

◆MENDOCINO COUNTY EMPLOYEES' RETIREMENT ASSOCIATION◆
BOARD OF RETIREMENT MEETING MINUTES
◆FEBRUARY 19, 2014 AT 8:30 A.M.◆

CALL TO ORDER

Shari Schapmire, Board Chair, called the meeting to order at 8:31 a.m.

ROLL CALL

Roll call was conducted with the following members present: Lloyd Weer, John Sakowicz, Ted Stephens, Tim Knudsen, Supervisor John McCowen, Richard Shoemaker and Shari Schapmire. Also present: Rich White, Retirement Administrator, Jeff Berk, Legal Counsel, and Judy Zeller, Administrative Assistant. Absent: Craig Walker, Randy Goodman, and Bob Mirata. Crystal Ekanayake and Daniel Matzinger of Gallina LLP teleconferenced the meeting in order to participate in the discussion of agenda item 6.

PUBLIC COMMENT: None

1) PRESENTATION OF A PROCLAMATION HONORING RICH WHITE FOR HIS SERVICE TO THE ASSOCIATION AND THE BOARD OF RETIREMENT

Presenter/s: Chair Schapmire presented Rich White with a Proclamation to honor him for his service as Retirement Administrator. Mr. White accepted and thanked the Board. He also thanked the retirement office staff for the very important work they do. He thanked Jeff Berk for his legal assistance and thanked all of MCERA's consultants for the excellent job they do. Mr. Sakowicz thanked Mr. White for his service and for introducing him to so many interesting individuals at the State Association of County Retirement Systems, SACRS, conferences.

2) APPROVAL OF CONSENT AGENDA

Presenter/s: Chair Schapmire referenced the Consent Agenda previously distributed to the Board which included 2-A Minutes of the Board Meeting held January 15, 2014, 2-B Membership, 2-C Retirements Processed, 2-D Retirement Administrator's report, 2-E Audit and Budget Committee Report, 2-F Government Finance Officers Association (GFOA) Certificate of Achievement, and 2-G Signature Resolution 2014-01.

Supervisor McCowen asked that board direction on page 2 of the minutes be amended to read as follows: Staff will recommend an amendment of the Board of Retirement Bylaws regarding the role of Treasurer to the Board of Retirement as deemed appropriate. Mr. Knudsen suggested review of the County Employees Retirement Law, CERL, when amending the Bylaws.

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Board Action: Motion was made by Supervisor McCowen to approve the Consent Agenda including the Minutes as amended. Mr. Weer seconded the motion and it was approved unanimously. (Motion Approved)

3) DISCUSSION AND POSSIBLE ACTION REGARDING ANY CONSENT AGENDA ITEM NEEDING SEPARATE ACTION

None

Supervisor McCowen left the meeting at 8:45 a.m.

4) MONTHLY INVESTMENT REPORT

- **Quarterly Investment Performance Report, Callan Associates**
- **Asset Allocation and Investment Strategy Discussion**
- **Investment Manager Information**
- **Discussion and Direction Regarding Cash Management and Rebalancing**

Presenter/s: Greg DeForrest and Greg Ungerman of Callan Associates distributed The Callan Periodic Table of Investment Returns during the meeting. Mr. DeForrest explained that the chart shows that diversification is an important tool and also shows volatility among asset classes. Callan created this chart during the tech market boom and it is a good example of stock vs. bonds.

Mr. Ungerman referenced the Quarterly Investment Performance Report for period ending December 31, 2013 which was previously distributed to the Board. The International market was up and active managers performed better than the index. Corporate bonds were up and long duration bonds were down. MCERA is in line with their policy target with a total market value of \$426 million. Domestic equity outperformed the Russell 300 index.

