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, SEPTEMBER 20, 2016

10:15 A.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. John Chiang, represented by Mr. Grant Boyken

Mr. Ron Lind

Ms. Priya Mathur

STAFF:

Mr. Doug Hoffner, Interim Chief Executive Officer

Ms. Cheryl Eason, Chief Financial Officer

Mr. Ted Eliopoulos, Chief Investment Officer

Mr. Matthew Jacobs, General Counsel

Mr. Brad Pacheco, Deputy Executive Officer

Ms. Tanya Black, Committee Secretary

Ms. Kimberly Malm, Chief, Operations Support Services Division

Mr. Alan Milligan, Former Chief Actuary

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

STAFF:

Ms. Kristin Montgomery, Controller

Mr. Tom Noguerola, Senior Staff Counsel

Ms. Renee Ostrander, Chief, Employer Account Management Division

Ms. Arnita Paige, Assistant Chief, Pension Contract Management Division

Mr. Julian Robinson, Senior Pension Actuary

Mr. Scott Terando, Interim Chief Actuary

Ms. Laurie Weir, Investment Director

ALSO PRESENT:

Mr. John Cussins, City of Loyalton

Mr. George Linn, Retired Public Employees Association

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 morning. We're going to call to order the September meeting of the Finance and Administration Committee. Could we start with the roll first, please.

COMMITTEE SECRETARY BLACK: Richard Costigan?

CHAIRPERSON COSTIGAN: Here.

COMMITTEE SECRETARY BLACK: Dana Hollinger?

VICE CHAIRPERSON HOLLINGER: Here.

COMMITTEE SECRETARY BLACK: Richard Gillihan?

COMMITTEE MEMBER GILLIHAN: Here.

COMMITTEE SECRETARY BLACK: J.J. Jelincic?

COMMITTEE MEMBER JELINCIC: Here.

CHAIRPERSON COSTIGAN: He's here, but -- go ahead.

COMMITTEE SECRETARY BLACK: Henry Jones?

COMMITTEE MEMBER JONES: Here.

COMMITTEE SECRETARY BLACK: Bill Slaton?

COMMITTEE MEMBER SLATON: Here.

COMMITTEE SECRETARY BLACK: Lynn Paquin for Betty Yee?

ACTING COMMITTEE MEMBER PAQUIN: Here.

CHAIRPERSON COSTIGAN: All right. So just a couple housekeeping items before we get started. It's my understanding that folks are having difficulty hearing.

So if you're going to speak, we're going to do it like radio, so lean into your microphone. We also have -- Christina, please wave -- a couple piece ear devices -- listening devices. So if you need any of those, please see her.

So I know the acoustics in this room are not very good. But from that end if you would -- at least, if you're going to be speaking, please lean into the microphone.

So before we get started, there are just a couple observations and comments I would like to make. Over the last week or so, we have seen a number of news articles related to both the transparency of the organization and the history of the organization. And we're going to talk a little about that today. But I just wanted to point out that on the issue of transparency, Mr. Milligan is going to be going through valuations and actuarial statements. And all of this information is available on-line.

But I just want to point a few of the items that we done over the last five years. Ms. Eason, who's going to give her executive report shortly, was the position that we created with our Chief Financial Officer. We have focused on internal transparency. A lot of credit to our tech office, to Liana and others, who have made the information available.

Almost any document you are looking for, you should be able to find. And if you can't find the document, I would encourage you to actually talk to us tell us, hey, either the format needs to be differently or some of it is not available. But I will tell you, as we get into the discussion with that Mr. Milligan is going to talk about, the sets of books all exist. The information is available.

In fact, when Alan goes through the reports, what you're going to find out is that not only do we talk about the liabilities of each employer and each organization, we also talk about the termination aspects of it. And so again, if there's a format issue that you're not able to read on interpret the document, I'd like to hear the feedback.

On a personal note, I've been Chair of this Committee for 3 years. I read recently that there are a couple local governments that had concerns about some of the reports that we had put out. I'm always available to talk to anybody, I would say, as every member of this Committee is. Over the last 3 years, I don't think I have seen or heard from a local government agency as it related to the transparency of any of our documents, whether it's the liability, the actual -- actuarial statements and the valuations statements.

So again, I just want to make it available for folks that we, in fact, are available. We want to hear your concerns. I appreciate the folks I think from Los Gatos coming yesterday. Had a good conversation.

Part of it is we need to help educate you all as to what the right committee is. He sat here throughout the day, and really what he wanted to talk about was in front of this Committee. So I certainly hope he's watching. I encouraged him to watch, and to text me or email me if he had questions, and I encourage others to do that as well.

I also want to give some credit to Mr. Eliopoulos and to Mr. Jones. I think yesterday's discussion as to where the fund is going, as to the issues of transparency, as to the issues of liabilities, as the issues of cost were fairly stunning. The documents that Ted presented and his team, and what Wylie and his folks have been working on and as we rolled through the day are extremely impressive.

I've been on this Board 6 years. I hear what it used to be like. You know, reading an article about the past in 1999 and 2000, those don't happen anymore. The amount of information that we make available, what our team is doing, I don't think you all get enough credit. I know oftentimes I tend to be very critical. I know my questions can be sharp. But understand, the reason that that is the case is because you guys make the information available. I don't want us to lose sight on that.

Yesterday was a little bit of doom and gloom, because we think it is extremely important for all of you to understand what the System is facing and what we are struggling with. Today and yesterday, Mr. Jones, with a lot of the work that you and your Committee, Mr. Slaton, did, we're starting to set the paths forward on what the solutions are.

This Board has been moving towards that, whether it's been risk mitigation, Treasury Management, some of the things that Cheryl is going to go to. All this stuff has been going on. Oftentimes, it seems routine to us, and it's not. And I just want to make it clear, we are going to be successful. That is really part of today's intention, today's Committee meeting. We're going to have robust discussions. We make the information available. We want the input. We want discussions from stakeholders.

So, you know, with that, I am really looking forward to a very robust discussion today. We're going to talk a lot about liabilities. We're going to talk really -- again, the valuations, I look forward to Scott's presentation. I'm not going to try and stress him out too much. So it's going to be fun.

With that, I am going to ask the Vice Chair, she has a few comments, and then we're going to go to Ms. Eason, and we're going to present for today. I will take a page out of Ms. Mathur's book. I normally don't do this, but we will recognize Ms. Mathur, Mr. Boyken, Mr. Feckner, and Mr. Lind are all also here today.

So thank you. Ms. Hollinger, let me turn your microphone on, or does yours work?

Hang on a second. Okay. There you go.

VICE CHAIRPERSON HOLLINGER: Okay. Thank you very much. And what I wanted to say today is that we don't have a political problem, we have a math problem. And we're here looking for a formula to come up with a solution. And it's in response to the fact that the global macroeconomic picture has changed, and impacted the prospect of future return assumptions.

CalPERS fiscal year-end 2015 was 2.4 percent and for 20160 0.6 percent. Over the past few months, we've learned from our consultants, Wilshire, that they project our overall expected returns for the next 10 years to be 6.12 percent.

The McKinsey Global Institute report says that we need to lower our return expectations over the next 20 years, because economic and business drivers are shifting. So we really need to ask ourselves what level of risk can we afford to undertake, when we undertake to earn 7½ percent return?

In my industry, the insurance industry, we're currently pricing our risk where we have to guarantee a payout identical to that of the pension. You guarantee a payout, at somewhere point in time in the future at 2 percent.

So I remember not that long ago when we priced our guarantees at 4 percent. So at 7½ percent, we remain at a higher risk of loss to the portfolio than the market currently dictates. We cannot move off that position as long as we have a threshold of 7½ percent. So my comments to you are in the context of that dilemma.

Thank you.

CHAIRPERSON COSTIGAN: Okay. Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: Yeah.

CHAIRPERSON COSTIGAN: I want to hear from Ms. Eason first and then -- is that okay?

I'd like the --

COMMITTEE MEMBER JELINCIC: Sure. I was going to respond to partly what she said.

CHAIRPERSON COSTIGAN: I assumed that was going to be the case. Let's go -- if it's okay, I'll go with Ms. Eason, and then I'll call you. You'll be the first person I call on.

Ms. Eason, Executive Report, please.

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

Today's meeting has significant meaning as we continue the discussion of the funding of the CalPERS pension system in light of the low interest rate environment, volatility in the markets, managing our downside risk, negative cash flows, and the maturing of the CalPERS system.

Later in the agenda, the Committee will be presented with the annual funding levels and risk report that looks at the liabilities side of the asset liability management of the CalPERS pension system and the risks in that system.

But first, let me mention that the action item for today is the proposed Board election regulations, which you heard at the August Committee meeting. The amendments were submitted to the Office of Administrative Law for a 15-day comment period. Upon approval from the Committee today, the OAL will then have 30 working days to review the approved regulation package.

The first information item is the annual diversity report, which highlights initiatives completed across the enterprise and recent accomplishments through

June 30th, 2016. And for the second year, we will be hearing the risk profile review for the Finance and Administration Committee that will cover management of risk and look to the Committee for their feedback.

Next month, we will collect -- based on the risk profile, next month we will collect the enterprise assessments and provide a presentation to the risk management dashboard to the Risk and Audit Committee in November 2016.

And then lastly, additional information items today will include the annual valuation of the actuarial valuation for the terminated agency pool, update of the public agency valuations, annual review of the funding levels and risk report as I mentioned, and for the first time, the notification of the Risk Mitigation Policy.

The next Finance and Administration Committee meeting is scheduled for November 15th, 2016. And we'll include the draft 2015-16 basic financial statements. The first reading of the 2016-17 mid-year budget revisions, Finance and Administration strategic measures, replacement benefits trust administration charges, first reading of the 2017 to 2022 strategic plan, and several reports including the first reading of the actuarial contribution allocation policy, the long-term care valuation annual cost efficiency, and semi-annual self-funded health plans.

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

CHAIRPERSON COSTIGAN: Thank you.

Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: Before I start, were there any questions for her before I make my comment?

CHAIRPERSON COSTIGAN: No, turn your microphone on.

CHAIRPERSON COSTIGAN: There you go.

COMMITTEE MEMBER JELINCIC: Were there any questions for her before I make -- okay.

I want to react to what Ms. Hollinger said. Yes, we have a math problem, but we also have a political problem. And if we don't recognize that part of our investment problem is directly related to politics, then we are doing ourselves a disservice.

I am the optimist on the Board, which is a situation I'm not particularly used to. But I think we can do the 7¼, 7½ over the next long period of time. But we do need to recognize we get political pressure to reduce the risk, we get political pressure not to reduce the discount rate, and we've got politicians having major impacts on the economy and the world markets. So it's a math problem, but there's also a political element to it.

Thank you.

CHAIRPERSON COSTIGAN: No. Thank you, Mr. Jelincic.

All right. We're going to move on to Item 4, information consent. Is there anything?

Oh, I'm sorry. You know, I'm just moving along. I can't wait to hear from Scott.

So on the action consent items, are there any issues?

COMMITTEE MEMBER JELINCIC: Yes.

COMMITTEE MEMBER JONES: Move it.

CHAIRPERSON COSTIGAN: Uh-oh. Mr. Jelincic.

Wait a second. All right. It's been moved by Jones, but Mr. Jelincic you have an issue?

COMMITTEE MEMBER JELINCIC: Yeah. On page 2 of the amendment -- or the minutes down at the bottom, 5b, I think that that paragraph at the bottom fails to reflect the actual motion that I tried to make. What I tried to do was restore the language that was being taken out about the quarterly contracts and expenditure report for vendors over 100,000. It was not the million and over the -- and I've got the language from the last agenda item.

CHAIRPERSON COSTIGAN: So, Ms. Eason or Ms. Malm, does that -- is that more -- is that reflective of the action?

CHIEF FINANCIAL OFFICER EASON: Well, what we can do is we can take that away and have a look at that, and make sure that we've addressed it correctly.

Kim, did you have any comment? I know you had looked at this item.

OPERATIONS SUPPORT SERVICES DIVISION CHIEF MALM:

The Committee voted to remove that off of the semi-annual. However, we are bringing it back, as requested by the Chair, in September of next year to review.

CHAIRPERSON COSTIGAN: What I think Mr. Jelincic is getting at is do the minutes reflect the motion that he made? And it currently says Mr. Jelincic moved the million dollar contracts be added to the policy on a quarterly basis, but the motion did not receive a second. You're saying that's not an accurate reflection.

COMMITTEE MEMBER JELINCIC: Correct. What I -- there was a paragraph in additional reports that was being removed that I asked to be restored.

CHAIRPERSON COSTIGAN: So why don't we just put this item to the end, and if you could look at that.

OPERATIONS SUPPORT SERVICES DIVISION CHIEF MALM:

Okay.

CHAIRPERSON COSTIGAN: So thank you.

All right. So now we will move to Item 4, information consent. Any questions or concerns?

COMMITTEE MEMBER JELINCIC: Yes.

CHAIRPERSON COSTIGAN: Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: On 4e, I had a question and it ought to be quick. In the agenda item itself, in the last paragraph of page one, we added by converting all the letters of engagement to an Investment -- for the Investment Office into the eProcurement system this year, it changed the report. So I was wondering if you could explain what that meant.

And while you're thinking about that, the other issue I'd like to raise is in f, which is the small business report. I would like to request that we schedule that, at some point, for a discussion on how we report, given the fact that the statute says that if you're doing investment or health contracts, which are the bulk of our contracts, you are by definition not a small business. And I just think we need to have a discussion.

CHAIRPERSON COSTIGAN: So while she's looking at e, Ms. Eason, would you come back with a date that we could take up Item 4f, the policy, and just have a discussion just at a future Board meeting.

CHIEF FINANCIAL OFFICER EASON: Okay.

CHAIRPERSON COSTIGAN: So that will be direction from the Committee.

Ms. Malm.

OPERATIONS SUPPORT SERVICES DIVISION CHIEF MALM:
So, Mr. Jelincic, we implemented, as you know, a year ago the ePro system with PeopleSoft. And our first step was to get the contracts and procurements that are utilized throughout the Department into that system. And we did that with all of our contracts and procurements that did not use the continuous appropriation as our first step. This second year, we added all the continuous appropriation contracts and procurements into this system, which is why you see the increase.

COMMITTEE MEMBER JELINCIC: Okay. So it's more accurate and more -- all inclusive.

OPERATIONS SUPPORT SERVICES DIVISION CHIEF MALM:
Sure.

COMMITTEE MEMBER JELINCIC: Thank you.

CHAIRPERSON COSTIGAN: Anything else Mr. Jelincic?

COMMITTEE MEMBER JELINCIC: No.

CHAIRPERSON COSTIGAN: Okay. So we'll come back on 4f at a future date.

Okay. We're going to move to our first action item, which is 5a.

Mr. Hoffner, Ms. Malm.

And Mr. Linn, if you want to come on down, you're welcome to sit, since I know you want to speak on this item.

OPERATIONS SUPPORT SERVICES DIVISION CHIEF MALM: Good morning, members of the Finance Committee. Kim Malm, CalPERS staff. This is an action item. This item is to seek the Committee's approval to adopt amendments to the Board election regulations and approval to submit the financial regulation package to the Office of Administrative Law. This is the last hurdle in our 3-year process to allow our members to have additional Board election voting options.

Excited about that.

At the August 2016 Finance and Administration Committee meeting, the Board approved the proposed Board election regulation changes for a 15-day comment period. Since the last meeting, CalPERS procured the new Board election vendor. Based upon the discussions with them, we've submitted a second round of regulations providing additional details clarifying the newly adopted on-line and telephone voting process.

The additional regulation package was submitted for a 15-day commend period on September 1st and closed on September 16th.

The following details were added to the Board election regulations: We added electronic perjury statement for the on-line and telephone voting, similar to that of the mailed paper ballots. We added details to explain what criteria was needed to ensure that ballots were deemed valid. We clarified that the first vote received, whether it paper, on-line, or telephone would be the only vote counted. And we added member security language, requiring the voter to enter a secure pin number provided by CalPERS and a unique identification number.

Currently, we received one small -- or one email containing two comments that's in your package. The first comment requested the word "eligible" in section 554.5 to be removed as it is redundant when referring to eligible members. We had the word eligible 3 times in the same sentence. So after considering the comments and speaking with OAL, we are removing that word.

The second comment related to the original -- leaving the original language in when referring to majority vote in Section 554.58. The language was amended, because a Board member had concerns about the original language that refers to 50 percent of votes cast plus one. This language as approved at the August Finance and Administration Committee.

The staff recommends that we keep the current proposed language, and we do not adopt this requested change. That is also in your packet.

If the FAC approves the proposed regulations, the final regulation package will be submitted to OAL for final review. They have 30 days to review this package and make a final determination.

That concludes my presentation, Mr. Chair, and I'm happy to answer any questions.

CHAIRPERSON COSTIGAN: Mr. Jones.

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

I'm not interested in modifying the proposal you have here, but I would like to suggest that you have an internal process of verifying the people involved in the election sign off. All of those documents in this regulation rest with the election coordinator, and I just would like to see the election coordinator's signature rest with someone above the level.

OPERATIONS SUPPORT SERVICES DIVISION CHIEF MALM:

Absolutely. Thank you, Mr. Jones, for saying that. You had actually brought that up last month as well, and we are working with the Compliance Office, so that when we fill out the forms and we ensure that the forms are completely filled out, we will turn them over to Compliance to do the validation as well.

COMMITTEE MEMBER JONES: Good. Thank you.

OPERATIONS SUPPORT SERVICES DIVISION CHIEF MALM:

Thank you.

CHAIRPERSON COSTIGAN: I just want to make sure, before I call on Mr. Jelincic, that we're not having an issue with anybody. Can everybody hear us okay?

Okay. Great. So just remember to lean into your microphone.

Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: A couple of things. I'm not -- I will tell you I'm not prepared to vote for this. The language about the use of logo is something we discussed, and we had an off-line discussion. And I was led to believe that we would see slightly different language. Last -- Theresa Taylor last time had to take down a picture of the ballot envelope, because it had a logo on it. When I ran, I -- they did a videotape of the candidate statements. And somehow this lapel pin implied that the System was endorsing me. And so I had to take it off. So I think it is overly broad.

I think there are ways around it, but it didn't reflect in the -- the other thing that is in here that I find very troublesome -- it was not in here last month -- is a requirement to sign the ballot, not the envelope, but the ballot. And I really believe in secret ballots. And I recognize it saves us money, but I don't -- I'm not prepared to vote to eliminate the secret ballot.

Thank you.

OPERATIONS SUPPORT SERVICES DIVISION CHIEF MALM: If I may?

CHAIRPERSON COSTIGAN: Ms. Malm, please.

OPERATIONS SUPPORT SERVICES DIVISION CHIEF MALM: So the -- if a candidate uses the CalPERS logo in any way, it then requires CalPERS staff to make a judgment call as to whether or not it's an endorsement or is not an endorsement. So what we were proposing to do, in order to answer your question and fulfill what you were requesting, is that Public Affairs was going to provide all of the candidates four to five different pictures that they could use that has somebody holding a ballot, that they could use during their candidacy. And we'd be providing that as part of the candidate package.

So instead of it being that person holding the ballot, it would be a person, maybe one picture is male, one picture is female, one picture is family, whatever -- whatever we think would -- Public Affairs would advise would be helpful, and then that's what the candidates could use, as opposed to if a candidate uses the CalPERS symbol in anyway, then we would need to make judgment calls whether or not it constitutes an endorsement or not. That was the first one.

And then the second one, the signature is on the ballot only for the purposes to validate that there's a presence of the signature. Okay. So you could sign XXXOOO, and it would still be valid, because we do not have a signature database of our membership to validate it against. It's just there to acknowledge it's on the perjury statement, that you have seen the perjury statement and you have done something on that line to acknowledge that you've seen that.

The data regarding the member is stored in the bar code on the ballot, just like it was -- just like it is currently. And the data that's stored on there is just demographic data that the Board gets, reports on after the election, age, employer, gender.

The information that is captured is only that the person voted, not that the person -- or not how the person voted. And so we need to have that information in order to ensure that somebody doesn't vote more than one time. But that information, again, it's all captured by the third-party vendor. It is not -- it is not here. We have no access to any of it. But again, all they're capturing is that the person voted and not how they're voted -- or not how they voted.

The IVS everyone counts ballot facility is certified by the California Secretary of State. In addition, they process -- they audit their processes every two years with a third-party vendor. So I believe that all of these items provides a risk mitigation to your belief of the signature on the ballot, sir.

CHAIRPERSON COSTIGAN: So just as a follow-up, and then Mr. Gillihan I'll call on you, the -- if I sign the ballot and I fill nothing out, all that's reported back is that a white male age whatever submitted, not that I completed the ballot, not completed the ballot? We're capturing who I voted for? You're not even capturing I voted.

OPERATIONS SUPPORT SERVICES DIVISION CHIEF MALM:
You are not capturing who you voted for, but I am -- they, the third-party vendor, is capturing in the system that you voted, so that you are not able to vote a second or third time.

CHAIRPERSON COSTIGAN: Correct. So it's very similar to going to a polling location and signing in, so they have a record that I showed up, that I signed up, but they don't know --

OPERATIONS SUPPORT SERVICES DIVISION CHIEF MALM:
How you voted.

CHAIRPERSON COSTIGAN: All they know is I pulled a ballot --

OPERATIONS SUPPORT SERVICES DIVISION CHIEF MALM:
That's correct.

CHAIRPERSON COSTIGAN: -- but they don't know what I did with it.

OPERATIONS SUPPORT SERVICES DIVISION CHIEF MALM: That's correct.

CHAIRPERSON COSTIGAN: And so -- so I can understand --

OPERATIONS SUPPORT SERVICES DIVISION CHIEF MALM: But you do have to sign the perjury statement for it to be valid.

CHAIRPERSON COSTIGAN: Correct. But I'm just trying to get at is that the way it's audited is that they don't know who you voted for. So in the event that Mr. Jelincic would vote for me one day when I'm running, that --

(Laughter.)

CHAIRPERSON COSTIGAN: -- no one would ever know that.

OPERATIONS SUPPORT SERVICES DIVISION CHIEF MALM: That's correct.

(Laughter.)

CHAIRPERSON COSTIGAN: That's the at-large.

OPERATIONS SUPPORT SERVICES DIVISION CHIEF MALM: That's correct.

CHAIRPERSON COSTIGAN: Just looking out for you, J.J..

OPERATIONS SUPPORT SERVICES DIVISION CHIEF MALM:

That's correct.

CHAIRPERSON COSTIGAN: But from that standpoint, did we get any feedback from anybody concerning this provision?

OPERATIONS SUPPORT SERVICES DIVISION CHIEF MALM:

No.

CHAIRPERSON COSTIGAN: Okay. Mr. Gillihan.

COMMITTEE MEMBER GILLIHAN: Thank you, Mr. Chair.

I'd just like to move the staff recommendation that we approve the proposed regulations. Oh, then I'd like to second.

CHAIRPERSON COSTIGAN: All right. I'm going to call Mr. Jones now.

COMMITTEE MEMBER JONES: Yeah. Thank you. Clarification. Mr. Costigan said that it would indicate that male white voted. Ethnicity on those ballots?

OPERATIONS SUPPORT SERVICES DIVISION CHIEF MALM:

No, sir.

CHAIRPERSON COSTIGAN: You said demographic, so I was just trying to get at what's --

OPERATIONS SUPPORT SERVICES DIVISION CHIEF MALM:

It's gender, it's age, groups, it's employer. And it's the reports that you receive after every election of demographics.

CHAIRPERSON COSTIGAN: I was just curious when she said demographics. The same thing. We're on the same page. So it's just really -- then it's just age, gender, and location.

OPERATIONS SUPPORT SERVICES DIVISION CHIEF MALM: And employer.

CHAIRPERSON COSTIGAN: And employer.

OPERATIONS SUPPORT SERVICES DIVISION CHIEF MALM: Yes.

CHAIRPERSON COSTIGAN: So we're actually just capturing four pieces of information.

OPERATIONS SUPPORT SERVICES DIVISION CHIEF MALM: Um-hmm.

CHAIRPERSON COSTIGAN: Okay. All right. Any other questions?

Seeing none. It has been moved and seconded.

All in favor?

(Ayes.)

CHAIRPERSON COSTIGAN: Opposed?

I have Mr. -- Oh, I'm sorry Mr. Linn. I'm so sorry. So sorry, and after I called you up.

All right. Let's give Mr. Linn three minutes. We're not voting.

MR. LINN: First of all, I'm George Linn. I'm president of RPEA. I applaud the fact that CalPERS has looked into trying to find ways to encourage members to vote. The last few elections I don't think have been successful in encouraging members to vote, and I think this is a good process. I'm also encouraged by the fact that we're going to offer electronic voting. I think this is the way of the future. It's -- while it's cost savings, I think it is also where the future is with these kinds of organizations.

And while there may be some bumps and grinds along the way, as there always is with new processes, I think that the things have been set down in place, so that these can be addressed as they come up. And I applaud Kim for working on getting this process put forth.

CHAIRPERSON COSTIGAN: And, Mr. Linn, before you go, I appreciate you being here. Also, we would love to appreciate feedback from you and your members actually as to the use of technology. We recently had a discussion as to demographics, use of apps, smart phones, moving away from desktops, so...

MR. LINN: Well, and, you know, we had this other issue with the open enrollment and the opting in, opting out, and I'm glad to see that this process provides for the individual to make that choice at the point in time that they want to vote. So I think that it was well thought out.

CHAIRPERSON COSTIGAN: Great. And your feedback would be greatly appreciated as we move to using more technology as to how best to serve the folks you represent.

MR. LINN: And I can assure that we -- as we have in the past in our publications, we'll encourage our members to vote.

CHAIRPERSON COSTIGAN: Thank you, sir.

Just be careful with the logo.

I know. That was a joke. I get it.

All right. Next item. Item 6.

Oh, I'm sorry, you guys have got me -- thanks, Mr. -- so it has been moved by Jones, seconded by Gillihan

All those in favor?

(Ayes.)

CHAIRPERSON COSTIGAN: Opposed?

(No.)

CHAIRPERSON COSTIGAN: Please note Mr. Jelincic voting no.

Next item, Item 6, Mr. Hoffner.

INTERIM CHIEF EXECUTIVE OFFICER HOFFNER: Good morning, Mr. Chair, members of the Committee. Doug Hoffner, CalPERS staff.

(Thereupon an overhead presentation was presented as follows.)

INTERIM CHIEF EXECUTIVE OFFICER HOFFNER: We're not quite ready for that yet, but let me -- I'm going to be joined by my colleague Laurie Weir here to make this presentation regarding the annual diversity report.

So, one, I'll highlight the overall enterprise activity for the last fiscal year. In your materials, as attachment 1, is the annual report. Now, I've got a little more pretty version of it that we'll be pushing out through social media later today with a press release. But the material contained in agenda item is consistent with this document.

What I wanted to do is first go through that enterprise report, and then have Laurie identify the work that we and others have been doing in the Investment Office as it relates to diversity and inclusion and the 2020 Vision. And then finally, there's some documents that relate to CalPERS demographics, which you sort of just discussed a little bit, as it relates to our workforce.

So with that, let me just sort of kick-off the annual report. I'm not going to go through all of it, as you have it in front of you, but I wanted to make a few highlights as to the work we've been doing in diversity and inclusion space here at CalPERS.

As many of you know, this is a close collaboration across many different divisions. So while the program is housed within the CalPERS Diversity and Outreach Program, we work with our partners across Human Resources, and the different programs to help bring and tie these issues together. We have a significant focus on our workforce, what it is that the talent that we have in CalPERS and how we can develop and retain that, in addition to recruiting as well.

The focus on or workforce, how we can actively educate and inform our employees about diversity and inclusion and create an organization that includes respect and accountability for all individuals.

And then there's an emphasis on our marketplace, and the ability to serve our members, both internally and externally across the different programs that we have.

I want to highlight a few of the things we've been working on related to talent. We continue to be, what we call, a destination employer in the State of California. Last year, we received 55,000 applications for approximately 600 jobs. Now, that doesn't mean we have -- we don't have work to do. I think the emphasis that we'd want to place on that is our ability to continue to go out and recruit in very technical spaces for the talent that we can't bring and develop internally. But the hope is that we are gaining traditional talent through social and other media aspects. But given some changes to the State's rules this last year or so, we have a greater ability to also look into the private sector, not just in the investment operations, which is something you're very familiar with.

So we're looking to apply some of those skills to other portions of the organization to again help us recruit from a broad range of talents across the needs we have here at CalPERS.

We'll be having more information on this specific item in November, as we have the Annual Workforce Strategic Plan Report in the Performance, Comp, and Talent Management Committee. So we'll have a fuller agenda item there. But I wanted to highlight the fact that we had so many individuals looking to come work at CalPERS over the last year.

Highlighting generational demographics which we'll get into in a minute, but wanted to talk about the shift that we've talked about within the four generations. We've got Traditionalists. We've got Baby Boomers, Gen Xers, and Millennials.

I think two years ago, we were at a ratio of about 45, 46 percent of our workforce being Gen Xers, with the second largest population within that space as Baby Boomers. And then the third with Millennials. We've seen in the last 2 years that Millennials have actually out paced our Baby Boomers now. They're actually a higher percentage of the workforce in the last 2 years. That's a dramatic shift. And so you're going to look at, and you'll see in the later slides, is how much that's taken over. It's almost a 0 sum factor in terms of the retirements and loss of the Baby Boomers and the increase in our Millennial population, which will drive additional work that we'll be doing in the organization.

Third, I want to talk about culture. You know, it's what we talk about as though it drives an organization. And while we'll have a fuller agenda item on this in November as well, we have taken our third Organizational Health Index Survey. We've done this every 3 years since 2010. Culture and climate is the one item that continues to outpace all others here at CalPERS. It's the one thing that is on top of the list every time we do a survey, whether it's on 3-year cycle or on a more abbreviated sort of annual kind of identification.

I want to highlight the fact that in the last 3 years, we've seen a 7 percent increase in the overall enterprise score as the health of CalPERS. That's -- that outpaces our five percent performance plan objective we identified to the Board in our strategic measures. And we'll be talking more about this tomorrow in our strategic plan of workshop.

But again, it's -- we beat our benchmark in terms of what we anticipated we'd be doing. Again, that culture and climate, what makes people want to come and stay and work here at CalPERS has been outpacing any other item there.

I would highlight further that of the 9 categories that are ranked within this survey, 8 out of 9 went up dramatically. We were one point shy of being what is called a top quartile organization, based on the study methodology that was used. We had a 69 percent score. Seventy would have put us at the top quartile. That's a dramatic improvement from where we were 3 years ago, in the second quartile space.

So again, that's something I want to highlight. And both Doug McKeever and myself will be further discussing this in November at a pending agenda item.

Coming to training and development of the organization. I'm also pleased to report that over 1,300 of our nearly 2,800 employees participated in D&I, diversity and inclusion, training and development activities last year. These are things like training on unconscious bias, cultural competency, LGBT and gender identity issues in the workplace, color lingo, talking about how to communicate and what your communication styles are, and how you apply that in a team environment to get the most out of your peers and your employees.

I talk about our generational differences and how we all do things differently, depending on sort of the makeup of how we were, not only raised, but the experiences we grew through.

And then informal mentoring. This comes from the top. Anne Stausboll is no long with us. She's enjoying her retirement, but she very much instilled an informal mentoring culture here at CalPERS, which we further embraced and it really sort of helped instill across the organization.

Just to highlight some of the things that she helped lead us on in terms of informal mentoring was a whole series of programs related to not only mentoring your manager, development of a program called Illuminet, which I mentioned previously. It's a development of an internal, what we call, kind of like a LinkedIn for CalPERS employees to voluntarily raise their hand to say I'd like to be mentored or I'd like to be -- I'd like to mentor somebody else, again within your peer program or across the organization to help further develop skill sets we think that will be broadly applied to the organization as we move forward.

So with those things, those are key aspects that the employees tend to say that they really enjoy and appreciate, again on a voluntary basis. But the fact is, we are having a culture that allows that to occur, and we pay close attention to the feedback.

I also want to identify the employee resource groups. They're very powerful and vibrant organizations here at CalPERS. Two I want to call out, the Diversity and Inclusion Group, and our Disability Advisory Committee. Just to highlight for you, our Diversity and Inclusion Group was just nominated and accepted an ward for being within the top 25 resource groups across the country.

This is for both government, corporate sector, and non-profits. So the people and the companies that we invest in are receiving these types of awards as well. And we're being recognized as a governmental entity in that same space. That was for the current fiscal year, so I can't quite report it for this annual cycle. But I wanted to highlight that for you, given it's something that we've not achieved in the past. But again, it's putting us on the same kind of plane with some of our corporate partners that we're doing business with.

In addition, I want to just highlight a little bit more about the organization. We've got nearly 2,800 employees. We speak 33 different languages here at CalPERS, from many different countries and origins. And I wanted to sort of further elaborate on that the work we'll do tomorrow in strategic planning for the next 5 years we'll talk about our talent base, we'll talk about some of the reporting we're looking to get your feedback and approval on in terms of reporting these kinds of demographics and information out in the future, and really elaborate on the type of work that we look to do, as well as highlight the skills of our employees.

So with that, I'll just -- I'll see if there's questions. And if not, I'll let Laurie speak for a few minutes and we'll hit the slides.

CHAIRPERSON COSTIGAN: Okay.

INVESTMENT DIRECTOR WEIR: Good morning, Committee members. Laurie Weir, Investment Office.

The Investment Office has established a D&I Steering Committee, and importantly as well, an Investment Office Diversity and Inclusion 2020 Plan. And I'll talk about that a bit today.

The plan guides decisions and engagement, and establishes initiatives to be undertaken between now and June 30th of 2020. The plan and initiatives are consistent with what has been presented recently to the Investment Committee via Global Governance's ESG Integration and Human Capital presentations.

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INVESTMENT DIRECTOR WEIR: The plan is guided by the Investment Beliefs, in particular that diversity of talent is important, that long-term value creation requires effective management of human capital, and investment decisions may reflect wider stakeholder views.

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INVESTMENT DIRECTOR WEIR: The plan details the efforts we will undertake to increase diversity on corporate boards, to increase the diversity of our external investment managers, and to increase our own diversity through talent management initiatives.

Each of these initiatives will be further described in detailed workplans. The steering committee will approve each of the initiative's workplans prior to staff starting work.

And there are two items in particular that I wanted to provide a brief update on today. They are the Diverse Director Database, and our emerging manager 5-year plan.

So with respect to the Diverse Director Data Source, staff engaged in a thorough process to identify a new owner of 3D. A consultant and staff reviewed 30 possible candidates, and we received expressions of interest from 5 firms. We selected Equilar as the new owner, and are currently working with MSCI to transfer the ownership duties of 3D from MSCI to Equilar.

Equilar was selected as the new owner for the following reasons: Equilar provides access to a fully completed state-of-the-art technology at no cost to us. Whereas other candidates would have had to create a technological platform at what could have been a substantial cost to us.

Second, we have the opportunity to leverage their existing store of diverse talent including over 15,000 women in their current database.

And finally, Equilar is a diverse firm exhibiting strong passion for both the technology and the mission to diversify corporate boards. So we look upon our work with 3D and the establishment of Equilar as the new owner of 3D. By the way, we do this in concert with and linking arms with CalSTRS. We see Equilar as the hub of the wheel of our work around 3D.

