHEN: But in terms of --

CHAIRPERSON TAYLOR: So is that a problem?

CHIEF FINANCIAL OFFICER COHEN: -- coming back in May, we can -- the problem is in terms of kind of the way we've built the budget now is we've sort of forecast all personnel expenses at the middle level of an individual staff range. So we could try to come up with a vacancy rate, but it's going to -- we're a little concerned that it's not going to be internally consistent as a document. But we can spend some time, if that's the Committee's direction, that you would like to see something.

CHAIRPERSON TAYLOR: So, yeah, we -- I think --

CHIEF FINANCIAL OFFICER COHEN: Okay.

COMMITTEE MEMBER JONES: And please be aware that I --

CHAIRPERSON TAYLOR: Well, hold on. I've got more commentary on that too, Henry, sorry.

COMMITTEE MEMBER JONES: Huh?

CHAIRPERSON TAYLOR: I have more commentary on that from Margaret. So go ahead an --

COMMITTEE MEMBER JONES: Well, I've still got the mic.

CHAIRPERSON TAYLOR: No, no, no. I'm just saying we're not making a decision yet.

COMMITTEE MEMBER JONES: Okay. That's fine. And if you have a better way to do it, you know, I don't have a problem with that. It's just that it was a policy decision, and it was -- I saw the numbers change.

CHIEF FINANCIAL OFFICER COHEN: Right.

COMMITTEE MEMBER JONES: And I said, well, I don't remember that coming back to the Committee.

CHIEF FINANCIAL OFFICER COHEN: Gotcha. No, you're correct.

COMMITTEE MEMBER JONES: Okay.

CHIEF FINANCIAL OFFICER COHEN: We didn't bring a policy change outside of the budget document, but --

CHAIRPERSON TAYLOR: Okay. And I think we'll probably go ahead with that, but I'm going to -- I've got two more folks that want to talk.

Go ahead, Margaret.

COMMITTEE MEMBER BROWN: Okay. So thank you for bringing that up, Henry, because last year when I looked at the budget, I thought what the heck is this vacancy savings. I've never seen anything like this in a budget document. And it was odd. So I did not know it was a policy decision. But again, vacancies just fall to the bottom line at the end of the fiscal year. And, I mean, what you're doing, this budget is correct in terms of how you're supposed to budget those. So, yes, money falls to bottom line. And that's sort -- and that's sort of how it works. But I -- so I would not be in favor of it, but I may be overruled here.

CHAIRPERSON TAYLOR: So I will say the State of California actually does could salary savings and counts that on our budget for each agency. But, Mr. Perez.

COMMITTEE MEMBER PEREZ: I think this is an accurate representation what your presented. And it should just be on the bottom line. It is, as a guy that has to worry about salary and the budget that I have to work with, it is something that comes up and you do think about, if I don't fill it, maybe I have a little money over here. And I'm not saying CalPERS team does that, but there's always the potential.

So I like the way that you have it. And if it's an issue, just because of a process, maybe we can -- I don't know how it works, if we just undue that section of policy or --

CHAIRPERSON TAYLOR: We can, but I would need a motion.

Go ahead, Mr. Jones.

COMMITTEE MEMBER JONES: No, I think that it was a policy that had some debate on it. And I think if we're going to change the policy, we should --

COMMITTEE MEMBER BROWN: Have debate.

COMMITTEE MEMBER JONES: -- have debate on it.

COMMITTEE MEMBER BROWN: Yeah.

COMMITTEE MEMBER JONES: I don't think we should just change it.

CHAIRPERSON TAYLOR: So why don't we -- Mr. Cohen, why don't we have you bring this back with the policy we originally passed --

CHIEF FINANCIAL OFFICER COHEN: Sure. I'll --

CHAIRPERSON TAYLOR: -- and then -- for the next Finance and Administration meeting, and we can talk about it at that point.