Mr. Ungerman and Mr. DeForrest informed the Board of some upcoming Investment Manager changes. Mr. Sakowicz asked about Pimco. Mr. DeForrest explained that Pimco underperformed and had significant outflows in 2013, but that this is not necessarily significant because they are a \$250 billion dollar fund. They have outperformed the index in past, their view is long term, and they are going through organizational changes with the retirement of their CEO. Mr. Stephens asked if there was increased risk with Pimco. Mr. Ungerman added that Pimco is very strong and their track record is good. They are a group of extremely bright people. Mr. Stephens asked about investment fees. Mr. DeForrest replied that Prudential and Vanguard have incredible scale and low pricing of their sub-advisors which keeps fees down. Less expensive share classes are now available with other investments and MCERA will qualify

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for a few of them. This information will be provided to MCERA so that share class changes can be made.

Supervisor McCowen returned to the meeting at 9:30 a.m.

Mr. DeForrest referenced information on Fixed Income previously distributed to the Board. He simply stated that MCERA does not need to do anything with their fixed income portfolio at this time. There is a perception that the market is really difficult, but low return expectations and historic risk exposure may not reflect future risk exposure. Ten years ago we would have the same argument. The correlation of active management to the stock market was really high. Look at the periods when your portfolio over performed. Last year was the worst bond market in twenty years, but this pales to equity market volatility. There are other reasons to hold the bond portfolio. You are not looking to get excess gains, just to reduce the total portfolio volatility. Bond volatility will lower volatility, not increase return. It's a risk reducer that gives diversification to the market. Look at your total investments when looking at fixed income, not stand alone. You have the best balance now with two core plus managers, Pimco and Dodge & Cox. They compliment each other well and each takes different risk.

Mr. Sakowicz asked for opinion regarding bank loans, private loans, and pace loans. Mr. DeForrest stated that he understands that the asset classes diversify treasury, but they have different exposure correlated to the stock market. Bank loans do not diversify the total portfolio. Pimco has a small percent of bank loans. They have the discretion to buy and are not buying them. MCERA would need a custodian to buy bank loans through mutual funds. Custodial expense eats gain, bank loans would need a pooled fund, and how are they accounting for securities. Also, banks trade more often. Mr. DeForrest could not comment on Pace loans.

Mr. Stephens began discussion regarding operating cash, suggesting that MCERA take out the dollars we must spend in next year for benefits and keep as cash for payment of benefits and administrative expense. He added that there is no upside potential, but no downside either to choose a figure somewhere between \$7 and \$14 million with no allocation changes. Mr. DeForrest stated that a 2% cash position would lower return expectation. Currently MCERA sells what is above target and all funds are liquid. He felt that MCERA should stick to their policy target and continue to rebalance the portfolio to obtain cash, keeping fully invested as long as possible. Supervisor McCowen suggested review of the Cash Management Policy and discussion in the future.

Mr. Ungerman brought up the issue of a custodian. MCERA's investments are all in funds and there is no point person as custodian. Retirement office staff currently performs investment needs, but are these needs met, is this difficult for staff, and is it worth not having custodian. A

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point of contact person or custodian can assist MCERA with all services. Mr. Knudsen had some concerns and would like to find out more about options. He asked that this item be brought back for future discussion.

Chair Schapmire began discussion regarding cash management and rebalancing and Mr. Stephens expressed the need to reserve some cash to cover operating expense. They both agreed that we may have an issue with rebalancing without a Retirement Administrator. Mr. White stated that our current policy requires rebalancing quarterly, but we have been evaluating monthly. The policy provides direction to maintain three months of operating cash to pay benefits and administrative expense. Supervisor McCowen noted that this amount is about 1.5%. Mr. Knudsen stated that we need time to replace our Administrator. Chair Schapmire and Vice Chair Weer are our current signature authorities for investments. A signature resolution was approved at your last meeting. It was agreed that any direction to increase our cash should be temporary until we discuss our cash policy. The policy calls for review each year and will be agenized for discussion before the end of this fiscal year.

Board Direction: Supervisor McCowen made motion to direct the Retirement Administrator to implement the Cash Management Policy and liquidate fixed income in the amount of 1.5% cash on hand until we review our Cash Management Policy. Mr. Stephens seconded the motion and it was approved by the following vote:

<u>Ayes</u>	<u>Noes</u>	<u>Abstain</u>	<u>Absent</u>
Mr. Sakowicz			Mr. Mirata
Mr. Weer			Mr. Walker
Mr. Knudsen			Mr. Goodman
Ms. Schapmire			
Sup. McCowen			
Mr. Stephens			

5) MONTHLY FINANCIAL REPORT (Estimated Time 15 min.)