Our goal over time is to include spokes to that wheel. One of the spokes that we are working with currently is Leader Exchange. Many of you are familiar with Sophie L'Hélias, and the work that we have done with her to plan on three events across the country, where we provide networking opportunities between board secretaries and board chairs that have openings on their corporate boards with diverse, qualified talent, so that we begin to bring and make connection between diverse board talent and potential openings on corporate boards.

Over time, we hope to bring more spokes into this important wheel. For instance, one of the organizations we're currently talking with is the Toigo Foundation. Toigo has a board database themselves. It is specifically designed for their fellows and alumni to try to create a link between the corporate board community and opportunities on corporate boards, and these incredible diverse professionals that Toigo has nurtured over the years. We are working with Toigo currently to see if there aren't opportunities to partner and work together on this important topic.

We also have informally identified other organizations over the coming months and years. We will be working with them, and we will bring to you and report back to you a more complete wheel, which has Equilar in the center as the owner, and a number of these important spokes that bring our full picture of board diversity initiatives into focus.

With that, I'm going to transition for a moment to an update on our work with our emerging manager 5-year plan.

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INVESTMENT DIRECTOR WEIR: As you know, all of the initiatives under this plan are complete. Staff has elected to continue to work on ongoing initiatives, and we will continue to work on those ongoing initiatives through the end of the plan, which is June 30th of 2017. Staff will submit a final report to the legislature as required no later than March of 2018.

However, in December of this year, staff intends to bring a draft emerging and transition manager 2020 plan to the Investment Committee. The plan will commence July 1, 2017 and end June 30th of 2020. The new plan is intended to carry on the work that we started under the first 5-year plan and focus on initiatives that are intended to maintain CalPERS leadership in emerging and transition manager investment programs, continue our transparency in tracking and reporting our exposure, our costs, and our performance with investing with emerging and transition managers, continue our external outreach initiatives hosting and attending events, and finally to continue our strong presence in emerging and transition manager networks and organizations.

And that ends my formal presentation today. I'm happy to answer questions, but I also turn it over to Doug to talk about our demographics work.

CHAIRPERSON COSTIGAN: So before we get to Mr. Hoffner, any questions from the Committee?

If not, Ms. Mathur.

BOARD MEMBER MATHUR: Thank you. Thank you very much for your presentation on the diversity and inclusion plan. I have a question about the corporate boards piece. And forgive me if this is more Anne Simpson's wheelhouse than yours in this particular component. But one of the things that we've been talking about is that part of the challenge of getting increased diversity on corporate boards is that board tenures on existing boards is lengthening. That board -- that there's not enough turnover to really provide room for new individuals to take up those seats.

And so we have talked about, well, what -- should there be a term -- should we support term limits or some other mechanism to encourage greater turnover on corporate boards? And do you have any insights to share at this time about when we might consider options around that?

INVESTMENT DIRECTOR WEIR: I wish I had memorized the human capital presentation timeline. I can picture it in my head. And I know this is something that Anne Simpson and her team intend to pursue, and I'd like to be able to tell you the exact year and date that we would initiate that work. I do think it's soon.

BOARD MEMBER MATHUR: Yeah.

INVESTMENT DIRECTOR WEIR: But suffice to say, the answer to your question is yes, that is definitely on the plate of work that we will be doing around board diversity. And I think it's just a matter of at what point do we start that initiative.

BOARD MEMBER MATHUR: Okay.

INVESTMENT DIRECTOR WEIR: So it is definitely on that chart that was presented to you in April.

BOARD MEMBER MATHUR: Yes. All right. Thank you.

CHAIRPERSON COSTIGAN: Ms. Paquin.

ACTING COMMITTEE MEMBER PAQUIN: Thank you. I was just curious about the timeline for developing the establish manager outreach in the surveys?

INVESTMENT DIRECTOR WEIR: Moving back to my notes here. We have under our efforts to increase diversity with external investment managers, one of our initiatives is to survey our managers, which frankly we did several years back, and ask them, along with all of our consultants, what is their diversity and their key competency positions. We intend to do that again.

Based on the human capital presentation that was presented to the Investment Committee in April, that work will start in year two of this plan, and -- which is 2017, and will continue through year 3 of the plan.

ACTING COMMITTEE MEMBER PAQUIN: Thank you.

CHAIRPERSON COSTIGAN: Mr. Jones.

COMMITTEE MEMBER JONES: Yeah. Thank you, Mr. Chair. First of all, I would just like to congratulate Laurie for her outstanding work in this space. I've attended a number of diversity conferences and workshops. And I just wanted to say that Laurie has represented CalPERS very well. And so we appreciate all the work you do, and we're just -- we're going to miss you, but I want to thank you for all you do.

INVESTMENT DIRECTOR WEIR: And I you.

COMMITTEE MEMBER JONES: And also on the question of the new owner of the 3D, will our 3D remain separate or would it be integrated into these other two profiles?

INVESTMENT DIRECTOR WEIR: It will be integrated into the Equilar database. Quite frankly, as we reviewed the world of opportunities that out there with respect to a database of this kind, we felt that the Equilar database was superior to ours, and that we would benefit by porting that information into their system. It is far more user-friendly, and it is a system that will benefit both us and CalSTRS very well.

COMMITTEE MEMBER JONES: And will there be a charge for new members participation?

INVESTMENT DIRECTOR WEIR: Not that I'm aware of, no.

COMMITTEE MEMBER JONES: Okay. Okay. All right. Then the last one I guess is for Doug. And I recognize that we're embarking upon a -- pretty soon the new CEA -- the new CEO coming on board, but I don't want to lose the conversation that, Mr. Chair, where you directed staff to pursue the possibility of elevating the Chief Diversity Officer. So I just want to be sure that that continues on. And I recognize that, you know, we've got a short time frame here until the new CEO is on board, but I just don't want to lose that.

CHAIRPERSON COSTIGAN: And Mr. Jones, we are working on that.

COMMITTEE MEMBER JONES: Okay.

CHAIRPERSON COSTIGAN: There's a civil service process related to positions. And, in fact, we can talk to the Director of CalHR. We were having a side-bar conversation on another CEA position.

COMMITTEE MEMBER JONES: Okay. Thank you.

INTERIM CHIEF EXECUTIVE OFFICER HOFFNER: Thank you. Without any other questions, I'll just transition to some demographic slides that we've --

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INTERIM CHIEF EXECUTIVE OFFICER HOFFNER: Go the other way.

While those load, I'll just talk briefly.

Before -- let me just give you the caveats. So I'm just going to provide four or five slides here that -- it's information you've seen over the last 3 or 4 years related to demographics within the organization. I want to highlight the fact that as we've talked about in the previous 3 or 4 years -- thank you -- there's sort of a caveat.

So we're looking at ethnicity of the employees as compared to the CalPERS members. This information is derived from a company called Epsilon, which does a lot of marketing, communication. And this is use of an algorithm. So we do know, and we've talked about this before, that the level of participation by employees as it relates to this voluntary question about their ethnicity gets a fairly low response rate.

And so we've used a proxy, which is this Epsilon data, which is the footnote at the bottom to talk about this. So again, the methodology we've used is consistent for the last 3 or 4 years. I don't think that you're going to see any data points that really jump out at you being different from the last 3 or 4 years.

This is an effective proxy when you look at large numbers. But as we get into looking at data sets that are smaller, there's probably some -- a different approach that we'll need to take. But I wanted to highlight it for you, given the fact that the last report I saw was about 9 percent of State employees actually respond to these surveys on average. So data in, data out, and I'll just leave it at that.

So you can see the range between the different ethnic groups within CalPERS compared to our members, based upon this algorithm. It's fairly consistent in the lay in the last 3 years. So I don't -- without questions, I'll move on to the next slide, Mr. Chair.

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INTERIM CHIEF EXECUTIVE OFFICER HOFFNER: As we look at the comparison, we've also done a run, as the Committee has asked for, as we compare to the Sacramento County region, given that's where the vast majority of our employees live, other than the folks in the regional offices. But again, this captures nearly everybody that comes to the headquarters here. There are some outliers outside of the county, but it gives you a good proxy for that. And again, this is consistent with the prior year's reporting.

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INTERIM CHIEF EXECUTIVE OFFICER HOFFNER: And then we can look at it as a break down between managers and supervisors. And we see here the differentiation across multiple groups, again consistent with prior year documentation and reports back again used on this algorithm.

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INTERIM CHIEF EXECUTIVE OFFICER HOFFNER: And finally, I mentioned this earlier, and I think the slides may be inverted, but as we look at the individual people here, Millennials are outpacing the Boomers, even though I don't think it fully accounts for it by accounting the blue people up there.

It is a fact that it is -- it has changed in the last couple years. And at the end of the day, we're going to continue to see additional change within the organization shifting to a younger demographic, based upon this information. You can identify that we have four traditionalists that work here. I think the number, as of past July is probably 2, as they go on into retirement and do other things.

But -- so we're going to see a change in the overall make-up of the organization from a generational perspective as well, and we'll continue to report on that.

I don't have the comparison to what the statewide average looks like at this point, but that's something we can look at in the future to see how we're outpacing or are consistent with data that CalHR would be pulling together from that point.

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INTERIM CHIEF EXECUTIVE OFFICER HOFFNER: And then finally, I just want to identify, I think last time we reported we had a 60/40 split between the genders with the female population. This year it's at 59/41. And then we've played that out through the ranks. I don't have the slide that rolls it up through the supervisory levels, but we do have the data available, and it's fairly consistent across the organization in many respects as an enterprise.

So with that, Mr. Chair, that concludes my report and I'm happy to answer questions.

CHAIRPERSON COSTIGAN: All right. Mr. Hoffner, Ms. Weir, we really do appreciate the report, the work that goes in. And again, as I made my comments at the top of our committee meeting, the amount of information that we do try to make available is stunning, the amount of work that you all put into it.

I mean, this is again great information for particularly Mr. Jones and his Committee on the Investment Committee and the work that you're doing in that area, and then on the HR aspect of it. So I see no questions.

Thank you both very much.

INTERIM CHIEF EXECUTIVE OFFICER HOFFNER: Thank you very much.

CHAIRPERSON COSTIGAN: All right, Ms. Eason, our next item.

CHIEF FINANCIAL OFFICER EASON: Thank you. Cheryl Eason, CalPERS staff. This is the risk profile review. We presented a new enterprise risk management framework to the Risk and Audit Committee in June of 2016 that reduced the number of risks from 30 to 10, more focused enterprise level risks.

Each of these 10 enterprise risks listed in attachment 1 -- as summarized in attachment 1 has a corresponding risk profile sheet, which includes risk drivers and mitigations. And each of those risk profiles are assigned to a committee.

The Finance and Administration Committee has direct oversight for the following enterprise risks: Business continuity, data management, information security, operational efficiency, stakeholder confidence, and pension funding.

I just want to take a moment to point out the question that was raised in the Investment Committee yesterday by Mr. Jelincic. The investment risk elements of pension funding was presented at the Investment Committee. And the inquiry related to pension funding, Risk Driver number 4, regarding the mitigation for liability volatility, which was the actuarial smoothing policy.

And recognizing that the smoothing policy also has, as it spreads the employer payments over time, over a longer period of time, that could, in fact, add risk to the system by potentially impacting funded status and plan termination liabilities.

And so in anticipation, and as part of the review of the risk profiles, the amortization schedule risk is actually contemplated as a separate risk driver, which we've included in the Risk Driver number 2 that takes -- that I believe takes into consideration the question from Mr. Jelincic yesterday.

The overall format of the risk management framework will be presented to the Risk and Audit Committee later today, but we welcome this Committee's comments and feedback on the 6 risk profiles before you, and would then incorporate those comments into the enterprise risk dashboard that is presented in November to the Risk and Audit Committee.

And with that, I will pause to see if there are any questions or comments from myself or Brad Pacheco or Doug Hoffner who also have information regarding their specific risk profiles.

CHAIRPERSON COSTIGAN: So why don't hear first from Mr. Hoffner and Mr. Pacheco and then we'll see if there are questions.

INTERIM CHIEF EXECUTIVE OFFICER HOFFNER: Doug Hoffner, CalPERS staff. Basically, I was just going to walk through any questions you might have had. I have four specific risk drivers here related to business continuity, talent management, information security, and operational efficiency.

So I didn't know if there's a specific one that any of the Board members were interested in. There's a lot of interrelation between the business continuity and information security, particularly as we look to, one, have external threats against the organization, which we've talked about in previous sessions, how do we look to resolve and deal with those on a going forward basis, what are the impacts to the organization from a talent perspective over an operational perspective here on property?

And there's a fair amount of work that we're doing in terms of the alignment of our responses to these risks across the enterprise, which is a major component of the work that we're doing to ensure that we're consistent and not siloed in how we approach threats against the organization.

From a talent perspective, this is sort of the feedback that you've heard in some prior discussions at different committees. How do we look at the talent of the organization? It's a major driver of the work that we do. If we don't have the appropriate talent internally developed and promoted, we have to figure out how we're going to get those folks externally and other places.

Again, this is an item that we've also aligned with our workforce strategic plan, as well as the next 5-year strategic plan discussion we'll have tomorrow. The emphasis there is really on mitigating those threats and risks in each program area, which are quite unique and different in terms of their needs in order to function from a talent perspective.

And operational efficiencies, at the end of the day, is looking at how we can do things in a more efficient and effective manner. We've talked previously about using a cost effective measurement as a tool to help identify the areas that may be more costly in terms of running the organization. And this emphasis will be about how do we help align, based upon that data, and maybe changes statutorily or otherwise, that will be necessary to help be more efficient as we move this organization forward. And there's various impacts associated with that from this point.

CHAIRPERSON COSTIGAN: So before -- are you done, Mr. Hoffner?

INTERIM CHIEF EXECUTIVE OFFICER HOFFNER: Yeah.

CHAIRPERSON COSTIGAN: Okay. So a couple things. First of all, I do just want to reiterate, you guys are doing a fantastic job in looking at threats to the organization. I know that oftentimes we can't talk about that publicly, because we'd be telling the folks what we're up to. So I just do want to assure folks that what we do get from both IT and from Mr. Hoffner's operation really is that we understand what the external threats are and are continuing to focus on that.

A lot of credit to Mr. Bilbrey, and to Ms. Mathur just on talent management. I know we have done an extensive exercise as related to the Investment Office. And I know that over the next few months we'll be looking at other departments as well.

So we do have a few questions for Mr. Hoffner, is that right, Mr. Jelincic and Mr. Slaton?

Okay. Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: Yeah. On the business continuity, the Effect of Risk Mitigation number 1, hired a consultant to identify critical business functions. Can you -- what does that mean? I mean, it seems to me that we first have to explain the business to him so he can figure out what our critical functions are, so what --

INTERIM CHIEF EXECUTIVE OFFICER HOFFNER: Let me dive into that one. So we effectively had each program, each division has a business continuity plan. What we needed to do was to raise that to the level of an enterprise plan, so that it was interconnected with the work that we do.

Frankly, at the end of the day, in many respects, when you ask folk what is critical to their needs to be able to operate and do their jobs on a daily basis, they put everything from their perspective at the front of the line. And at the end of the day, we needed to take that information, consistently using a methodology, and that's why the consultant was brought in, across the different 32 divisions of CalPERS, and really help identify what is critical to -- from a business continuity perspective, the operations of this organization on a going forward basis.

And at the end of the day, there's going to be a lot things that get trumped by the need to pay benefits, the ability to trade from an investment perspective, our interaction with the State Controller's office to the degree we do certain things. They still make the payment on behalf of the System to the member.

So a lot of that was to elevate and identify and make sure we have a consistent enterprises approach, so it's not 32 separate, distinct, individual plans that don't necessarily -- there's a little bit sort of forced ranking that needs to go into the methodology. And that was the approach you're bringing the consultant in to help drive to that conclusion.

COMMITTEE MEMBER JELINCIC: Okay. And on data management risk driver -- down residual risk, future mitigations, Risk Driver 2. What exactly is that and was it completed by August 16th?

INTERIM CHIEF EXECUTIVE OFFICER HOFFNER: So are you asking about the Data Management Risk Profile?

COMMITTEE MEMBER JELINCIC: Yes.

INTERIM CHIEF EXECUTIVE OFFICER HOFFNER: Okay. That's -- I'll --

COMMITTEE MEMBER JELINCIC: And it's 245 of the iPad. I don't know what it --

INTERIM CHIEF EXECUTIVE OFFICER HOFFNER: Right. So that's under a -- I'm not the owner of that item, so...

CHIEF FINANCIAL OFFICER EASON: Yeah. Kristin Montgomery our Controller will join us. She actually chairs the committee that we have around data management.

CONTROLLER MONTGOMERY: Kristin Montgomery, CalPERS staff. We have not completed the -- you're asking about the charter, is that correct, at the bottom of --

COMMITTEE MEMBER JELINCIC: Well, it's bottom of page -- attachment 2, 3 of 7, the future mitigation, Risk Driver 2, is availability of reports and systems. What are the reports and systems, and --

CONTROLLER MONTGOMERY: Yes, that was implemented in August. It's in our my|CalPERS system. And what we did with this is it's really important to define who owns the data, and especially our employer data, so appointment information -- member appointment information. So we wanted to be able to give our employers proactive reporting. And so we developed this so that they can go out, they can look at it and say, oh, this member appointment I need to fix this information, so that we can get the data in our system accurate.

COMMITTEE MEMBER JELINCIC: Thank you.

CONTROLLER MONTGOMERY: You're welcome.

CHAIRPERSON COSTIGAN: Don't go far, just in case.

Mr. Slaton.

COMMITTEE MEMBER SLATON: Thank you, Mr. Chair.

On the information security side, and I'm looking at Risk Driver 1, which talks about security training and -- annually for existing employees, and within I think it -- there's a space added, but I think they mean 90 days of hire for new employees. It just seems to me that 90 days is a long time, especially if employees have access to desktop PCs, et cetera. A problem can occur pretty darn fast.