CHIEF FINANCIAL OFFICER COHEN: Okay. That's -- and I certainly -- we can think more about it and sort of come with a formal recommendation whether we think the old policy makes more sense than the way we presented it. I would say we do have the benefit here at CalPERS of doing the mid-year budget updates that we always do, so we can always -- it's not a matter of us not being able to provide a number that sort of shows you what vacancies have generated in terms of savings. Certainly, I would support the notion of constantly providing this Board the information, in terms of how much vacancies we have at a particular point in time, and how much that savings generates. But why don't we do that and come back in May with a little bit more discussion.

CHAIRPERSON TAYLOR: Since we have -- we have two dissenting opinions on whether it should be in the budget or not. I do know the State -- I don't how current that practice is, but I do know the State of California makes that a normal practice. Go ahead, Ms. Brown.

COMMITTEE MEMBER BROWN: Thank you. I had two other questions, and I can't find it on this PowerPoint. But can you tell me how much we spend in legal fees on an annual basis, and how many staff we have, and then also how much we spend on like the Communications Stakeholder group, and how much -- how many number of staff we have?

If you don't want to tell how many -- you can just tell me positions, because I assume some of them are open.

CHIEF FINANCIAL OFFICER COHEN: Yeah. I think if -- are in the full document, page 12, we'll have the positions by the branch, but --

COMMITTEE MEMBER BROWN: Yes, positions, but not the cost, right, or does it have both?

CHIEF FINANCIAL OFFICER COHEN: Correct. All this chart has is the positions.

FINANCIAL PLANNING, POLICY & BUDGETING DIVISION CHIEF HARRIS: And if you look at the appendix on page 22, you'll find the budget by branch.

COMMITTEE MEMBER BROWN: Great. Thank you.

CHAIRPERSON TAYLOR: Okay. I'm showing no further requests to speak by the Board. So this is an action item. I'll need a motion.

VICE CHAIRPERSON MILLER: So moved.

CHAIRPERSON TAYLOR: All right. It's been moved by Mr. Miller.

COMMITTEE MEMBER JONES: Second.

CHAIRPERSON TAYLOR: Second by Mr. Jones.

All those in favor of passing the first reading of the 2019 annual budget proposal in favor say aye?

(Ayes.)

CHAIRPERSON TAYLOR: Opposed?

COMMITTEE MEMBER BROWN: I'm going to abstain.

CHAIRPERSON TAYLOR: Okay. I have one abstention with Ms. Brown.

It has passed.

And we are moving on to 6b, which is annual review of Board member employer reimbursement.

CHIEF FINANCIAL OFFICER COHEN: Right. Members, this item reflects, for those of you who are affected by the reimbursement rates, sort of the percentages that you submitted as requested for the Board to approve. So unless people want to get into more detail, I'll stop there.

CHAIRPERSON TAYLOR: Okay. I'm not showing any requests to speak.

So all those -- I need a motion for the annual review --

COMMITTEE MEMBER BROWN: Move approval.

CHAIRPERSON TAYLOR: Okay. It's been moved by Ms. Brown.

VICE CHAIRPERSON MILLER: Second.

CHAIRPERSON TAYLOR: Second by Miller. All those in favor of passing this?

(Ayes.)

CHAIRPERSON TAYLOR: All those opposed?

All right, 6b has passed.

And 6c, State Valuation Employer/Employee Contribution.

CHIEF FINANCIAL OFFICER COHEN: Right. We'll bring up the actuary team here.

CHAIRPERSON TAYLOR: And Scott, I haven't seen you in forever.

Go ahead.

CHIEF ACTUARY TERANDO: Good afternoon, Madam Chair, members of the Committee. Scott Terando, Chief Actuary for CalPERS.

Item 6c is a action item, and sets the State valuation and State employee rates for the fiscal year 19-20.

(Thereupon an overhead presentation was presented as follows.)

CHIEF ACTUARY TERANDO: The contribution rates for the upcoming year are a little bit higher than what was last year. But the change is generally what we consider in line with our expectations. If we look at what we projected last year and compare them to what we've calculated this career, they're in alignment.

We're looking at approximately about the $7 billion contribution overall for the State plans, with the funded status increasing slightly about 2 percent to 69 and a half percent.

Joining me today is Ms. Nina Ramsey, which will -- and she will step through the presentation and provide a little bit more detail about the rates, the funded status, and where the contributions are.