- **Statement of Plan Net Assets**
- **Statement of Changes in Plan Net Assets**
- **Cash Flow Analysis**
- **Rental Income Net of Expenses**
- **Vendor Ledger**
- **Quarterly Budget Report**

Presenter/s: Mr. White referenced information previously distributed to the Board regarding the monthly Financial Report for December 2013, Vendor Ledger for January 2014, and a Quarterly Budget Report. Our actual administrative expense is at 48% and personnel expense is at 47%. Legal fees exceeded the budget and Technology was at 9% because we have not been

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billed for the pension system yet. This item was included in the budget because the contract had not been completed before the budget was due. Our Investment budget was at 39% and we revised the accounting budget January 1st with the new accounting service contract.

**6) FINANCIAL STATEMENTS AND ANNUAL INDEPENDENT AUDIT REPORT
(Timed Item at 10:45 a.m.) (Estimated Time 30 min.)**

A. Discussion and Possible Action Regarding the Schedule of Employer Contributions

B. Discussion and Possible Action Regarding Approval of the Financial Statements and Audit Report for Year Ended June 30, 2013 (Gallina LLP)

Presenter/s: Rich White referenced information previously distributed to the Board regarding the Schedule of Employer Contributions, Financial Statements, and Annual Independent Audit Report for fiscal year ended June 30, 2013. He added that we have had a number of discussions regarding the Schedule of Employer Contributions which is included in the financial statements and the CAFR. This schedule reflects three plan sponsors, the County, the Courts, and the Russian River Cemetery District. The Audit report includes this schedule for just a few years, the CAFR for many. The schedule shows that employer contributions were not at 100%. It has been difficult to replicate the accounting and to resolve this discrepancy for you. Today we are as close as we can get without spending valuable time and resources for a forensic accounting of the actual numbers. We don't believe the employers contributed less than the required annual amount. The schedule shows less than 100% due to calculations made by the past actuary.

Examples have been provided to show the discrepancies in employer contributions in 2009 and 2010. The numbers don't calculate correctly. We know the estimated amount of contributions required based on previous actuarial valuations, estimating payroll, and applying rates to get a projected amount. Actual contributions are calculated by the plan sponsors by taking the approved contribution rate and applying to the actual active payroll. This amount is sent biweekly to the association. The actual number is different from the projected number. We have verified that we did receive the actual required contributions. Our current Actuary reflects only actual contributions not projected.

We propose placing four paragraphs in the Management Discussion and Analysis, M D & A, section of our Audit Report to explain the schedule and why the numbers are not 100%. This item was reviewed by the Audit and Budget Committee and has been recommend to the Board for discussion by a 3 to 1 (Stephens) vote.

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Mr. Knudsen commented that page 39 of the CAFR is always confusing. The past Actuary did not think this through when putting the information together. Pension Obligation Bonds are not accounted for and we cannot explain the differences. Supervisor McCowen commented that this is more of a math problem than an accounting and audit problem. He agrees with the analysis and we should not change schedule as presented, but we should check and balance to assure that the correct amount of contributions were made. Mr. Weer stated that he traced the journal entries and verified that 100% was put in the trust. Mr. White explained the extensive calculation that would be needed calculate the contributions. We would need to apply rates to payroll, breaking down by tier and type. The rates are age based and different for each employee. This would require a separate calculation for each and every employee during the periods in question.

Supervisor McCowen recommended amendments to the Audit report. The budget information on page 5 should reference our policy administrative cap and page 8 should include reference to the future unfunded liability amortization of 18 years. Ms. Ekanayake stated that this recommended change is subsequent event that would be included in next year's report. Supervisor McCowen also recommended amendment to the description of plan on page 12 which should breakout the 3 plan sponsors shares and the last sentence on page 12 should include additional language regarding plan sponsor approval of the an annual cost of living adjustment. The Retirement Administrator will work with Gallina on adding the appropriate language.