So I would just suggest that maybe that be revisited. I think that's a very high priority. For me, that briefing would be in the first week of hire, if it -- if I were -- if it were my organization. So just thought I'd make that suggestion.

INTERIM CHIEF EXECUTIVE OFFICER HOFFNER: So I appreciate the observation and we'll take that back and look at the timing of when -- I see what it says, the 90 days, when it would actually typically occur. Then we can talk about making it a more proactive approach to getting that done earlier. So I appreciate the feedback.

COMMITTEE MEMBER SLATON: Thank you.

CHAIRPERSON COSTIGAN: Anything else on that item? Otherwise, we'll go to Mr. Pacheco.

DEPUTY EXECUTIVE OFFICER PACHECO: Thank you, Mr. Chairman. Brad Pacheco, CalPERS staff.

I'm happy to address any questions related to the risk drivers and mitigations that we've outlined for the risk profile on stakeholder confidence. In general, the mitigation steps outlined the efforts we've taken to build and maintain strong relationships with our stakeholders, ensure they have the information they need, and understand the policies and actions of the system.

It also addresses the work we do to protect the reputation of CalPERS, and maintain confidence by our members through all our communications channels, some of which we've been employing in the last couple days.

So with that, I'm happy to take any questions.

CHAIRPERSON COSTIGAN: Thank you.

Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: Just an encouragement on Risk Driver 2, 2.4, fulfill all public records requests. Encourage you to do that more quickly, but recognize sometimes -- and also I know that we occasionally will try to provide the minimum, even if we know that there's more that's there. And I just -- so I really encourage you to be fully cooperative. If it's a public records, it's a public record, they shouldn't have to threaten to sue us to get it.

DEPUTY EXECUTIVE OFFICER PACHECO: Thank you for that comment. Thank you.

CHAIRPERSON COSTIGAN: Thank you, Mr. Pacheco.

Okay. Any other comments, concerns, questions?

So we will now go to 7b, which is the Public Agency Contracts review. We will have one person from the audience who will be speaking. So if I forget, wave at me.

So, Ms. Eason.

CHIEF FINANCIAL OFFICER EASON: Okay. Thank you, Mr. Chair. Cheryl Eason, CalPERS staff.

Today's item regarding public agency contract review is an update to the information you've received in Agenda Item 7b. A public agency voluntarily chooses to provide retirement benefits to its employees and agrees to the statutory provisions governing the system, which includes timely payment of required contributions.

There are 3 contracting public agencies that are significantly delinquent on their pension payment obligations, which we wanted to bring to the Committee's attention today.

The City of Loyalton, who voluntarily terminated their contract in March 2013, the California Fairs Financing Authority, or CFFA, and the Niland Sanitary District, who has -- who both have inactive plans, therefore no active members, and have not yet terminated their contracts.

Staff's efforts to collect delinquent amounts owing to CalPERS has been going on for a prolonged time, and these agencies have not paid the amounts owed.

In response, on August 31st, 2016, CalPERS sent a final formal letter to each of these agencies requesting payment and providing 30 days to bring their accounts current. Mailed copies of the final demand letters have been sent to retirees whose benefits are subject to potential reduction if the delinquent amounts owed to

CalPERS are not resolved timely.

Staff will continue to work with each agency to resolve the issue. However, for failure to do so would require the adoption of a resolution by the Board in November to terminate their contracts, or in the case of Loyalton, declare the agency in default, which could lead to a reduction in members' retirement benefits.

And with that, I will take questions.

CHAIRPERSON COSTIGAN: Mr. Slaton.

COMMITTEE MEMBER SLATON: Thank you, Mr. Chair. A question about Loyalton. They terminated in March of 2013. Am I reading it -- the report correctly?

CHIEF FINANCIAL OFFICER EASON: That's correct.

COMMITTEE MEMBER SLATON: So -- and the PERL requires us to -- what's the time limit given for making timely payments?

CHIEF FINANCIAL OFFICER EASON: I'll --

COMMITTEE MEMBER SLATON: Is it 30 days or 60 days?

CHIEF FINANCIAL OFFICER EASON: Well -- so they have -- and I'm sure my staff will come up here, if I am incorrect in saying this, but they do have --

CHAIRPERSON COSTIGAN: Why don't we have them come up. Just go ahead and whoever needs to be up, please come up.

CHIEF FINANCIAL OFFICER EASON: So on termination of a contract, the agency has a year in order to respond and to file that paperwork. And so that's part of the process. We also go through a process to determine the actual benefits, the -- confirm the member. So there is somewhat of a process that goes through, but that is a longer time period than we would normally have in terms of a termination.

COMMITTEE MEMBER SLATON: Yeah, but when did they -- they terminated on -- in March of 2013. So they gave us notice, and there's a time period where we have to verify what the termination amount is? Am I understanding it correctly?

CHAIRPERSON COSTIGAN: Can you turn on her mic, please?

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: Arnita Paige, CalPERS staff.

Once the agency terminates, they receive a termination bill, and then they have 30 days to pay that termination bill. If they do not pay it, then it goes into our -- it goes to our collections staff to attempt to recover the funds.

COMMITTEE MEMBER SLATON: So did they receive a bill in April of 2013?

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT

CHIEF PAIGE: Yes, they did.

COMMITTEE MEMBER SLATON: Okay. So within that month, we were able to calculate the numbers and give them a proper bill?

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: Correct.

COMMITTEE MEMBER SLATON: And so what -- why is this coming now and not after they didn't pay? It seems like it's an awful long time from April of 2013 to September of 2016. What happened in the interim?

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: Well, when an employer cannot pay, that -- the account actually goes to our collections team for collection. It was forwarded -- after multiple attempts tempts of collection, they did not pay, so it was forwarded to our case management team working on it to continue collection efforts. And we received that early this year. And so we did a deeper dive working with the employer to try to remedy the issues.

COMMITTEE MEMBER SLATON: It just raises the issue to me should there be -- you know, what's the policy of CalPERS in this regard, and, you know, what should the timing be? I know that in -- typically in -- this doesn't necessarily apply to the public sector, but in debt collection, the more time that goes --

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: Right.

COMMITTEE MEMBER SLATON: -- the less chance that the money is going to come in.

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: Well, here's what we've done. We've actually had to -- using -- utilizing these cases really informed practice. So what we've done working closely cross-divisionally with our collect -- and with our collections team, we've developed an escalation process. And as 30, 60, 90 day letters go out as well as 120 days letter, and then a final letter from our Controller. And then it is transferred over to -- then a letter will go out after that, a final demand letter, from our CFO, which was sent August -- the August 31st letter.

So we've actually had to go in and add additional processes. This -- actually, the City of Loyalton, as well as the other two cases you're going to hear really inform what we need to do going forward.

COMMITTEE MEMBER SLATON: So, but at this point, we don't have a policy in regard to the length of -- the maximum length of time from the time someone does not respond to that first demand until the time we declare them, as you're asking for this action today?

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT

CHIEF PAIGE: Well, we do have a -- our collections team I know has a -- we've been -- there's a draft policy in place right now to address that issue. Basically, at this point, it's still -- we're still revising that.

CHAIRPERSON COSTIGAN: So just to follow up on Mr. Slaton. I just want to do it from a timeline.

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: Sure.

CHAIRPERSON COSTIGAN: This organization voluntarily terminated in March of '13?

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: Correct.

CHAIRPERSON COSTIGAN: They received a true-up letter in April of '14?

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: Correct. And then --

CHAIRPERSON COSTIGAN: We haven't received any payment. I just want to make sure.

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: Okay. Sure.

CHAIRPERSON COSTIGAN: We've continued to pay benefits to their employees?

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: Um-hmm.

CHAIRPERSON COSTIGAN: As of today, almost 2½ years removed, regardless of whether they were in collection or not, and we're going to have to talk about process, because there are multiple questions here. The moment they quit paying, and the liability had been accruing, is both a collection issue and a payment of benefit issues.

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: Correct.

CHAIRPERSON COSTIGAN: And so we need to talk about both, the collection -- and Ms. Eason and I have talked about this, because I -- when the agenda item came up, and also with the other two, we have to do -- and it may have been the Board needs to just give you all more direction from a process. But to go 2½ years with Loyalton, since -- I want to be correct. They're the ones who asked for the termination?

CHIEF FINANCIAL OFFICER EASON: Yes. And so the -- there's also -- the city also requested to rescind termination. So there was some back and forth through this process as well, where they had asked for termination. They were going through filing of the information, and then they chose to rescind. So --

CHAIRPERSON COSTIGAN: So how does that work?

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: Well, when they actually put in a request to rescind, my understanding is that they would not be able to do that. Once you terminate, you terminate. So that request was denied.

CHAIRPERSON COSTIGAN: And, I'm sorry, I just don't understand the process as well. Is that the statute states that or is that CalPERS policy? So I terminate pursuant to a statute that I have the right to do that. And I know this is getting fairly technical --

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: Yeah, we did put a request in to receive legal counsel on that.

CHAIRPERSON COSTIGAN: Okay.

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: So maybe they can come up.

CHAIRPERSON COSTIGAN: All right, Matt.

And look, if we don't have all the answers, that's okay. I mean, we can have a further discussion in November, because this is an information item.

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: It is.

CHAIRPERSON COSTIGAN: But what I just would like to know are a couple things. One, what is the process? You know, once someone has hit that terminated agency, why is it not wrapped up within a year? So we need to work on that. And two, well both -- the second question is the continued payment of benefits. And the third question is what they've just posed is, can you come in, then can you go out, then can you go back in?

So I'm not interested in being whipsawed by saying do it, then don't do it, and then we'll run into the same problem. So maybe we --

GENERAL COUNSEL JACOBS: Yeah, I think your question to legal is the third one.

CHAIRPERSON COSTIGAN: Can they go back in, um-hmm.

GENERAL COUNSEL JACOBS: Right. And so I'm going to let my colleague here, Tom Noguerola, address that.

SENIOR STAFF COUNSEL NOGUEROLA: I think the short answer would be no. Under the statute, once you terminate you have to wait, I think, it's 3 years before you can seek to enter the system again.

CHAIRPERSON COSTIGAN: So they would have had to true-up completely.

SENIOR STAFF COUNSEL NOGUEROLA: Yes.

CHAIRPERSON COSTIGAN: So they're coming up on 3 years. They have not made the system. What happens in March of '17, they can petition to come back in?

SENIOR STAFF COUNSEL NOGUEROLA: Well, no. I think, at this point, if they don't true-up, we're seeking to have them held in default and then proceed with potential benefit reductions.

CHAIRPERSON COSTIGAN: Mr. Slaton, do you have further questions?

COMMITTEE MEMBER SLATON: Yeah, I just -- by the way, I think it's -- by my math, we're 3 years.

CHAIRPERSON COSTIGAN: Yeah, I was --

COMMITTEE MEMBER SLATON: Over 3 years in right now. So I just -- you know, look, these are not good situations that occur. There's no question about that. Everybody agrees with that. Whatever the circumstances that they faced as a local government entity to be able to withdraw, obviously it's not a easy decision to make.

I just want to make sure that we're clear, and that we treat every jurisdiction the same. If we have 3½ years go by before we're trying to, you know, get an ultimate resolution, I'm not sure that that's the way we want to do business. So I'm just -- I'm -- I don't have an answer today. It just strikes me as something that needs work, whether it be just staff process or whether it be Board direction. It seems to me that resolutions need to happen in a more timely fashion than 3½ years out.

CHAIRPERSON COSTIGAN: And Ms. Eason and I have had that conversation and we will probably be bringing something back, if we can't delegate it to staff, with an actual process, because what this has shown is that we --

and you need the enforcement of the Board backing you as these decisions are made.

An entity saying we may pay, we may not pay, and continue to drag out, we have dates and deadlines, and these are statutory requirements. And so, you know, Ms. Eason, we'll talk, but that will be staff direction -- or direction to staff for the November meeting that we bring back and have a more -- further discussion about process and potentially schedule it for an action item with dates. Thirty, 60, 90, it sounds as though we have a draft one. And then maybe a discussion on the legal aspects of both the statute, and how -- a little bit of primer on how you terminate and how you can come back in on the 3 years.

So we have a few more questions, so you all don't go anywhere.

Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: One of the issues we have is our statutory lien. And how does that fit into this and does it -- have we learned anything in this process that would suggest that we need to do some legislative changes to deal with that lien?

SENIOR STAFF COUNSEL NOGUEROLA: I think the short answer is --

CHAIRPERSON COSTIGAN: Lean in. Lean into the microphone, because I can't hear you.

SENIOR STAFF COUNSEL NOGUEROLA: I don't know that we've learned anything from this process that would suggest we need further legislation. I think invoking the lien or trying to perfect the lien would be a case-by-case basis. And I think at least for these three agencies, there are no assets, so not I'm not sure that it would be productive to try and place, you know, where there's nothing to place a lien on, so...

CHAIRPERSON COSTIGAN: Okay. Mr. Jones -- or Mr. Jelincic, anything else?

COMMITTEE MEMBER JELINCIC: No. But you know, it -- since the State collects their DMV fees and their sales tax, it seems to me there ought to be at least some asset that may be attackable. And I don't know the answer, but --

SENIOR STAFF COUNSEL NOGUEROLA: I think the other factor that would come into play is if there's a determination made that they couldn't pay all or a portion of the termination liability, whether there would be benefit reductions. And if we are cutting the benefits, there's really no purpose in placing a lien on trying to recover assets for amounts that we're not going to be paying out.

CHAIRPERSON COSTIGAN: Okay.

COMMITTEE MEMBER JELINCIC: Thank you.

CHAIRPERSON COSTIGAN: Ms. Mathur.

BOARD MEMBER MATHUR: Yeah. A few observations, maybe questions as well. One is that it -- as we're reevaluating the process by which we manage -- or we evaluate these types of termination situations, one of the things we might want to consider doing is not actually allowing the termination to go through until we are sure that the money is there to pay the termination payment.

So the timing of it, you know, just sort of relying on their verbal or certification that they'll be able to pay the termination payment maybe is not sufficient. Maybe we need some additional documentation and/or evidence that they can actually afford such a payment. Because, you know, even though we educate -- we educate employers that the termination payment is significantly higher than the annual contribution, maybe they're not hearing it or some -- I don't know. I don't know what the problem is.

With respect -- I mean, I'm very concerned about reducing benefits to our members. Obviously, that is not something we want to be in the business of doing. So I guess I would push a little bit further on this question of is there a way for us to attach to revenues that are coming into these cities to at least continue to make benefit payments at the appropriate -- at the level that they are currently being paid at. And how deeply have we explored that option?

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: Well, we do look at the financial statements for each of the 3 employers. They are financially distressed in this case, so we were not able to do that.

BOARD MEMBER MATHUR: So they are -- so I -- so in a regular bankruptcy -- an individual personal bankruptcy, you can attach to somebody's wages, et cetera. And that would be siphoned off even before it arrives in their bank account. Is that the case here where if there are revenues coming through the State, that we could attach before they even got to the city?

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: I'm not sure about that. Sorry, I'd have to look into that. I'm not sure.

CHAIRPERSON COSTIGAN: I mean, the question both is the attachment of revenues, the other is the -- is that revenue stream -- would that revenue stream be sufficient to pay their liabilities.

BOARD MEMBER MATHUR: Well, that's the second question.

CHAIRPERSON COSTIGAN: I mean you have many things moving. But I don't believe -- and this goes back to, I think, Mr. Jelincic's question, and again talk about

November is, does the statute even permit that, because we're not a revenue collector? And Mr. Gillihan has left at the right time.

(Laughter.)

CHAIRPERSON COSTIGAN: Is that -- that's a State function, and then the State transferring. Because as I understand it, we can seize an asset, but we can't -- and this is why we probably need --

BOARD MEMBER MATHUR: I don't know. That's the question.

CHAIRPERSON COSTIGAN: -- clarification in November is can we seize a revenue stream?

GENERAL COUNSEL JACOBS: I think there's all kinds of questions about this lien. And, I mean, it is in there, but it doesn't --

CHAIRPERSON COSTIGAN: They have no assets.

GENERAL COUNSEL JACOBS: -- say much beyond that. And I know there's problems with trying to attach a lien to revenue sources. You know, the municipalities have pretty much won on lawsuits that have attempted to do that. So a lot of questions about this lien.

As you may recall, the Stockton bankruptcy judge said it was invalid in bankruptcy, so there's a -- it's fuzzy what we can and can't do with this lien.

CHAIRPERSON COSTIGAN: Okay. But -- and that will be -- since again this is an informational item, so that would be something we'd like to flesh out for November.

BOARD MEMBER MATHUR: Yes. Thank you.

CHAIRPERSON COSTIGAN: All right. So we have several more questions.

Mr. Jones.

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

Yeah, I look at this as two components. The first component is that it happened, and nothing was done for a period of time. And the second component is that there are steps being taken now to create a process to deal with this kind of situation. And I think that as you said, Mr. Chair, that that is the next step, I believe, in support is having a process developed and presented to the Committee and have us opine on whether or not it's strong enough. And perhaps I don't know whether we will need additional legislation or not. But that can be part of the discussion after we see what the processes are to deal with these kind of situations.

My question though goes to this piece of two of these are voluntary terminations, is that correct?

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: We have --

CHAIRPERSON COSTIGAN: Microphone, please.

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: Excuse me. The City of Loyalton was a voluntary termination. Niland and CFFA, those are both active contracts that have not terminated.

COMMITTEE MEMBER JONES: So kind of go to Mrs. Mathur's question about not wanting to see our members lose their benefits. But if they voluntarily terminate, we don't have any say to suggest they can't do that, right?

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: That's correct.

COMMITTEE MEMBER JONES: So we don't have any authority to protect those members at that point when the agency actually voluntarily terminates.