ASSOCIATE PENSION ACTUARY RAMSEY: Thank You, Scott. Good afternoon, Madam Chair, members of the Committee. Nina Ramsey, CalPERS team member.

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ASSOCIATE PENSION ACTUARY RAMSEY: We are here to present to you the results of the latest State valuation valued as of June 30th, 2018. The State plan consists of the five member subgroups listed on the slide above. And it will be setting the rates for the 2019-20 fiscal year.

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ASSOCIATE PENSION ACTUARY RAMSEY: There have been a few significant events that have occurred since our last valuation. First, the PERF earned a 8.6 percent investment return for the fiscal year ending June 30th, 2018. Second, we've had some assumption changes. They include the Board-adopted reduction to the discount rate to 7 percent, and the Board-adopted reduction to the inflation rate to 2.5 percent. At this point, all of the Board-adopted assumption changes are included in the State valuation.

Last year, the State made an additional contribution $6 billion towards their unfunded liability. The payment was included in last year's valuation and effectively reduce their 2018-19 required contributions. This payment is now also included in the funded status as of June 30th, 2018, and it improved the funded status by approximately 3 percent.

Lastly, we are now using a new actuarial valuation system. The new system has refined and improved our calculation methodology. And the impact of the change is treated the same as an assumption change would be for valuation purposes.

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ASSOCIATE PENSION ACTUARY RAMSEY: Here, we have the prior and current year results. We have a market value of assets as of 6 -- as of June 30th, 2018 of $136 billion. This includes the $6 billion payment that was made during the 17-18 fiscal year, and the 8.6 percent investment return.

We have an accrued liability of nearly 196 billion leaving us with an unfunded accrued liability of approximately $60 billion.

The expected annual contribution rate for the 19-20 fiscal year is approximately $7 billion, which is 670 million -- sorry, $675 million greater than last year.

The contributions are increasing, primarily due to the following factors:

First, the progression of the amortization basis, which include a ramp of up costs over 5 years. We've reduce the discount rate from 7.25 percent to 7 percent. And the fact that the State's payroll grew by 4. -- 4.6 percent as compared to last year, which is greater than our 2.875 assumed payroll growth.

These increases were offset by the investment return, which was greater than our assumed rate of return and due to new members entering into lower benefit formulas due to PEPRA.

We estimate that the State will see $43 million in savings in the 19-20 fiscal year, due to the increase in PEPRA members.

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ASSOCIATE PENSION ACTUARY RAMSEY: This slide shows the prior and current results by member category. We have each of the five plans with their 18-19 contribution requirement and their 19-20 contribution requirement. You can see that all of the contributions are increasing, but that is as expected, as described during the previous slide.

On a positive note, the 19-20 contribution rates are close to the projected rates that were provided in last year's annual valuation.

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ASSOCIATE PENSION ACTUARY RAMSEY: Here, we have the total 2019-20 contributions by plan. We have the actuarially required contributions in the left column, and the additional statutory contribution that is required of the State. They sum together to get the total contribution. This information is also on page 6 of the agenda item.

Government Code section 20683.2 requires that the State use the savings realized from increased member contributions due to PEPRA as additional payment towards their unfunded liability. This is not something that we are asking the Board to approve. This is more for informational purposes. The additional contribution is maintained by the State during their annual budget process.

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ASSOCIATE PENSION ACTUARY RAMSEY: This shows the brief history of the State's funded status. The funded status is a measure of the State's overall plan health. Each of the plans within the State has its own funded status. But as of June 30th, 2018, the overall funded status for the State plans is 69.5 percent, which is 2.1 percent greater than last year.

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ASSOCIATE PENSION ACTUARY RAMSEY: Moving on to member contributions. There are some recommended changes to member contributions for the 19-20 fiscal year. In general, most State plans are exempt from the PEPRA requirement that they pay half of the normal cost.

However, there are three groups that are not exempt. They include the Legislature, the California State University, and the Judicial Branch. This year, the normal cost has increased by more than 1 percent, which triggers a change for the POFF members in these groups. Their member contribution rate will change from 11 percent to 12 percent effective July 1st, 2019. The miscellaneous groups in these -- in the groups listed above have no change for this year.