Mr. Sakowicz referenced page 69 of the CAFR stating that the actual employer contribution amounts received by MCERA are listed and that may help answer your question regarding whether the required contributions were made.

Board Direction: The Retirement Administrator will work with Gallina to make the changes discussed regarding page 5 and the .21% adopted policy cap, and on page 12 regarding clarification of the COLA. These two changes will be added to the Audit Report.

Mr. White reminded the Board that the Financial Statements are due on 12/31 of each year. The State Controller's report is due 12/31 of each year. It is partially filed, waiting for the final Financial Statements, and is subject to fine. We have received notice regarding the fine if we do not submit prior to March 18, 2014. The CAFR is due 12/31 of each year, is also waiting for the final Financial Statements, and we have filed for extension through 2/28/14.

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Board Action: Motion was made by Mr. Knudsen to approve the Independent Audit Report for year ended June 30, 2013, including the previous Board direction. A copy of the report will be transmitted to the County Auditor-Controller and the State Controller's office per Government Code Section 5193. Mr. Sakowicz seconded the motion and it was approved by the following vote:

<u>Ayes</u>	<u>Noes</u>	<u>Abstain</u>	<u>Absent</u>
Mr. Sakowicz	Mr. Stephens		Mr. Mirata
Mr. Weer			Mr. Walker
Mr. Knudsen			Mr. Goodman
Ms. Schapmire			
Sup. McCowen			

7) DISCUSSION AND RECOMMENDATION REGARDING THE COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR) FOR YEAR ENDED JUNE 30, 2013

Presenter/s: Rich White referenced information previously distributed to the Board regarding the CAFR for the year ended June 30, 2013. The Audit & Budget committee reviewed the CAFR on Feb 5 and has recommended it to the Board for approval and completion.

Board Direction: Staff will finalize the CAFR for the year ended June 30, 2013.

Board Action: Motion was made by Supervisor McCowen to approve the CAFR for the year ended June 30, 2013. Mr. Weer seconded the motion and it was approved by the following vote:

<u>Ayes</u>	<u>Noes</u>	<u>Abstain</u>	<u>Absent</u>
Mr. Sakowicz	Mr. Stephens		Mr. Mirata
Mr. Weer			Mr. Walker
Mr. Knudsen			Mr. Goodman
Ms. Schapmire			
Sup. McCowen			

8) DISCUSSION AND POSSIBLE ACTION REGARDING AGREEMENT WITH SEGAL CONSULTING TO PERFORM ACTUARIAL SERVICES

Presenter/s: Mr. White referenced information previously distributed to the Board regarding an agreement with Segal Consulting for Actuarial Services. The existing agreement expires on June 30, 2014. A new agreement, beginning July 1, 2014 if approved, now has a clause which designates Paul Angelo as primary actuary. If he is unable to be our primary contact for services for any reason we have the resources to re-open the contract for negotiation. We have also added compliance with GASB 67 which begins this year. This is not defined in the contract, but is referenced in Exhibit B, the Fee Proposal letter from Segal. The fees have been revised

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and are described in Exhibit B of the agreement. Staff would like to recommend Segal Consulting due to their professionalism, their level of service, and the reports they provide.

The Board discussed the quarterly retainer and how that works, the fact that GASB 67 will require some coordinated meetings with employers regarding the new requirements, and the increase in fees compared to our current agreement. Supervisor McCowen expressed concern regarding the annual accelerating of charges and will not vote for this item. Mr. White explained that it would not be an efficient use of time to do a Request for Proposal, RFP, after just three years. Chair Schapmire mentioned the outside audit of our actuary will be due in two more years. A RFP about every five years or so would be considered normal and the list of providers has not changed. It's a small universe of firms. Cost may not be more reasonable with another provider and we must spend significant resources to comply with GASB requirements.