CHAIRPERSON COSTIGAN: Because Loyalton, to Mr. Jones point, should true-up --

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: Correct.

CHAIRPERSON COSTIGAN: -- for the benefit. If they don't true-up, we have no discretion.

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: Absolutely.

CHAIRPERSON COSTIGAN: Because the only alternative is you have the assets that are left and then you run out the liabilities.

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: Correct.

COMMITTEE MEMBER JONES: Okay. So I'll wait to see the process.

CHAIRPERSON COSTIGAN: But again, we have -- I just want to be clear for November. We have multiple actions going on. First of all, we have these 3 agencies that will probably -- should come before us for an action item in November, separate and apart from the process question. But there should be a discussion about liens and revenue sources related to the actions on these three. It's a little bit different. I mean, we're 3 years in on Loyalton, so I'm not -- we're not going to have a discussion about another year process for them. Again, theirs was a voluntary termination.

All right. Ms. Paquin.

ACTING COMMITTEE MEMBER PAQUIN: Thank you. I'm just curious, other than these 3 employers, are there anybody else that you see in the pipeline? And how do you track agencies that may face the similar conditions as Niland?

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: We are -- we have identified a few other potential reporters. And basically, we're looking at delinquency reports that we have, as well as just whatever information we can find in terms of whatever we find in terms of just communication that we've had with them. So we are reviewing those, and we'll be reporting those up to our management.

CHIEF FINANCIAL OFFICER EASON: Also, what was added to the process, and I just want to mention that the whole contracts area has just recently moved into the Finance area, because we recognize that there's some breakdown in just making sure that we get to these collections sooner. And so this is all -- I think it's important to note that this is all new sort of uncharted territory, given that this would be the first time that we'd be looking at this situation.

But having said that, one of the things that we've added to the process is we do look at the State Controller's office work that they do in terms of the financials, and we compare that to our agencies. We also, from a collection perspective, ask that our collection team if they're finding that there's -- we start to see some delays in payments, or that payments are starting to be missed, we elevate that sooner than we have in the past.

So it's -- we certainly identify that there are ways that we need to strengthen that process and make it more timely. So we're hoping going forward that that's going to be a lot better process, and there is some clean-up that we have to do for sure.

ACTING COMMITTEE MEMBER PAQUIN: Thank you.

CHAIRPERSON COSTIGAN: Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: Have -- since this item was written, have we had any communications from Niland or CFFA --

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: We have.

COMMITTEE MEMBER JELINCIC: -- that gives us some hint on what's going on?

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: Yes. We did talk to Niland, and the response was that they're okay with the contract being terminated. Actually, last year, in February of 2015, they initiated a voluntary termination, but they did not complete the paperwork, which they could have, March this year forward, present to us to actually go through with a voluntarily termination. So they do not plan to pay the amounts owed on the contract. And they said they're okay with Board termination or involuntary termination.

In the case of the City of Loyalton, they are trying to raise funds. We are -- we have been having ongoing discussions with them. And we do plan to meet with them next week to listen to another proposal that their Board has come up with. And we'll send that information up upon receipt.

COMMITTEE MEMBER JELINCIC: And the CFFA.

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: And the CFFA, we also met with them last week, their Board, and they too are trying to raise the funds. And they will be contacting us on September 30th with their proposal.

CHAIRPERSON COSTIGAN: And it's my understanding in following up with Mr. Jelincic's question, we don't offer payment plans.

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: That is correct.

CHAIRPERSON COSTIGAN: So it's all or nothing? I mean, I just -- because it jeopardizes other organizations -- other members of our organization with the payment plan structure. So I just want to make sure that's out there that -- not a payment plan.

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: Thank you.

COMMITTEE MEMBER JELINCIC: Thank you.

CHAIRPERSON COSTIGAN: Mr. Slaton.

COMMITTEE MEMBER SLATON: Yea, just one other quick question. The Loyalton -- you know Loyalton is a very, very small town in Sierra County. They have a population 769 people. I don't know how many of those are children. And we have an obligation quoted of a million six --

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: Um-hmm, correct.

COMMITTEE MEMBER SLATON: -- over a million six. So, you know, you do that math. That's $2,000 for every human being that lives in the city, who's a resident.

What's the number of employees that we're talking about, the active and retirees. Do you happen to have that number?

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: Yes. We have a total of 4 retirees and 1 who's invested, so for a total of 5. So there are no active employees.

COMMITTEE MEMBER SLATON: No active employees.

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: Correct.

COMMITTEE MEMBER SLATON: There's five retirees, and the obligation is a million 661.

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: Correct.

COMMITTEE MEMBER SLATON: Wow. Well --

CHAIRPERSON COSTIGAN: Actually, we have, I believe, one of those folks who would like to make a public comment.

PENSION CONTRACT MANAGEMENT DIVISION ASSISTANT CHIEF PAIGE: He's here.

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

CHAIRPERSON COSTIGAN: Do we have any other questions before I call Mr. Cussins, if you'd still like to comment. Is it Cussins[cus-ins] or Cussins[cou-sins]?

MS. CUSSINS: It's Cussins[cus-ins]

CHAIRPERSON COSTIGAN: Cussins. Thank you.

MR. CUSSINS: Than you for the opportunity --

CHAIRPERSON COSTIGAN: Just have a seat, please. They'll turn on your microphone. And you'll have 3 minutes, but we'll give you additional time, you need it. So go ahead, sir.

MR. CUSSINS: Okay. Thank you for the opportunity to speak to you folks today. I am actually one of the retired employees, and I'm actually a board member right now. I came on the Board. I was just appointed to the Board last May. And I didn't really know what was all going on, because I'm a CalPERS recipient, because I had to retire because of my illnesses.

Until I got my notice, I didn't know what really kind of shape the City was on with CalPERS. I did notice on the bill sheets that we -- I never seen any money going to CalPERS or anything. And I'm here today representing the employees. We'd all met, and they requested me to come down and try to speak to you folks for any assistance we may get from you folks or anything or direction that you may be able to help us in, because we're like everybody else on CalPERS, we really depend on our pensions.

And there's multiple ones of us retired employees that have come back to try to help the city, and everything. I came back on-line to help them out with the water and sewer. They've actually been operating off my water and wastewater licenses for over a year and a half, and everything. You know, and I did it just out -- to try to help out.

So we're -- like I say, we're at the point now, we were hoping maybe the city could get back into CalPERS and make you guys payments or do something to try to, you know, make this right, and everything.

And I can say this much, I guess -- well, I'm going to say it anyhow. You know, there is some problems with the City's finances, bad problems that's gone on with the City's finances. You know, we went through quite an ordeal before we even passed the last audit report, because of discrepancies in the audit, and stuff, and where money has went to, there.

We personally feel the employees, you know, they fairly well misused money is our part of the deal, is the way we feel, you know -- and I guess -- like I say, I'm just -- we're looking for some kind of direction.

CHAIRPERSON COSTIGAN: Well, I believe that what we've -- at least what you do have is at least 60 days before the item will come back before the Board to work with Ms. Eason and her staff. We are bound by the statute, as you know, as to what our options are. And we understand, as Mr. Slaton pointed out, the difficulty of the situation.

MR. CUSSINS: Yes.

CHAIRPERSON COSTIGAN: And we struggle with it. As Ms. Mathur said, it is not taken lightly when we have to look at a reduction in benefits. But as the fiduciaries of the System, we have to look at it within that role. So I would strongly encourage you, and I appreciate you being here, to work with Ms. Eason and her team, and see if there's anything that can be done. And then we will also give you an opportunity, on -- when this item is on the November agenda to have a further discussion. But I do think we'll be taking some action at the November meeting.

MR. CUSSINS: Okay. Well, can I request that maybe the -- at least as far as us employees, since we're kind of joined together that we could be kept in the loop of what's going on?

CHAIRPERSON COSTIGAN: Talk to Ms. Eason. They'll do that. And we -- no, we will work with you. I mean, the five of you will be impacted by whatever the ultimate decision is. So just, first of all, thank you again for being here.

MR. CUSSINS: Thank you.

CHAIRPERSON COSTIGAN: And Ms. Eason will take -- will keep in touch with you.

MR. CUSSINS: Thank you.

CHAIRPERSON COSTIGAN: All right. Here's what we're going to do, folks. We are going to break for lunch. This next two items -- I know, Scott, very disappointing -- is that this -- the next items are going to be fairly long. And I don't want to take a break during the middle of it. I appreciate all of you all that have been sitting here waiting for the next 2 items to come up. But we will break until 12:45, Mr. President?

PRESIDENT FECKNER: (Nods head.)

CHAIRPERSON COSTIGAN: We will reconvene at 12:45. So we stand adjourned until then.

(Off record: 11:50 a.m.)

(Thereupon a lunch break was taken.)

A F T E R N O O N   S E S S I O N

(On record: 12:45 p.m.)

CHAIRPERSON COSTIGAN: Ms. Eason, we're going to go to the next item, if you'll start off, please, which I believe is 8.

CHIEF FINANCIAL OFFICER EASON: 8a.

INTERIM CHIEF ACTUARY TERANDO: Good afternoon, Mr. Chair members of the Committee. Scott Terando, CalPERS staff.

I'm joined by Julian Robinson. And he will be here to help present the valuation for the terminated agency pool.

This report --

CHAIRPERSON COSTIGAN: Could we get the back door, please.

Thank you.

Okay. Sorry, Scott.

INTERIM CHIEF ACTUARY TERANDO: Sure. This report presents the results of the terminated agency pool, and it sets forth the funded status for the risk pool, and provides additional actuarial information as of June 30th, 2014. At this point, I'll pass it on to Julian to provide more details.

SENIOR PENSION ACTUARY ROBINSON: Good afternoon, Mr. Chairman, members of the Finance and Administration

Committee. I'm Julian Robinson, CalPERS staff presenting Item 8a, Actuarial Valuation for the Terminated Agency Pool.

The good news, the terminated agency pool remains in a very strong financial position. The funded status of the terminated agency pool as of June 30, 2014 is 261.9 percent. The market value of assets exceeds the accrued liability by approximately $133 million.

The estimate for the funded status as of June 30, 2015, and we're currently working on that valuation, is 250 percent with a market value of assets exceeding the accrued liability by about $130 million.

As of June 30, 2014, there are 94 plans in the terminated agency pool. As of that date, there were 1,056 members in the pool, 733 pensioners and beneficiaries. The average pension is $544 per month. The total annual pensions of approximately $4.8 million has been paid. There are 323 terminated members in the pool. And, of course, there are no active members in the terminated pool.

The discount rate used in the valuation is 3.64 percent. This is based on the 30-year U.S. Treasury STRIPS. And we consistently use that rate from valuation to valuation.

As the cash flows in the TAP are matched through the immunized portfolio, the major risk to the TAP is mortality risk. We have measured this risk. If mortality rates improve uniformly by 10 percent, the funded status would drop by approximately 9 percent to 252.6 percent. If mortality rates, on the other hand, decline uniformly by 10 percent, the funded status would improve by 9 percent to 270.8 percent.

These are the highlights of the valuation results. I'd be happy to answer any questions which you have.

CHAIRPERSON COSTIGAN: So I have a couple. And I've learned so much about how living longer. So when you talk about a 10 percent increase, I know in the last -- and the months begin to roll together -- we've recently adopted longer life span. So if you -- the trend has been to longer life expectancy, not shorter life expectancy.

SENIOR PENSION ACTUARY ROBINSON: That's true, even though the improvement has been slowing down.

CHAIRPERSON COSTIGAN: And when -- just from a timing standpoint, when would we relook at mortality?

SENIOR PENSION ACTUARY ROBINSON: Well, we look at mortality as part of the overall experience study which we conduct every 4 years. So the terminated agency pool experience is also included with the rest of the -- all the State plans and the public agencies. And that gets done on a 4-year cycle. And we're going to launch into that starting at the end of this year and moving into 2017. And I believe the results will be presented sometime during 2017.

CHAIRPERSON COSTIGAN: No, thank you. I just again sort of want to point out as it relates back to comments at the top of the Committee meeting about the information that's available. And so again, as we go into valuations, and as we look at -- this is not something that's done in a vacuum. You take the data. There is a process. We'll revisit it in a couple years as part of 4-year cycle. Again, run another set of actuarials based upon rate and all of that.

So, no, I find this to be a very informative report. And I also note that average benefit, as you said, was under $600 inside of it?

SENIOR PENSION ACTUARY ROBINSON: That's right, yeah.

CHAIRPERSON COSTIGAN: Mr. Slaton.

COMMITTEE MEMBER SLATON: Thank you, Mr. Chair. On the -- and I'm looking at the accrued and unfunded liability. And if I read the number correctly, we are -- the funded ratio, am I correct, is 262 percent?

SENIOR PENSION ACTUARY ROBINSON: That's correct.

COMMITTEE MEMBER SLATON: Okay. So -- and we got to that point based on a set of actuarial assumptions, and investment philosophy that we have implemented to make sure that we're able to pay those remaining benefits without a single dollar coming from an employer, is that correct?

SENIOR PENSION ACTUARY ROBINSON: That's right. When plans terminate, as we've discussed earlier, we send a -- we perform a termination valuation, and if they owe money, we send them an invoice for that amount.

COMMITTEE MEMBER SLATON: Right. But a plan that terminates, as we discussed earlier, comes in with a set of liabilities that are matched, in other words, those liabilities if the contribution is not sufficient to pay the current benefit schedule, then the benefit schedule is adjusted.

SENIOR PENSION ACTUARY ROBINSON: Right. To date, we've never adjusted a benefit schedule. We always assume that we do add valuation based on the assumption that accrued benefits will be paid, and we send out -- we do send out a bill based on that.

COMMITTEE MEMBER SLATON: Right. But we create an environment where that terminated agency pool, we're not going to allow a new member to come in to -- or new agency to come into the terminated agency pool without making sure that there's enough assets contributed to be able to actuarially meet the obligation.

SENIOR PENSION ACTUARY ROBINSON: That's the current policy, yes.

COMMITTEE MEMBER SLATON: That's the current policy.

SENIOR PENSION ACTUARY ROBINSON: Um-hmm.

COMMITTEE MEMBER SLATON: So right now, when you mesh those policies together, we are 262 percent funded.

SENIOR PENSION ACTUARY ROBINSON: That's right.

COMMITTEE MEMBER SLATON: Is there anything that would tell us that if we go forward, say the next 5, 10, 15, 20 years that, in fact, the current set of assumptions we use are going to continue to be at that level, or even higher, as a funded status.

SENIOR PENSION ACTUARY ROBINSON: Well, the funded status is very sensitive to the -- you know, the size of the assets and the size of the liabilities. So here we have approximately, you know, $215 million of assets and $82 million of liabilities with the difference of 133 million. If a new plan terminates and joins the pool --

COMMITTEE MEMBER SLATON: Who's much larger.

SENIOR PENSION ACTUARY ROBINSON: Right. So that 133 million pretty much stays the same. However, you're dealing with, you know, a million -- let's say it jumps up to a billion dollars. So we have a billion dollars of liabilities, and a billion point one of assets. So there, of course, the funded status is a lot different. So the magnitude of the current assets and liabilities compared to the difference is very --

COMMITTEE MEMBER SLATON: So here's where I'm trying to go, I understand a big agency comes in. You do the matching, and if benefits -- if the contribution is not sufficient, then benefits are adjusted. And therefore, you come in effectively at what you think is going to be 100 percent.

SENIOR PENSION ACTUARY ROBINSON: And we, in fact, add a small --

COMMITTEE MEMBER SLATON: You add something, right?

SENIOR PENSION ACTUARY ROBINSON: -- a small cushion for mortality.

COMMITTEE MEMBER SLATON: So there's a hedge.

SENIOR PENSION ACTUARY ROBINSON: Yes.

COMMITTEE MEMBER SLATON: So let's call it 110 percent.

SENIOR PENSION ACTUARY ROBINSON: Yeah.

COMMITTEE MEMBER SLATON: So -- but from that point on, then life plays out.

SENIOR PENSION ACTUARY ROBINSON: Yes.

COMMITTEE MEMBER SLATON: The way life has played out so far, we're now at 262. So have we designed a system that's going to start at 110, and if nobody else comes in is going to end up at 262 down the road? In other words, are we making too conservative a decision?

MR. MILLIGAN: I think that the growth of the surplus in the terminated agency pool is a historical anomaly. We'd have to go back really and take a look at the history of that to really see what happened. We had the good fortune, I think, in the nineties that the terminated agency pool was not being invested in this very risk averse manner, and so we gained the benefits of the nineties.

COMMITTEE MEMBER SLATON: Okay.

MR. MILLIGAN: But quite fortunately we made the -- we've made the move to being more risk averse. And so to a certain extent, we may well have locked in the level of surplus that we have. I would certainly not, given the way we're investing things right now, expect the growth and the surplus to repeat itself. It's a different -- very different approach and very different times, but I don't -- I would not say that we're investing too conservatively.

COMMITTEE MEMBER SLATON: Okay. Well, that explains it. Thank you. I forgot that window of time where we got very lucky with that particular amount of money.

Okay. Thank you.

CHAIRPERSON COSTIGAN: Mr. Slaton's question. We assume, after they've entered the terminated agency and they've trued-up, we assume all liability until that last employee passes away.

SENIOR PENSION ACTUARY ROBINSON: That's right. So essentially it's a completely different function. For the PERF we're essentially administrators. But when we take over a terminated plan, we're essentially acting as an insurance company.

CHAIRPERSON COSTIGAN: Great. Okay. Any other questions on this item?

All right. Thank you very much for the presentation.

Ms. Eason, are we back to -- back to you for 8b.

CHIEF FINANCIAL OFFICER EASON: Yes. We will have Alan Milligan present the update on the public agency valuations.