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ASSOCIATE PENSION ACTUARY RAMSEY: Bargaining Units 9, 10, and 16 have also bargained that their members will pay 50 percent of the normal cost. This year, the normal cost has increased by more than 1 percent for certain groups.

The following groups will have their member contributions changed as of July 1st, 2019: The miscellaneous members in bargaining units 9 and 10 will increase from 8 to 8.5 percent; and the safety members in bargaining units 9, 10, and 16 will increase from 11 to 11.5 percent.

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ASSOCIATE PENSION ACTUARY RAMSEY: Lastly, we have the projected future employer rates. You can see that the rates are going up for the next five years and then decreasing in the final year. This is due mostly to the progression of the amortization basis where the costs are ramped in over 5 years, which is why the last one is lower.

We will be putting out our full valuation report towards the end of this summer. This will include our methods, assumptions, and participant data information. It will also include a revised projection, which will include the June 30, 2019 final rate of return.

That concludes my presentation. And with that, I would be happy to take any questions.

CHAIRPERSON TAYLOR: Okay. Thank you. I'm going to start with Ms. Brown.

COMMITTEE MEMBER BROWN: Thank you. Can we go back to page 5 of the presentation. You said that the new employer contribution rates are close to what we told them. So that's a real accurate number for the actuarial department. So maybe, plus or minus 1 percent, plus or minus 1/10th of 1 percent?

ASSOCIATE PENSION ACTUARY RAMSEY: Yes. So we have the miscellaneous and industrial groups are lower than our projection last year.

COMMITTEE MEMBER BROWN: Great.

ASSOCIATE PENSION ACTUARY RAMSEY: They're -- they're all within 1 percent of the projection.

COMMITTEE MEMBER BROWN: Much better number than close to. Thank you.

Go ahead.

CHIEF ACTUARY TERANDO: Yeah. If you want, we can run through numbers, if you want it all?

COMMITTEE MEMBER BROWN: You can just -- you can just give me your little cheat sheet when you're done. That would be great.

CHIEF ACTUARY TERANDO: Okay.

COMMITTEE MEMBER BROWN: I just worry when I hear close to.

CHIEF ACTUARY TERANDO: Well, on the --

COMMITTEE MEMBER BROWN: Go ahead, show off.

(Laughter.)

CHIEF ACTUARY TERANDO: -- proceed -- no, for -- I'm not quite as close as Ben, but pretty close.

(Laughter.)

CHIEF ACTUARY TERANDO: For the CHP and the State Police Officers, the increases were a little bit higher than we anticipated. On the other ones, they were a little bit lower. So fairly close on both ends.

COMMITTEE MEMBER BROWN: So for some on the Board, we'd probably like a little -- a number --

CHIEF ACTUARY TERANDO: The numbers.

COMMITTEE MEMBER BROWN: -- a number than close to.

CHAIRPERSON TAYLOR: One percent.

CHIEF ACTUARY TERANDO: Okay. So why don't I just run through them all.

COMMITTEE MEMBER BROWN: Sure. Thank you.

CHIEF ACTUARY TERANDO: For State miscellaneous we projected 31.2.

COMMITTEE MEMBER BROWN: And it's 30.977. Okay. Great.

CHIEF ACTUARY TERANDO: State industrial, it was projected to be 21.0.

CHAIRPERSON TAYLOR: Okay.

CHIEF ACTUARY TERANDO: State Safety was projected to be 21.5.

CHAIRPERSON TAYLOR: Well, there we are. You are as close as Ben.

(Laughter.)

CHIEF ACTUARY TERANDO: Yeah. And now for State Police Officers, it was 46.6. So the rates are about a half percent higher. And for CHP, it was 57. So approximately 8/10th of a percent higher.

COMMITTEE MEMBER BROWN: Well, that's very close. You are -- you are correct, close to was correct.

So let's do something fun on page 3. The last bullet you talk about a change in actuarial valuation system. So you guys got new calculators --

(Laughter.)