Board Action: Motion was made by Mr. Sakowicz to approve the agreement with Segal Consulting. Mr. Knudsen seconded the motion and it was approved by the following vote:

<u>Ayes</u>	<u>Noes</u>	<u>Abstain</u>	<u>Absent</u>
Mr. Sakowicz	Sup. McCowen		Mr. Mirata
Mr. Weer			Mr. Walker
Mr. Knudsen			Mr. Goodman
Ms. Schapmire			
Mr. Stephens			

9) DISCUSSION AND POSSIBLE ACTION REGARDING APPROVAL OF ANNUAL COST OF LIVING ADJUSTMENT (COLA) AS OF APRIL 1, 2014

Presenter/s: Mr. White referenced information previously distributed to the Board regarding the Cost of Living Adjustment, COLA, as of April 1, 2014. Segal Consulting has provided a letter recommending the COLA per the County Employees Retirement Law, CERL. The Consumer Price Index, CPI, has been rounded to 2.5% for use as the annual COLA adjustment. Any members subject to COLA banking will get a 3.0% increase using their COLA bank, but most current retired members do not have a COLA bank.

Board Action: Motion was made by Supervisor McCowen to approve the COLA as of April 1, 2014. Mr. Knudsen seconded the motion and it was approved unanimously. (Motion Approved)

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**10) DISCUSSION REGARDING THE INTERNAL REVENUE SERVICE (IRS)
DETERMINATION LETTER RECEIPT**

Presenter/s: Mr. White referenced information previously distributed to the Board regarding MCERA's favorable determination letter from the IRS dated January 29, 2014. This letter confirms that the terms of the plan comply with the Internal Revenue Code, IRC, Section 401(a). Mr. White commended the Board, staff, Hanson Bridgett, and the folks at SACRS for all the work that went into this project. All items submitted have been agreed to and it is time to file for a new determination letter choosing cycle E with a January 2016 filing date. Hanson Bridgett will come in to address specific items to correct with the Board in the near future. The largest part of the correction is to correct the plan document, the CERL, and this process is underway. Orange County has taken the lead, beginning work with the IRS regarding changes to the CERL. SACRS has completed a legal review of the CERL and the IRS has requested modifications to CERL which are in legislation now. This was coordinated by the SACRS Legislative Committee. Some of our policies and procedures will need correction and some have already been corrected. The Board took action on the excess earnings component and the remaining health care trust account balance of \$658 thousand will become assets of the system. The \$9.6 million in excess earnings has its own amortization schedule and will be tracked. There are no other contributions required by the plan sponsors.

Mr. Stephens asked about the proposed legislative bill. Mr. White stated that Julie Wynn, Sonoma County Retirement Administrator will continue in her legislative role in this issue. This legislation contains Voluntary Correction Program, VCP, related issues only. Mr. White referenced a news release which is ready to go out that includes direct answers to questions about the determination. The Board discussed whether they should approve the release or review at their next meeting. It was agreed that the release should be issued now.

Board Direction: Staff will issue a news release and will present this information to the Board of Supervisors at their meeting next Tuesday.

11) CLOSED SESSION

- **Pending Disability Applications Update**
- **Billie Timpson Disability Application**
- **Lori Broin Review of Service Connected Disability Pursuant to Government Code Sections 31729 thru 31731**
- **Consideration of Appointment/Employment of Interim Retirement Administrator Pursuant to Government Code Section 54957(b)(1)**

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REPORT OUT FROM CLOSED SESSION

Billie Timpson was unanimously approved for Non-Service Connected Disability Retirement. There was no action taken on the Lori Broin matter. The Board of Retirement unanimously appointed Thomas Watson to serve as Interim Retirement Administrator.

12) GENERAL BOARD MEMBER DISCUSSION

Mr. Shoemaker commented the age category in the CAFR and that the age of retirement is going up by 3% each year. Some have been retired longer than they have worked. This follows the substantial increase in retirement benefits.

Chari Schapmire thanked Mr. White again for his hard work. Mr. White thanked her and commented on the hard work of retirement staff.

ADJOURNMENT (3:45 p.m.)