CHAIRPERSON COSTIGAN: Now, Mr. Milligan, before you start, while I know we honored you last month, I do appreciate all the service, everything that you've done. You will be sorely missed, and we do appreciate you coming back today to help us go through that. So don't assume you're going far, because we have questions we will be tracking you down, regardless of where you're traveling.

(Laughter.)

MR. MILLIGAN: Thank you. Thank you, Mr. Chair. My honor to be back here for one last time. I believe this will be the last time.

Before I get going, I would like to take a moment to acknowledge Scott Terando. He is the Interim Chief Actuary with my departure, and until we get a new permanent Chief Actuary.

He's done a great job. And on the particular agenda item, the update on the public agency annual valuations, the first thing I'm going to do is give Scott some recognition, because what's really unusual about the report this year is how early in the year we're presenting it. And we're presenting it early this year, because staff have done an incredible job of getting the annual valuations completed much earlier than we have in the past.

Normally, for many years, we've been aiming for the end of October to get all of our valuations done. We have occasionally failed to meet that. And, in fact, one year we were not able to get all the valuations out until January.

This year, we got all the valuations out and uploaded in my|CalPERS. I think actually the upload happened -- the last one happened in August. So that's -- Scott was the leader of that effort. And between him and some heroic work on the part of the actuarial staff, we got those valuations done significantly earlier this year. And I certainly credit Scott with a major responsibility. And thank you Scott for that. I would really like to take credit for that, but that was really Scott and the staff in the Actuarial Office.

The results of the public agency annual valuations this year came in very much in line with what we expected, given that the returns in the capital markets in the -- this is not the last fiscal year, but the prior fiscal year were what they were. That was not a good year in the capital markets and our returns reflected what the capital markets were providing.

This has resulted along with previous amortization schedule changes in an average increase in the employer contribution rate of about 1.3 percent. So that's actually about 1 percent for miscellaneous plans, and a bit over a 2 percent increase -- 2 percent of pay increase for safety plans on average.

So the employer contribution rates are high. And as we highlighted in the report, they're scheduled to go higher. I'll be talking a little bit about that in the next agenda item, cause obviously this is indicating the risk of high contributions is increasing.

The other results -- there's a pretty extensive set of results in the report. There was nothing I would say was especially surprising or something I would want to bring to your attention, other than the general increase in contribution rates that we are seeing.

So this is not a very pleasant hearing for the public agencies. But fortunately, they already know this from their individual valuation reports. So for the individual employers, it's much more important for them to look at their valuation reports, because their results can differ from the average, but it's not good news.

Contribution rates are quite high, and this is, I think, putting some strain on our public agency employers.

With that, I'd be happy to take any questions.

CHAIRPERSON COSTIGAN: Mr. Milligan, just -- can you just address very quickly, so folks that are watching or looking for the information, so we just have the report in front of us. But as you were discussing, each individual agency receives a valuation report from us. So can you talk a little about that process.

MR. MILLIGAN: So each -- yes, each individual employer receives a valuation, a separate valuation report for each of their plans. So a typical public -- a typical city might well have a miscellaneous plan, a safety police, and a safety fire plan. So they would get 3 reports from us.

Some of the smaller agencies, because of the -- we had to do the risk pooling differently, we'll get more -- actually, more valuation reports than that. They get one report for every plan every year. And within those reports, we present their individualized financial condition of that plan, their future contribution requirements, some sensitivity analysis about the future contribution requirements, and discount rate sensitivity analysis, as well as a hypothetical termination liability, basically because that basis is quite different from the funding basis.

Some years ago, the Board took action to basically protect the System. And as a result, we realized that we needed to start providing that information to the employers every year, not just when they were actually thinking about terminating.

So those reports, when they become available, they are available to the individual employers through our my|CalPERS computer system, which they use to report things like payroll, et cetera. But we also upload them to our external website, so that everybody -- anybody who has an internet connection can get -- can look at all of these valuation reports. We produce some 4,000 of them every year. So there's a lot of valuation reports out there in a level of detail that I'm sure will satisfy anyone who is interested.

CHAIRPERSON COSTIGAN: All right. And just last point. For the employers, we would encourage them to attend the meeting in Riverside because you and your staff have the opportunity, or make available, workshops for folks to go through to go through the reports as well.

MR. MILLIGAN: It's a great thing for employers to come to the Employer Forum in Riverside. And, yes, the Actuarial staff will be there. One correction, I will not.

CHAIRPERSON COSTIGAN: Except you will not.

(Laughter.)

CHAIRPERSON COSTIGAN: Because you'll be driving by in your trailer.

(Laughter.)

CHAIRPERSON COSTIGAN: Okay. All right. Any other questions on this item?

Mr. Milligan, anything else?

Ms. Eason?

MR. MILLIGAN: Not on this item.

CHAIRPERSON COSTIGAN: Okay. That was information. So we're now going to go to Item 8c, the

Annual Review of Funding Levels and Risk Report.

Ms. Eason.

(Thereupon an overhead presentation was presented as follows.)

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

Let me just introduce this, and then I'll turn this over to Alan to get into some of the detail of the report. And we also have Ted Eliopoulos is here as well, if there are any questions regarding the ALM overall.

I just want to mention that with many public pension plans in the U.S. today, they're experiencing the impact of maturing plans, fewer active members to retirees, members living longer, negative cash flows, downside volatility risk, and a lower interest rate environment.

And as Alan had mentioned, the risk continues to be high, which makes risk mitigation more important than ever. But I also want to balance that with reminding the Committee of a number of important steps that the Board has taken to address funding risk and put CalPERS on a more solid ground. And this slide that we've put up here just really helps to remind ourselves about how we've been addressing funding risk, starting with the asset liability management that takes a holistic integrated view of our assets and liabilities.

We had the adoption of the set of Pension Beliefs that articulate the pension views, as well as the Investment Beliefs on our public pension design, our funding, and our administration; the adoption of new actuarial policies that use smoothing and amortization to fund the System for the long term; enhance valuation reporting, as Alan just mentioned, to assist employers in their planning and financial management; and just last year, the implementation of a new Treasury Management Program that identifies cash flow requirements, avoids -- helps to avoid future liquidity problems, and the strengthening of internal controls that facilitate better decision making around treasury; the streamlining of the investment program to save costs and reduce complexity by eliminating our hedge fund program and reducing the number of external managers; and then the adoption of PEPRA that was in effect for new employees in 2013.

And while the impact of that will take time, some 20 to 30 years to recognize long-term savings, those cost savings are significant and meaningful to the funding of the system.

All of these measures ensure our overall goal, which is aimed to fully fund the system by reducing the risks and lessening the impact of a future financial crisis. But there is more work to be done, and as Alan will talk about, given the risks in the System, today, as staff provides the annual pension funding level and risk report, it provides an annual assessment of the risks in the System and how those risks impact the System.

So I have the honor of handing the presentation over to Alan Milligan one last time, who will now go over the funding levels and risk report in more detail. And I also want to mention that the report has been prepared to provide greater transparency for the Board and stakeholders. I think it's a very easy document to read, and I applaud the Actuarial Office for their efforts in this report. I think it's very -- very helpful for employers, Board, and stakeholders.

And with that, I will turn that over -- the item over to Alan.

MR. MILLIGAN: Thank you, Cheryl. This is the -- I guess the last funding levels and risk report that I will be presenting to you. It is also the first funding levels and risk report that we have prepared since the adoption of the Risk Mitigation Policy last November.

And so with that change -- with that adoption of that policy, I have refocused the report a little bit, so that now in addition to reporting on funding levels and risks, I've also incorporated an assessment of the successfulness of the funding levels and risks -- sorry the risk mitigation policy. So it's -- I will admit it's a bit earlier this year in the -- and you'll see when I get to the results that our main result is that it's too early. But still, I think that this will become an important document for the Board to help evaluate the progress of the Risk mitigation Policy and determine whether or not you need to tweak that policy, because much as we put a lot of time and effort into that policy, I'm pretty sure it's not perfect, and I'm sure it can be tweaked to improve that -- to improve it over time.

Since last year, there's been two -- really two main events that have significantly affected the risk levels that are showing -- being shown in the report.

The first of those two events was the relatively poor performance in the capital market. That's our 0.6 percent return in the last fiscal year. The capital markets just didn't deliver the level of investment returns we would have liked.

That has resulted in us projecting lower funded status in the funding levels and risk report. It's not yet built into -- that particular year's returns was not built into the public agency annual valuations that I just reported on in the last item. We are now, at this point, moving from looking at the past to looking into the future. And because of that, we know that we need to project that 0.6 percent lost, because it's real. That has resulted -- will result in higher contribution rates, as well as a higher risk of low funded status.

The second significant event in the year was the passage by the Board of the Risk Mitigation Policy. While it didn't really impact the probabilities of high contributions very much, it did mitigate, to a large extent, the increase in the risk of low funded status that would have otherwise occurred as a result of the poor investment return in the last fiscal year.

So those are the kind of two main factors. To some extent, they were offsetting, especially in fact at the lower -- at the risk of lower fund -- lower -- lowest funded status, the risk levels have actually reduced. And that's because that Risk Mitigation Policy is actually fairly powerful at preventing those very low-funded statuses.

Some of the higher funded status levels that we do record in the report, the risk of it getting to those levels has actually increased. It's still a low-funded status, but it's higher than the really low one that we were talking about -- I just talked about.

In addition to those factors, in the report, we do take a scan of, what we call, environmental factors, and how -- taking a look at how we think those may affect risk levels in the future.

The first two of these is something that we've been reported on -- reporting on in the funding levels and risk report in past years, and that is the ongoing maturing of public plans. Our plan is like all -- like many other public plans, becoming more and more mature. We're having more retirees relative to the number of actives. And that means that we are accumulating more assets relative to payroll, which means that the System is becoming more sensitive to investment volatility. And employer contributions are -- the volatility of employer contributions is -- will increase, unless we take action, which we have been doing.

There is also a trend towards lower discount rates. There's a very nice chart, I think, in the report that shows this. And you can see from that chart that this is not abating, that it continues, and I would expect it will continue on into the future. So I think that this is being caused by factors which have already been brought before this Board, that the capital markets are simply not expecting to return as much in the next 10 years or so as they have historically, and, in fact, not as much as the lower expectations that we had even four years ago.

So that is a factor that is, I think, widespread amongst, not just public plans, but private sector plans as well. It's really driven by a change in capital market -- the capital markets expectations about the capital market returns.

We also have another environmental factor, and this one is a little bit different in that it's going in the right direction. More and more we're seeing employers really taking responsibility for the funding of their plans. CalPERS, by its nature, has to set a required contribution level, and employers have to pay at least that amount, but employers can elect to contribute more.

And more and more employers are realizing that they should be taking a more of a take-charge approach to that, and putting in place, either ad hoc, additional funding, or formal programs to do additional funding. And so I can -- I think of that as a really good development. I hope it continues to spread amongst the employer community.

I do, however, limit my -- treat this with a certain -- there's a certain limit there that you need to understand, and that is the employers who are in the strongest financial position are the ones that are most able to do this, and are the least likely to get into trouble in the first place.

The ones that are in the weakest financial position probably can't afford to make more than the minimum contribution, and so this will have limited impact in terms of improving their funded status quicker.

There's really two new factors that we haven't really talked to you about before. The first is that we are becoming concerned that we may have a more transitory -- more transitory employers. In the past, the vast bulk of our public agencies are cities, counties, and special districts that are very long-term in nature.

We now have, we think, and this is more anecdotal than something I can substantiate, but we have more joint powers authorities. And these -- and other more short-term type governmental entities. And these governmental entities can go out of existence much more easily than, for example, a city can. The city will always -- you know, there will be a population. It would take something pretty extraordinary to make a city's population decrease significantly.

But these other agencies, the special redistricts, joint powers authorities can go out of existence. Our funding policies are generally based on an assumption that the employers will be around for a very long term. And it may be that over the next 5 or 10 years, this Board has to start looking at do we need to change our funding policies to reflect a change in the underlying nature of public agencies?

You'll still have the very long-term public agencies in the mix. The cities aren't going away, but you may need to change the policies to account for a less permanent type of employer. I don't think we'll ever be as -- the way the private sector is where employers go out of existence on a very regular basis. I don't ever see that happening in government in California. But I do think that it is becoming less -- the employers are becoming less permanent and we may need to reflect that in our policies.

The final environmental factor I wanted to talk to you about was the, what I call, the charter schools phenomenon. We know that there are a number of charter schools that are being formed. At the present time, I don't think that, in any way, constitutes a threat to the revenue or membership base of the school's pool.

I am, however, concerned that over the course of a couple of decades, they -- the increasing number of charter schools could actually undermine the revenue and employment base of the school's pool. What that means is that the school's pool could become very extraordinarily mature with a very high number of retirees relative to the number of actives. And that could mean that they become very much -- very sensitive to investment fluctuations, and employer contributions may become somewhat unstable.

The -- so while this is a very long-term concern, I think it is something that the Board should keep in mind in the near term. And the reason for that is that if you're to affect the best way to address this would be to strengthen the funding of the schools' pool some 20 years before the problem really arises.

So if it's a 20-year problem -- if it takes 20 years for the problem to arise, but also takes 20 years to solve the -- to solve it, you may have to -- you may have to act before you have good evidence that this is, in fact, a real threat. It is, I think, something that is unique to keep an eye on, and you may need to act in the absence of perfect information on this particular topic. And the action you would be looking at would be making the funding of the schools' pool more conservative.

The final sort of -- before I get to my conclusion, I would like to mention something that I have not had to mention in the past, and that is a concern that the assumptions that are embedded in the funding levels and risk report may not be the best possible set of assumptions.

While we use very long-term assumptions in the funding of our System, there has been, I think, an unusual degree of change within the capital markets about the future expectations for returns. And that means that we may be operating with slightly out-of-date assumptions. And so you may want to mentally add a caveat that the risk levels may be higher than they are shown in the reports, because of this issue.

It is not going to remain an issue. We are, of course, embarking on the asset liability management cycle, where we will be reviewing our capital market assumptions, as well as all of our other assumptions, and that will address this issue.

But it could mean that the risk levels shown in the next report may be higher than you would otherwise be expecting. And I just wanted to warn you to keep that in mind.

Sort of in conclusion, going back to the success of the Risk Management Policy, the Risk Management Policy was not triggered in the year because their investment returns were not sufficiently good. That's not an unexpected result. In fact, we expect the Risk Management Policy to be triggered only in a minority of years. Most years it will not be triggered, and a single year is just simply too short a time frame to assess the success of the policy. So this is something you should continue to monitor, and take another look -- keep looking at it each and every year.

And the final -- my final comment on the funding levels and risk report is that the report shows, as have the previous risk funding levels and risk reports, that the risk levels remain very high. And that is a concern, I think, of you. You certainly have expressed it to me repeatedly over the last few years. It remains a concern of me and the other -- my colleagues on the -- in the risk management -- the asset liability management process. With that, I'll conclude and take any questions you may have.

CHAIRPERSON COSTIGAN: All right, Mr. Milligan, excellent report. I would like Mr. Eliopoulos, if you want to make any comments. I know -- you know, first, I want to make the observation, I know we focus a lot on the 0.61. It was a very difficult year for many folks. Again, I just want to say I think the Investment Office did an amazing job, given the volatility of the markets. You have been talking to us about this for the last 2, 3, 4 years, Mr. Dear prior to that, about what we were -- the headwinds we were beginning to face.

And I think those headwinds they are really a gale force. And I think, as Mr. Milligan addressed, and I think that you raised on Monday, capital markets have changed. The old assumptions of what may have been true 5 years ago or 10 years ago -- and I know that Ms. Hollinger is going to have some questions, but I'd just like any input or comments that you want to make. I know you were very thorough with Mr. Jones yesterday, but anything else you'd like to add.

CHIEF INVESTMENT OFFICER ELIOPOULOS: Well, we did cover it very thoroughly yesterday and over the past few years for sure. And Alan's comments were concise and very well taken.

The capital market assumptions, as this Committee I think is aware, have come down. Our outside consultant, Wilshire, basic -- their base assumptions going forward now this year on our asset allocation are about 90 basis points lower than they were when we conducted the last ALM. And that's what Alan is referring to in terms of the capital market assumptions. And so we are in a time period of muted returns, and certainly muted capital market assumptions for the asset classes going forward.

CHAIRPERSON COSTIGAN: So as expected, Mr. Milligan, we have a few questions. We'll start with Ms. Hollinger.

VICE CHAIRPERSON HOLLINGER: Thank you. I'll just ask two for now, and I'll come back later, because I want to give other people the opportunity to speak, but we've been talking about capital market assumptions. So if you assume our current discount rate of 7½, and we take

Wilshire's expected rate of return of 6.12 over the next 10 years - I know I'd prepared staff - but what would then be the effective rate of return?

MR. MILLIGAN: So if we were -- if in the course of the ALM review that you'll be going through over the next year and a bit, the capital market assumptions that you adopt are very similar to Wilshire's current capital market assumptions that would produce something like a 6.2 percent return over the next 10 years. The returns out beyond that would be actually be higher than 7½ percent based on long-term historicals.

If we marry those long-term historicals with the 10-year number, and essentially convert it back to a single discount rate, we would anticipate that that would result in a discount rate about 7 percent.

VICE CHAIRPERSON HOLLINGER: Okay. And my other question, Alan, can you speak to the trade-offs of waiting until the 2017 ALM workshop to lowering the discount rate versus doing it now?

MR. MILLIGAN: So the natural would be that we would wait until the ALM cycle plays out, and presumably adopting a new set of assumptions, both capital market assumptions, asset allocation, economic assumptions, discount rate, demographic assumptions, in February of 2018.