COMMITTEE MEMBER BROWN: -- or do you want to tell us a little bit about what that might be.

(Laughter.)

ASSOCIATE PENSION ACTUARY RAMSEY: Yes. So it is something of a new calculator for us. We are now able to store a lot more data that will improve our calculations, so that we have a more precise calculation of what future benefits will be. For example, we are now able to store a member's max historical compensation, which is what their benefit will be based off of in the future. So that's how we are making our future benefit calculations more precise.

We also have switched to monthly calculation from annual calculations, which allows us to better predict when COLA increases are, and how those will impact a member's future benefits.

COMMITTEE MEMBER BROWN: So for all 1.9 million members?

ASSOCIATE PENSION ACTUARY RAMSEY: Yes.

COMMITTEE MEMBER BROWN: Awesome. Thank you. That's very, very helpful.

CHAIRPERSON TAYLOR: Mr. Perez.

COMMITTEE MEMBER PEREZ: This probably is more for Marcie. Where is Governor Newsom on giving us that extra 3 billion bucks.

CHIEF EXECUTIVE OFFICER FROST: So it was presented in his budget proposal and it now needs to work its way through the legislative budget cycles. So we'll know in a few months.

COMMITTEE MEMBER PEREZ: All right.

CHIEF ACTUARY TERANDO: And just a quick comment, these results don't reflect --

CHAIRPERSON TAYLOR: Any of that.

CHIEF ACTUARY TERANDO: -- and of that. There was discussions about what the amount would be, timing, and there were too many variables for us to accurately incorporate those into these numbers.

COMMITTEE MEMBER PEREZ: Scott, I didn't -- I should have taken notes when you were talking. Can I have that cheat sheet too that you're going to --

CHIEF ACTUARY TERANDO: Yeah, I can --

CHAIRPERSON TAYLOR: So can we provide the Board with the cheat sheet? That would be awesome.

CHIEF EXECUTIVE OFFICER FROST: I will -- I will send that as an attachment to the full Board.

CHAIRPERSON TAYLOR: Okay.

COMMITTEE MEMBER PEREZ: Thank you.

CHAIRPERSON TAYLOR: And I'm wondering does the Board want to see the pre -- when we get this presented next year, does -- after all the readings are done, do we -- does the Board want to see, in the future, the projected amounts and how close we were, so that that's one of the columns?

CHIEF ACTUARY TERANDO: Sure. Sure. We can just add that to the agenda item, so it's --

CHAIRPERSON TAYLOR: Always in there.

CHIEF ACTUARY TERANDO: -- either it's an attachment or it's in there.

CHAIRPERSON TAYLOR: Okay. That would be awesome.

CHIEF ACTUARY TERANDO: So you can have that information. Sure.

CHAIRPERSON TAYLOR: Thank you.

Thank you very much.

So any other questions?

It doesn't look like it. So that's an action item.

COMMITTEE MEMBER BROWN: Move approval.

CHAIRPERSON TAYLOR: It's been moved by Ms. Brown.

ACTING COMMITTEE MEMBER GREENE-ROSS: Second.

CHAIRPERSON TAYLOR: Second by Ms. Greene-Ross.

So all those in favor -- oh, Henry.

COMMITTEE MEMBER JONES: No. No. Go ahead and finish.

CHAIRPERSON TAYLOR: Okay. All those in favor?

(Ayes.)

CHAIRPERSON TAYLOR: All those opposed?

Okay. So the motion passes on State valuation employee/employer contribution.

Mr. Jones.

COMMITTEE MEMBER JONES: Yeah. Thank you, Madam Chair. I would just ask that you -- ask for the record to show that I'm present here, because when the roll was called, I was not present.

CHAIRPERSON TAYLOR: I said you were here.

COMMITTEE MEMBER JONES: Oh, you did. Oh. Okay. I'm sorry. Thank you.

(Laughter.)

CHAIRPERSON TAYLOR: But that's okay. Yes. Let the record reflect Mr. Jones is here.

I said he's here, so -- all right. So we're moving on to 6d, Schools Valuation Employer/Employee Contribution.

(Thereupon an overhead presentation was presented as follows.)

CHAIRPERSON TAYLOR: And Mr. Terando again?

CHIEF ACTUARY TERANDO: Yeah. Thank you, Madam Chair. Item 6d is also an action item. And this establishes the contribution rates for the schools pool for fiscal year 19-20. I'm joined today by Kurt Schneider who will step through the valuation results and the contribution rates.

And before we get started, I'll just point out really quick that our expected -- or projected rate was 20.7, and the actual rate is 20.7. So right on --

CHAIRPERSON TAYLOR: There you go. Ben again, man.

CHIEF ACTUARY TERANDO: So at this point, I'll let Kurt go ahead and step through the results.

SUPERVISING PENSION ACTUARY SCHNEIDER: Thank you, Scott. Kurt Schneider, Actuarial Office.

So we'll run through this one. It will look a little familiar, because we just did one.

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SUPERVISING PENSION ACTUARY SCHNEIDER: So this is the actuarial valuation as of June 30, 2018, which determines the employer and employee contributions for the upcoming fiscal year 19-20 -- 19/20.

All school employers remember are in the same pool. This all acts as a one big plan with one single employer rate for the entire pool.

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SUPERVISING PENSION ACTUARY SCHNEIDER: The significant events -- now, be careful, this isn't quite the same as the State. We did have the same investment return, 8.6 percent in the 17-18 fiscal year, which will now be reflected. The assumption changes though are a little bit different. So for the schools pool, for the

'18 valuation, we're reflecting the demographic assumptions from the '17 -- the December 2017 experience study. And we're moving the discount rate to 7.25 percent. So we're one year behind the State valuation on the assumption changes.

The change to Amortization Policy that happened in 2018 was set to begin implementation with the 2019 valuation. So nothing about that policy actually impacts this valuation or these contribution rates.

The same updates to the actuarial valuation system. I'd just like to add, so there is a extra unfunded liability for most of these plans because of that. And it looks high an extra cost, but remember the benefits haven't changed. So when we reflect the extra cost, it really means a long-term savings for the plan by reflecting them now rather than waiting till they're paid.

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SUPERVISING PENSION ACTUARY SCHNEIDER: Here, we have last year's and this year's numbers side by side. The market value of assets increased by about $4 billion. The accrued liability increased by about 8 billion, which means the unfunded liability went up. The funded status is now 70.4 percent. And that gives us an employer contribution rate, as Scott said, 20.733 percent compared to what was projected of 20.7.

So going from 18.062 to 20.733, there's a lot of different reasons. And in the agenda item, there's a whole page that kind of breaks it out into all the different things that happened. The main takeaway is that when we have 5-year ramps to smooth the impact of various changes, it means in any given valuation, you're being impacted by everything that happened in the last five years.

The PEPRA member contribution rate is staying at 7 percent. The same as last year.

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SUPERVISING PENSION ACTUARY SCHNEIDER: Here's the contribution rate broken on by normal cost and unfunded liability payment. And you can see how those -- again, those are broken out in much more detail in the agenda item. And as well, at the bottom, we have the dollar amounts. The entire employer contribution for the fiscal year is projected to be just under $3 billion.

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SUPERVISING PENSION ACTUARY SCHNEIDER: Here is the funded status history over the last five years. As Ms. Brown pointed out, it't better to look at a period of time rather than a single number. And there you have it.

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SUPERVISING PENSION ACTUARY SCHNEIDER: PEPRA contributions, so let's talk about that for a minute. So the active members right now in the schools pool, their payroll is $4.15 billion. That's 31 percent of the active payroll. That means, you know, 31 percent of the cost for actives is based on the PEPRA benefit rather than the classic benefit. So that's a savings right now in this current rate of about 0.8 percent of payroll, the fact that these PEPRA members are there rather than all classic.

And again, the PEPRA member contribution rate is staying at 7 percent, because we have not crossed that threshold, which would be a 1 percent change in the total contribution rate.

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SUPERVISING PENSION ACTUARY SCHNEIDER: And here, we have the projected contribution rates going forward for the next five years. Again, in year five, they peak at 26.6 percent of payroll, and then a slight drop as that last gain gets ramped up 26.5 percent of payroll.