I think that you want to go through that full blown process. There's a lot of thought and analysis that goes into that. I don't think you want to short-circuit that process or that analysis. If you were concerned about the level of risk, and I think you would be -- that would be wise of you to have such a concern, you may want to think about just simply making a move on the discount rate without changing your -- all of the other capital -- the capital market assumptions, just basically being a little bit conservative, there's a mechanism which we call -- which I refer to as the margin for adverse deviation, which is totally something that the Board should always own.

And that is just a margin for being a bit conserve -- a bit more conservative. We've got our best estimate assumptions, but you know what, those can be wrong, and almost certainly will be wrong. And you may want to -- they may be wrong in one way or they may be wrong in the other. But because of the impact, you may want to have a little buffer for -- a little bit of a margin for conservatism, a margin for -- a margin for adverse deviation.

Certainly, it's normal practice to have such a margin for adverse deviation. What our analysis showed over the last 3 or 4 years is that a better way to reduce the overall risk is to actually change your asset allocation, accept a lower rate of return, and the lower discount rate that comes with it, in order to get less investment volatility. That's the best way to do it, but that requires the full ALM cycle.

You can get a significant element of that risk reduction by adopting a margin for adverse deviation, essentially just dropping the discount rate without waiting for -- without changing what your market expectations are, knowing that a year from now, you'll do that thorough study of the market expectation. And with a much better grounding say this is what we want to do in the way of capital market assumptions, this is what we want to do in the way of an asset allocation. That's great. You can do that, and I would encourage to go through that full process, culminating in February of 2018.

But you can elect to adopt a lower discount rate now or pretty much any time between now and February to provide a little bit of a margin. I say this partly because I think that I'm concerned a little bit about the amount of the change in the assumptions that you're going to see in February of 2018. I'm quite concerned about what we're hearing on the capital markets front.

I'm also concerned about the level of inflation.

I think we may have -- that assumption may be a bit too high. And the wage inflation assumption, I think we may have that a bit too low.

And so the combined effect of this may be fairly large. And so if you were to adopt a lowering of the discount rate now, that would buffer the impact to some -- on employers to some extent. And you could do that pretty my any time between now and February by adopting a margin for adverse deviation.

VICE CHAIRPERSON HOLLINGER: And just so everyone understands, the reason it buffers the impact is because similar to an insurance contract, what we're really doing is mitigating the potential adverse costs of catching up.

MR. MILLIGAN: You mitigate the adverse costs of catching up, but you also, just by simply doing it in two steps --

VICE CHAIRPERSON HOLLINGER: Right.

MR. MILLIGAN: -- it means that less -- there's a less of an impact in the first year. Employers have more time to plan.

VICE CHAIRPERSON HOLLINGER: Right.

MR. MILLIGAN: We would have -- this could be part of an integrated communications strategy with our stakeholders, so that they -- you know, we may need to bring the stakeholders along on this journey with us. And by spreading that out over a longer period of time, they don't have to accept it as much as they --

VICE CHAIRPERSON HOLLINGER: Right, it's not as shocking. It's evolution. Thank you.

CHAIRPERSON COSTIGAN: So just a couple points and more questions. I mean, just our 20-year running average is right around 7, slightly north of 7. So the historical trend over the last 20 years is actually trending lower on it. And what Wilshire, out consultant, is telling us is actually the next 10 years we'll actually be slightly above 6. So actually our running 30-year average is going to be well below 7, just based upon, at least the way I look at the data, where we are for '20 and going forward.

So Mr. Jelincic.

COMMITTEE MEMBER JELINCIC: Yeah. Alan, I wish you luck. You started off being very optimistic that you weren't going to be back, and I wrote a little note, "An optimistic actuary"?

(Laughter.)

COMMITTEE MEMBER JELINCIC: And then I listened to the rest of your report and that problem went away.

(Laughter.)

COMMITTEE MEMBER JELINCIC: But I'd like to focus on the two new issues you raised, the transitory employers. I mean, there's been a lot of talk about transitory employees, but transitory employers was new to me.

MR. MILLIGAN: It may only be transitory to an actuary, because these are not really short-term employers. These are -- but they're just not the kind of really long-term employers that we've had -- traditionally had in the past.

COMMITTEE MEMBER JELINCIC: Okay. And you've raised the issue that we've put in place procedures to more thoroughly vet the financial stability and -- or capacity and stability of these prospective contracting agencies. Can you talk a little bit about what we did?

MR. MILLIGAN: I think you may have taken that remark from Cheryl's -- from -- that comment from Cheryl's remarks, and she's actually the best person to respond to that.

COMMITTEE MEMBER JELINCIC: Okay. But I just read it out of your report. But you took it --

MR. MILLIGAN: Yes, my report yes.

COMMITTEE MEMBER JELINCIC: But you took it from her. Okay.

MR. MILLIGAN: I'm just trying to think of all the things that certainly we put in place some vetting of these public agencies before we elect to contract with them. When I arrived at CalPERS some 16 years ago, pretty much any employer -- any public agency who asked to contract with us, we would contract with them.

We're now asking, well, can we see your -- some financial statements. You know, can you actually afford to put in place a pension plan. We don't want you putting in place a pension plan, contracting with us for it, and then failing.

And a few years ago, we took the unusual step of refusing to contract with a potential new public agency, because we did not feel that their financial strength was sufficient.

Sorry, Cheryl, I'm drawing a blank on the other.

CHIEF FINANCIAL OFFICER EASON: Well, I can add to that, because one of the things, as Alan alluded to, and I think one of the things that we're discovering is that that up front due diligence around not only, you know, qualify -- that they meet the requirements to come into the plan, but also the financial test. We've added a lot of rigor to that.

And it was actually the collaboration of the Actuarial Office, our Legal team, as well as our Program area -- our Contracts and Program area that we've started to look at the end-to-end process, and making sure that we have coordinated that for agencies coming in.

And as part of that work, what we had discovered, and what Alan was talking about, is that not all of these agencies necessarily have that life into perpetuity or 30-, 40-year life, that long-term life that you need when you're looking at actuarial assumptions and spreading the costs over a long term.

And so that is another consideration, as we look at not only the financial viability of the organization's coming in, but also do they have -- do they have a certain life span, if you will, of that organization. Another, I think, important aspect of the financial test was what type of funding are they subject to? So is it funding that can -- that is subject to being withdrawn, and is it their only source of funding?

So those are the types of things that we're looking at that help just to shore up the financial viability of not only the agency, but collectively the plan.

COMMITTEE MEMBER JELINCIC: Okay. Because I've certainly heard you talk about vetting the charter schools largely over governmental agency status, but I hadn't heard about -- or if you told it, if you told us about it, this one hadn't registered that we were taking a harder look at public agencies.

And the other new issue you raised was the charter schools. And you point out that it's a 20-year problem, but around here 20 years is not all that long. It's sort of mid-term, not long-term. The -- but can you expand on that a little bit? And one of the things that was interesting to me, because I was unaware of it, is the optionality that the charter schools have. So can you expand on that?

MR. MILLIGAN: So charter schools are structured a number of different ways. And they have the option of coming into CalPERS. And even if the law were changed such that they were automatically brought into CalPERS, if they structure themselves as a private entity and not as a governmental entity, then they're not permitted. So by the way they structure themselves, they can always control whether or not they are eligible to come into CalPERS. So they will always -- there will always be this optionality with whether or not they come into CalPERS or they elect to stay out.

The experience so far, by the way, has been that they very much want to come into CalPERS. That's not something that they are staying out. But I could certainly see over many years, a trend developing where they say you know what, let's not go that route. Let's go with say just a straight defined contribution plan and not come into CalPERS membership at all.

Right now, they really need CalPERS membership in order to attract the teachers that they need. The staff that they need, not so much the teachers, but the rest of the staff. That may not always be the case. The economic conditions could change, and they could say, well, gosh, we can hire the folks that we need very easily. We don't need to come into CalPERS membership.

I'm sorry, I may have missed the part of your question.

COMMITTEE MEMBER JELINCIC: No, I was simply asking you to expand on that issue. And, you know, one of the other things that I learned, not all that long ago, was that if a -- if a charter school comes into the system and fails, it is the rest of the schools that pick up that liability. They're all part of that same pool.

MR. MILLIGAN: Correct.

COMMITTEE MEMBER JELINCIC: So they've got a additional option there that, you know, Sacramento Unified School District does not have.

MR. MILLIGAN: I think that there have been -- there are situations where school districts do merge, et cetera. And so some of this may already be happening, but I think it is more of an issue with charter schools.

COMMITTEE MEMBER JELINCIC: And thank you, and good luck. And I'm glad you didn't end on a completely optimistic note.

CHAIRPERSON COSTIGAN: Mr. Jones.

COMMITTEE MEMBER JONES: Yeah. Thank you, Mr. Chair. Thank you for the report, Alan. And then wish you the best on your retirement and whatever endeavor you might pursue.

I have a few questions. The first one on the adverse -- adverse deviation. When I first got on the Board, it seems as though I remember us removing that adverse deviation. And what was that rate then? And what is the difference between that adverse deviation versus just changing the discount rate? And what's the impact on the agencies?

MR. MILLIGAN: So let's answer your second question first, what's the difference between the adverse deviation and just changing the discount rate? There really is no difference.

COMMITTEE MEMBER JONES: Okay.

MR. MILLIGAN: It's the same -- it's equivalent -- entirely equivalent, one is entirely equivalent to the other. Dropping the discount rate with no change in your economic -- your expected return means that you have added a margin for adverse deviation. The margin for the adverse deviation is the difference between your discount rate and your expected rate of return.

You're right, that a number of years ago, I think it was in 2011, we were reviewing our assumptions. And the new capital market assumptions at that time indicated that we were -- we would have to lower our discount rate, because we were no longer expecting to be able to get the same level of return, or alternatively, we could keep the old discount rate, but increase the level of investment risk that we were taking in order to, you know, change -- move to more risky assets, or the third alternative was we could say, well, we are going to accept these new capital market assumptions, adopt these new lower capital market assumptions, not change the asset allocation, but instead of lowering the discount rate, we're going to remove the existing -- then existing margin for adverse deviation.

Of course, 2011 employer, public agencies' budgets were being badly hit. Generally, public agencies are a bit of a lagging economic indicator. Their budgets get hurt -- when the market tanks, as it did in 08-09, it takes sometime before that really translates into employer public agency governmental revenues.

And so they were really hurting at that point, and so the Board took the step of saying, well, we don't think we can maintain our current level of margin for adverse deviation in this economic environment. Employers are hurting too much. We will remove the margin and be realistic about what we think the investment returns can generate.

You don't have the option of removing the margin, because you have no margin anymore. And, in fact, my belief is that when you do go through the asset liability management process, set the new capital market assumptions, you'll be faced with the choice of increasing the investment risk, or lowering the discount rate. And you can -- you no longer have a margin, so you can't take the margin out. And so that's something that I think that you may have to -- you will have to address.

COMMITTEE MEMBER JONES: Do you recall what that rate was -- the margin of adverse deviation was?

MR. MILLIGAN: You had -- it was a essentially about a quarter percent.

COMMITTEE MEMBER JONES: A quarter percent.

MR. MILLIGAN: Yeah, and that's what you removed.

COMMITTEE MEMBER JONES: Okay. Thank you. The next question, you mentioned that the Risk Mitigation Policy that we adopted had a positive effect. But since it wasn't triggered, I'm not quite understanding how it had a positive effect.

MR. MILLIGAN: Because it does -- because our model does anticipate future investment volatility. And so the model is predicting that it will be triggered in the future, and that you will be -- that will be gradually lowering the amount -- the amount of investment risk that we're taking over time. And so that in the future that lowering of the investment volatility will lower the risk to employers.

COMMITTEE MEMBER JONES: So it's more of a future benefit as opposed to right now.

MR. MILLIGAN: Yes, it is forward-looking model that takes into account kind of the future investment volatility.

COMMITTEE MEMBER JONES: Okay.

MR. MILLIGAN: And so, yes, just the fact of adopting that means that the model is now predicting that there will be this -- that it will be -- the risk mitigation policy will be triggered in the future, and it will result in lower risk.

COMMITTEE MEMBER JONES: Okay. Thank you.

And then the last question before I move on, the charter schools. The numbers that's shown on the chart, does that include both the private and public, both independent, dependent charter schools?

MR. MILLIGAN: I believe it does, but it might be worthwhile checking and getting back to you on that.

COMMITTEE MEMBER JONES: Yeah, because it could make a difference in terms of number, because that was going to be my second question is, related to charter schools is what steps can we take to look -- as was stated earlier by there's a 20-year outlook, and you can't wait 20 years to take action, so what actions that we can take now to deal with the charter schools?

Because you're right, it's going to continue to grow. And I look back at you started in 20 -- 1999, I think, in this data, but I go back further than that on charter schools, because I helped set up the financing for one of the first charter schools. So it's been growing rapidly. And you're right, that it's -- the curve is going to rapidly increase.

MR. MILLIGAN: Yeah. What you -- there's things that you can do, actions that you can take. I think that there may be some political or legislative efforts that you could undertake to basically try to ensure that charter schools do come into membership with CalPERS.

But I think that those are of limited usefulness, partly because the charter schools, for example, even if they do come into membership, my understanding is that they are often use far fewer classified employees than a traditional public school. And as such, that would probably still result in a significant decline in the membership, even if they did still come into CalPERS membership.

The other thing that you can do, and this is totally under your control is change the way we fund the schools pool. So, for example, right now we are amortizing gains and losses for the schools pool over a 30-year period. You could shorten that to, say, 20 years. You could shorten the other, you know, amortizations, other amortization bases as well.

You know, you might want -- you -- at the extreme, you could potentially look at doing something like adopting a larger margin for adverse deviation. I think that there's a number of -- essentially, what it all comes down to is fund the schools' pool more conservatively than we are currently, and potentially more conservatively than we are funding either the State or the public agencies.

COMMITTEE MEMBER JONES: Okay. Thank you.

CHAIRPERSON COSTIGAN: And I just want to point out before I call on Ms. Paquin, back to Ms. Eason's chart, in response to Mr. Jones' question and Mr. Milligan's answer is, these type of policies we've been putting in a place to get ahead of this. And there's still some additional actions that we have to take as we're discussing today, both the discount rate, the ALM.

But again, I think what shows is everything from treasury management to risk mitigation, these are the policies, and we've made all the assumptions, and at some point, we're going to have to come back and take some additional action.

So, Ms. Paquin.

ACTING COMMITTEE MEMBER PAQUIN: Thank you. Thank you so much, Mr. Milligan, for the report. It's such a great report. And I guess my question relates more to separating -- this question of separating out, making a two-step process with the discount rate versus going through the ALM process.

And yesterday, we had public comment from the CFO, I believe it was Los Gatos -- the City of Los Gatos, and his point was that they need more information. They need more input to be able to accurately explain to their constituents what's going on with contributions and their budget and so on.

And I think that that is very important not to lose site of that. And you addressed that a little bit here. But if there was to be a two-step process, when would the discount rate decision have to be made, and does that actually give enough time to survey employers, stakeholders, and get their input and make sure that they have the information that they need.

MR. MILLIGAN: So if the Board were to adopt a new set of actuarial assumptions as part of the regular

ALM cycle, that would probably happen in -- that would probably happen in February of 2018. That would be what would be kind of the existing set up, not doing anything unusual. The -- those new assumptions will affect the 2018-19 contributions for the State and schools' plans, and the 2019-2020 contribution rates for public agencies.

If you were to adopt a lowering of the discount rate a year earlier, so sometime between now and February of next year, we would -- that would then affect one year earlier valuations, it would affect the 17-18 contributions for the schools -- for the State and schools plans, and the 2018-19 contributions for the local public agency plans.

ACTING COMMITTEE MEMBER PAQUIN: Okay. And have you had any contact with local employers at this point or any discussions about potentially doing something like this?

MR. MILLIGAN: I have not had any discussions with local agencies about the possibility of adopting a lower discount rate a year earlier. What I can say is that my experience with local agencies is that they don't want surprises. They want us to communicate as soon as we can. They don't necessarily want us to defer funding. In fact, defer -- that's something that they -- surprisingly enough, it does not seem to be something that public agencies want.

They want to get to the ultimate funding level as quick as they can. In fact, that's, I think, seen and the employer is actually -- kind of the employer is taking charge of their own future that I mentioned in the report, them taking -- making these additional contributions. Part of that is they want to get to that ultimate level of funding as soon as they can, so that they're not putting off costs into the future.

But they certainly want to have adequate notice about that. And I think that you have time to provide that adequate notice, so long as you do make the decision sometime before February.

ACTING COMMITTEE MEMBER PAQUIN: Okay. And the last question is -- I think I know the answer to this, but is there any way to accelerate the ALM process at all?

MR. MILLIGAN: Yes, there are ways that we could accelerate the ALM process. What we cannot really do, there's parts of the ALM process that we would not be able to complete by February of next year, and so -- and once we get past that, we can't build the new assumptions into the valuations -- the annual valuations. And so once you get past February of 2017, it's almost no difference between adopting it in March of 2017 and February of 2018.

There's a -- you know, February is -- for us, in many ways, the critical month. That's when we need to know what our assumptions are going to be for the upcoming set of cycle evaluations.

So we can accelerate some parts of it, but we can't, for example, accelerate the demo -- the experience study which results in the -- underlies the demographic assumptions. There's certainly work I know of in the investment -- on the investment side that can't be done in time for February of 2017. And so I think it would be best to have the full-blown -- let the full-blown ALM cycle play out.

If you do want to move to lower the level of risk earlier, then I would suggest that you look at the mechanism of a margin for adverse deviation just lowering the discount rate.

ACTING COMMITTEE MEMBER PAQUIN: Okay. Thank you.

CHAIRPERSON COSTIGAN: All right. Mr. Gillihan.

COMMITTEE MEMBER GILLIHAN: Thank you, Mr. Chair. So this is a bitter sweet day, the last time Alan is going to be here, if he can be held to his word on that. But I just want to thank you on behalf of the State of California for your public service to the State and being a good State employee that we can all be proud of.

And with that, I'm going to hit you with the questions. I wanted to soften you up first.

(Laughter.)

COMMITTEE MEMBER JELINCIC: It's a probability that he won't be back.

COMMITTEE MEMBER GILLIHAN: Right. I heard what you said about following the ALM process, and letting that sort of work it's way on the natural. And I also heard what I thought you said relative to the Board potentially taking action now on the discount rate. And so given your unique role now as the Chief Actuary Emeritus of CalPERS, and the freedom that that must provide you, I wanted to ask a more direct question. Is it -- in your professional opinion for the -- do you think it's in the long-term benefit of the System, the employers, and the employees that we think about taking action now on the discount rate in advance of letting the ALM process play out?

MR. MILLIGAN: I think that employers would find it beneficial for you to make a move, at least a partial move, on the discount rate. I don't think that they would want you to risk overshooting, reducing it by more than ultimately you have to. So I think that you may -- you should consider lowering the discount rate.

I think the ultimate -- you are looking at a fairly significant change in the discount rate as the ALM process plays out. And certainly, I think it would be --

you know, dropping the discount rate by a quarter percent this year, that would probably -- if I were -- if I were on the other side of the table and sitting as a Board member, I think that's probably the sweet spot for me.

But, you know, ultimately, this issue of how conservative to be is a Board responsibility. I believe that would be where I would be voting, if I were a member of the Board.

COMMITTEE MEMBER GILLIHAN: Thank you.

CHAIRPERSON COSTIGAN: Mr. Jones.

COMMITTEE MEMBER JONES: Yeah. Thank you, Mr. Chair. Yeah, one more question, Alan. I don't know if this is a question for Matt, but joint powers agreement. You were mentioning that we have this explosion of these new agencies popping up and joint powers agreements are one. And generally, those agreements are set up to provide some kind of good for the community or the city, et cetera. And many times the resources to set those up come from existing agencies.

So the question is if they were to go under, are they liabilities back to the funding agency that set up those joint powers agreements?

MR. MILLIGAN: I think I'll give Matt a little bit of an out. My understanding is that that may depend on the documents, the original documents that set up the agency.

GENERAL COUNSEL JACOBS: Everybody was looking towards me and now I'm looking towards my lawyer who specializes in this.

COMMITTEE MEMBER JONES: And you know it's -- go ahead. No, go ahead.

GENERAL COUNSEL JACOBS: I think that's right. The JPAs are an issue that we're taking a hard look at. There's a number of them that have kind of stopped being active, and may owe us some money, so we're taking a look at that. But I'll have to get back to you on that specific question.

COMMITTEE MEMBER JONES: Thank you.

CHAIRPERSON COSTIGAN: Actually, Mr. Jones, isn't the Fair Financing Authority a JPA.

CHIEF FINANCIAL OFFICER EASON: Yes, they are.

CHAIRPERSON COSTIGAN: So we have one in front of us. So, yeah, in fact, one of the three that we took up earlier today was a JPA or is a JPA.

COMMITTEE MEMBER JONES: We could use that as a test case.

CHAIRPERSON COSTIGAN: Yes, we could.

Any other questions on that one?

COMMITTEE MEMBER JONES: No.

CHAIRPERSON COSTIGAN: Mr. Feckner.

PRESIDENT FECKNER: Yeah, thank you, Mr. Chair.

You know, a number of years ago, we did -- well, we had -- Alan, you and I talked about this awhile back. We had a roadshow, where you had a couple of actuaries that went out and met with employers. I know we've changed over time. We now televise or webcast our meetings. But virtually you see no employers sitting in the audience anymore, which we used to see. I don't know if they're watching on TV, so I don't know if they're catching this -- this way, or if we need to start going out with a roadshow and start educating, because part of it is an education process, and it seemed that we were better served last time when we went out on a roadshow to the employers, not only Board members went, but especially the chief Actuary and somebody else from the Actuary Office went and met with employers to explain to them what was coming up, how it was going to affect them, et cetera, so it didn't hit everybody all at once.

So I would just like to encourage, Scott, through the Chair, that perhaps we look at doing something like this in the future, if we're going to move down this path that we start getting out there and actually meeting with the employers, because I'm not sure enough of them are watching our webcast to make it worthwhile.

MR. MILLIGAN: I think you have a very good point there, Mr. President. I believe that roadshow was particularly effective, and it may well be time -- I kind of talked about a -- sort of an integrated approach to educating our stakeholders over the next 18 months or so, about the ALM process and any action the Board may take. I think a roadshow might be a good component to that.

CHAIRPERSON COSTIGAN: Okay. So two quick things. Did counsel want to say anything? You came up to the table.

EMPLOYER ACCOUNT MANAGEMENT DIVISION CHIEF OSTRANDER: Renee Ostrander, CalPERS staff. I'm not part of the legal team, but I'm going to give a really legal answer. It depends for -- whether or not --

(Laughter.)

CHAIRPERSON COSTIGAN: That is a legal answer.

EMPLOYER ACCOUNT MANAGEMENT DIVISION CHIEF OSTRANDER: So, yeah, it depends. So actually, Alan was right, it does depend on some of the documentation, and in terms of how those JPAs are set up as to whether or not that is the case of liability.

CHAIRPERSON COSTIGAN: Okay. Thank you, Renee.

Mr. Pacheco.

DEPUTY EXECUTIVE OFFICER PACHECO: Yes. Thank you, Mr. Chairman. Brad Pacheco, CalPERS staff.

I just wanted to note a couple things. First, over the course of the last couple of months, we've been communicating with both the leaders of the employer associations, the league, the counties, rural districts -- or special districts, as well as the labor leaders. Given the current environment, we knew that this meeting would probably be the impetus of a discussion around this, and some of those people are here in the audience and/or watching. So we have been doing that communication.

And, Mr. Feckner, we recognize the importance of this stakeholder outreach. We've been talking as a team as to what we can do at the employer conference, because that's a prime opportunity. And we're looking at our Monday general session to focus on what we've been talking about over the next couple days. So we'll make that an emphasis and a priority.

CHAIRPERSON COSTIGAN: Thank you, Pacheco.

Mr. Slaton, you came in -- on and off. Did you want to speak?

COMMITTEE MEMBER SLATON: Yeah, I just wanted to reiterate, and you've made the point, but what Mr. Feckner said, that, you know, this is -- whatever decision we make it is not an easy decision to make, and it needs to be a collaborative decision. So we've got time between now and February. We've got an event already scheduled. We have the ability to have conversations, so that people can start to understand, you know, why this is happening, and what -- in particular, what the implications are, because that's really what it comes down to is understanding how that would affect an employer, how would it affect members, and what that roll-out might be if we were to make that decision.

So I think it would be good for us to get that feedback, not only -- because we'll get it from external parties, I'm sure, but also the reaction of staff to say what are you hearing? You know, what kind of reaction are you having to this? It will be very important over this next several months.

Thank you.

CHAIRPERSON COSTIGAN: And again, today, this is just an informational item, so we're not taking any votes yet.

Ms. Hollinger.

VICE CHAIRPERSON HOLLINGER: Yeah. Thank you. Thank you, Alan. Thank you for your service.

And I guess this is mainly for Cheryl and Scott for November. As we're trying to understand the overall cost of this liability, if you could bring for me in November for the Board, I'm interested in knowing what is the current cost of the COLA rider as a portion of the total contribution, and also what portion of the unfunded liability goes to covering the current cost of the COLA benefit? Thank you.

CHAIRPERSON COSTIGAN: All right. Mr. Linn, I have you just for Item 8. It didn't say A, B, or C. So this -- do you want to speak now?

MR. LINN: At the conclusion.

CHAIRPERSON COSTIGAN: Well -- oh, we now -- why don't you come on down, because we only have one more question, so we're about to conclude this matter, unless you want to speak at the end of 8d.

COMMITTEE MEMBER SLATON: Thank you. As he's coming down, I just had to say, Alan, I'm going to miss those phone calls, and where you said, "Bill, I need to talk to you about something". And as the Board member that represents employers -- local government employers, I was always -- you know, that -- just my blood pressure went up, my pulse went up every time he said that. So that part I'm not going to miss, but I'm going to miss your wise counsel.

MR. MILLIGAN: I think I've cut back on that particular -- the use of that particular phrase in recent years.

COMMITTEE MEMBER SLATON: You have. Thank you very much.

CHAIRPERSON COSTIGAN: Mr. Linn, I just had that you wanted to comment on the actuarial reporting. So we'll give you 3 minutes. So go ahead, please.

MR. LINN: Yes. I'm George Linn. I'm the President of the Retired Public Employees Association.

Mr. Chairman, Committee members, we, as a stakeholder in this organization, have some concerns about the information as it is received by our members. We all read the newspapers, and we all know that if we can find a newspaper that loves CalPERS, we would send them a birthday cake.

My problem is I get emails every day telling me that what is happening the sky is falling. And it's really difficult to provide a adequate answer to someone who is 85 years old about the stability and the surety that their pension is going to be there for the rest of their life.

We need some help in communicating that on an ongoing basis. I know that the public relations office here at CalPERS provides a lot of information out, but not as much as the newspapers pump out, and that becomes a little bit of a problem, because our members are reading the newspapers, and then they're sending emails. And they want answers, because they don't know how many pills they should take today to resolve the fact that they are concerned about their pensions.

The other comment that I have is I come from a contract agency, and I don't think that my contract agency is the flushest in the world, but I think that they do manage. There are a lot of them out there that are in trouble or are on an edge of financial issues. And what happens, in many cases, is that when they come to where are they going to put their money, they hit away at those wonderful things called health care.

So it's a real difficult issue when we're increasing rates, and they say, oh, yeah, we can deal with the rates. But then what they turn around and do is they reduce the health care issues. And so I think that when we're talking to contract agencies, in particular, about how we're going to increase the rates, we need to ask them how they're going to be able to satisfy this rate and will it impact the health care issues?

CHAIRPERSON COSTIGAN: Thank you, Mr. Linn.

I would also note that Mr. Pacheco continues to work on communications issues, so any input from you would be greatly appreciated as we -- how we could be doing a better job.

All right. Oh, Ms. Paquin, did you have a request on this item?

ACTING COMMITTEE MEMBER PAQUIN: Yes.

CHAIRPERSON COSTIGAN: Okay. Ms. Paquin.

ACTING COMMITTEE MEMBER PAQUIN: One more quick question. Thank you.

Cheryl, if it's possible, for the next meeting, or at some point during the process, I think we would also find it helpful to have information. I know that Mr. Milligan shared this little bit with us anecdotally about how some local employers are dealing with pension liabilities, being able to set some aside, or maybe they have policies. But if we could do maybe a quick sample or survey just to give a broader picture of what local employers are doing and how many of them could possibly do it, and how man of them just cannot for financial reasons.

CHIEF FINANCIAL OFFICER EASON: Thank you. Lynn -- Ms. Paquin, you're referring specifically to additional contributions towards their unfunded liability.

ACTING COMMITTEE MEMBER PAQUIN: Right. I think some of the options might be prefunding it or maybe having a policy in place where they only put aside -- sort of like our RMS policy, when they hit a certain target, they put that aside.

CHIEF FINANCIAL OFFICER EASON: Yes. Okay. Thank you.

ACTING COMMITTEE MEMBER PAQUIN: Thank you.

CHAIRPERSON COSTIGAN: Okay. That's the item.

We're going to try and move quickly through the next item, because we still have 2 more committee meetings.

So Item 8D, Mr. Milligan, on asset liability management, or Scott, who's up? Cheryl.

CHIEF FINANCIAL OFFICER EASON: Yes. The -- Cheryl Eason, CalPERS staff. The funding Risk Mitigation Policy has established a mechanism whereby the CalPERS investment performance that significantly outperforms the discount rate would trigger adjustments to the discount rate, the expected investment return, and the strategic asset allocation targets.

I would just bring to your attention that there is a correction on the -- on this item. The threshold is 4 percent not 2 percent, as noted in the original documents. Having said that, the policy that the Board did approve would not be initiated, unless investment returns exceeded the current 7½ percent discount rate by four percent, as we know with a total return for 2015-16 fiscal year of only 0.61 percent.

We will not be able to trigger the funding Risk Mitigation Policy. This item is just to notify the Committee that no action will be taken according to the policy adopted by the Board.

CHAIRPERSON COSTIGAN: Okay. Any questions on that item?

All right. So before we get to public comment, we have a few, we have to go back to the minutes, the vote. So have we gotten that issued cleared up, Ms. Malm?

CHIEF FINANCIAL OFFICER EASON: We do. Ms. Malm will address the minutes, and the question that Mr. Jelincic brought up.

OPERATIONS SUPPORT SERVICES DIVISION CHIEF MALM:

Thank you, Mr. Chair. Kim Malm, CalPERS staff. Mr. Jelincic is absolutely correct. The minutes should reflect instead that Mr. Jelincic moved to approve a revised amendment to the proposed Board of Administration contracting activity reporting policy to include the next to last paragraph in the original policy regarding the Investment Office providing a quarterly spring-fed pool letter of engagement committee report, but the motion did not receive a second.

CHAIRPERSON COSTIGAN: Mr. Jelincic, is that correct?

Push your microphone.

COMMITTEE MEMBER JELINCIC: I don't know, since I gave her my minutes. But I don't think it was -- it was the first paragraph that I tried to re-establish.

OPERATIONS SUPPORT SERVICES DIVISION CHIEF MALM:

We looked at the transcript, Mr. Jelincic. It was in regards to the investment spring-fed pool report, which is why Mr. Jones gave direction to -- or stated that he would give direction to the Committee.

COMMITTEE MEMBER JELINCIC: Okay. If that's what the transcript said, then fine, but thanks for the correction.

OPERATIONS SUPPORT SERVICES DIVISION CHIEF MALM: Thank you.

CHAIRPERSON COSTIGAN: So can I take motion? Don't go far Ms. Malm yet.

COMMITTEE MEMBER JELINCIC: Yeah, I'll move it.

CHAIRPERSON COSTIGAN: All right. So it's been moved by Jelincic to amend the minutes to reflect --

COMMITTEE MEMBER JONES: Second.

CHAIRPERSON COSTIGAN: All those in favor?

(Ayes.)

CHAIRPERSON COSTIGAN: Opposed?

Motion carries.

And, Ms. Malm, I just want to clarify Mr. Jelincic's --

COMMITTEE MEMBER JELINCIC: And you need a motion to adopt it. You just approved the amendment.

CHAIRPERSON COSTIGAN: We need a motion to approve the amended minutes.

COMMITTEE MEMBER JELINCIC: Yeah, moved.

COMMITTEE MEMBER JONES: Second.

CHAIRPERSON COSTIGAN: Moved by -- seconded by Jones.

All those in favor?

(Ayes.)

CHAIRPERSON COSTIGAN: Opposed?

All right. Then, Ms. Malm, on the election, it is my understanding -- I just want to clarify Mr. Jelincic's point -- it was 2 separate actions on the --

OPERATIONS SUPPORT SERVICES DIVISION CHIEF MALM:

It was 2 --

CHAIRPERSON COSTIGAN: Turn your mic on, please.

OPERATIONS SUPPORT SERVICES DIVISION CHIEF MALM:

It was 2 separate actions. I've confirmed with staff that the first package that came to the August Committee, and that was approved, was sent out to the 15-day comment period August 16th through September 1st. The second package was sent out for a 15-day comment period from September 1st through September 16th, and that's what I briefed the Committee on today.

CHAIRPERSON COSTIGAN: Okay. Does that address your questions, Mr. Jelincic?

COMMITTEE MEMBER JELINCIC: Yeah. Although I'm not sure that we really want staff sending out proposed regulations that haven't been approved by the Board, but that's apparently what they did.

CHAIRPERSON COSTIGAN: Okay. We'll take that item up later.

All right. Ms. Eason, I think we've had 3 or 4 items, so -- and then we'll go to -- I don't have any public comment, so if anybody wants to speak now while we're going through this item, please let Christina know.

Ms. Eason, Board direction. I think we had a few items.

CHIEF FINANCIAL OFFICER EASON: Yes. Okay.

CHAIRPERSON COSTIGAN: You want to start, and see what your notes are.

CHIEF FINANCIAL OFFICER EASON: Yes, I can try and summarize. So we were asked to bring back to the Committee on how to report the annual small business and disabled veteran business enterprise contract participation report. We were asked to bring back the process on contracting public agencies, specific to the notice -- noticing of the process, regulatory changes, and legal remedies. We were also asked in November to bring back the information on the current cost of COLA, and the percentage of the portion of unfunded liability related to COLA, and as well, information on agencies that are prefunding their pension liability.

CHAIRPERSON COSTIGAN: Ms. Paquin, did that capture your request?

Let me -- push your button, please.

ACTING COMMITTEE MEMBER PAQUIN: Partially. I think we're also interested in finding out, for those agencies that are not doing that, what are some other options that are out there for them?

CHAIRPERSON COSTIGAN: You got that.

Ms. Hollinger, your questions were addressed.

VICE CHAIRPERSON HOLLINGER: No.

CHAIRPERSON COSTIGAN: Okay. Let's get clarification.

VICE CHAIRPERSON HOLLINGER: I wanted to understand what the current cost of the COLA rider is as a portion of the total contribution -- annual contribution, and also what portion of the unfunded liability goes to covering the COLA benefit?

CHAIRPERSON COSTIGAN: Mr. Jelincic, the DVBE was yours. That answered your question for November on the contracting out, on the contracts?

COMMITTEE MEMBER JELINCIC: Yes. That question got answered.

CHAIRPERSON COSTIGAN: And the last one I believe was mine. So I believe that's it. No comments.

This meeting is adjourned.

(Thereupon the California Public Employees' Retirement System, Board of Administration, Finance & Administration Committee meeting adjourned at 2:09 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 26th day of September,

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