And again, the entire valuation report will be available in the summer with a lot more detail. But right now, the important thing is the contribution rate of 20.733 percent.

And with that, I'll take your questions.

COMMITTEE MEMBER BROWN: Move approval.

VICE CHAIRPERSON MILLER: Second.

CHAIRPERSON TAYLOR: Moved by Ms. Brown, seconded by Mr. Miller.

All those in favor?

(Ayes.)

CHAIRPERSON TAYLOR: All those opposed?

Motion passes for the schools valuation employer/employee contribution.

And we're moving on to 7a, Semi-Annual Health Plan Financial Report.

And that is -- who's coming up here?

(Thereupon an overhead presentation was presented as follows.)

CHAIRPERSON TAYLOR: Emily Zhong. Hi.

HEALTH ACTUARY ZHONG: Good afternoon, Madam Chair and Committee members. Emily Zhong, CalPERS team member.

CHAIRPERSON TAYLOR: Your mic is not on.

HEALTH ACTUARY ZHONG: Oh, sorry.

CHAIRPERSON TAYLOR: There you go.

HEALTH ACTUARY ZHONG: Good afternoon. This is Agenda Item 7a, Semi-Annual Health Plan Financial Report. It is an informational item.

This report summarize, as of December 31st, 2018, the financial result for the partially self-funded, or flex-funded HMO plan, and for our self-funded PPO plan. I'll give you highlights of the report.

Let's start with the PPO plans. As you may recall, a new Reserve Policy was approved by the Pension and Health Benefit Committee in September 2018. The financial figure in this report reflect the updates of a new policy.

Attachment 1 has the financial result for the PPO plan. As of the end of 2018, the total assets for PPO plan was 660 million. The actuarial reserve, base on new reserved level, was 507 million. Medical claim cost for the basic plan increased less than 2 percent over 2017.

On the Medicare side, medical claim costs increased around 4 percent. Pharmacy cost for the PPO plan are trending around 8 percent, and the PPO enrollment increased about 2 and a half percent over 2017.

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HEALTH ACTUARY ZHONG: Let's move on to the flex-funded HMO plans. Attachment 2 shows the financial result for the flex-funded HMO plan. Total assets for HMO are currently 233 million with an incurred, but not reported, claim reserve of 149 million. That leaves a balance of 84 million for all flex-funded HMO plan as of the end of last year.

Still to be accounted for are the final risk adjustment transfer for phase 4, 2018. And those will be reflected in the next semi-annual report in the November Board meeting.

In total, the medical and pharmacy claim costs are trending in the low to mid single digits for HMO. However, there are a lot of variation between the individual plans. This is mainly caused by the amount of migration in the HMO plan year over year. And the HMO enrollment decreased slightly, less than 1 percent over 2017.

And the team will continue to monitor the plan cause experience and financial results for the first half of 2019, and we will report back to you next time.

And that concludes my report. I'll happy to answer any question.

CHAIRPERSON TAYLOR: I forgot that was off.

I'm not seeing any questions from the Committee, so this is an action item, I believe.

HEALTH ACTUARY ZHONG: Information.

CHIEF FINANCIAL OFFICER COHEN: Information.

CHAIRPERSON TAYLOR: Information item.

So, we're going to move on to summary of committee direction at this point.

CHIEF FINANCIAL OFFICER COHEN: Chair, I have four items. Three from the budget discussion. First, a written counsel opinion on the 1090 fiduciary insurance issue. Second, historical data on the real assets performance fees. And then third agendizing the vacancy rate conversation for a deeper conversation in May.

And then in the State valuation, we'll send out the cheat sheet of projected versus actual. And then going forward in agenda items, we'll include that as standard practice.

CHAIRPERSON TAYLOR: Thank you very much. I appreciate it.

So I don't have any public comment. Does anybody want to make public comment?

All right. Then this meeting is adjourned. Thank you very much.

(Thereupon the California Public Employees' Retirement System, Board of Administration, Finance & Administration Committee meeting adjourned at 3:08 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 21st day of April, 2019.

James F. Peters

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