MENDOCINO COUNTY EMPLOYEES' RETIREMENT ASSOCIATION BOARD MEETING AGENDA

AUGUST 15, 2012 – 8:30 A.M.

ROLL CALL (8:30 A.M.)

PUBLIC COMMENT (Estimated Time 5 min.)

Members of the public are welcome to address the board on subjects within the jurisdiction of the Board of Retirement regarding items both on and off the agenda. The board is prohibited by law from taking action on matters not on the agenda, but may ask questions to clarify the speaker's comment and/or briefly answer questions. The board limits testimony on matters not on the agenda to 5 minutes per person and not more than 10 minutes for a particular subject at the discretion of the Chair of the Board. To best facilitate public expression please complete the speaker form available at the entrance to the boardroom and present to the Clerk to the Board. If you wish to submit written comments please provide 13 copies to the Clerk to the Board prior to the start of the meeting. Public speakers are reminded to announce their names before they address the board.

1) **APPROVAL OF THE MINUTES OF THE BOARD MEETING HELD JULY 18, 2012 (Estimated Time 5 min.)**

2) **MONTHLY INVESTMENT REPORT (Estimated Time 1 hour, 30 min.)**
   - **Quarterly Investment Report by Callan Associates (view at www.co.mendocino.ca.us/retirement/reports.htm)**
   - **Discussion of manager fees**
   - **Presentation by Callan Associates on Hedge Fund Investing (view at www.co.mendocino.ca.us/retirement/reports.htm)**

3) **DISCUSSION AND POSSIBLE ACTION REGARDING EXTENSION OF PROFESSIONAL SERVICES AGREEMENT WITH CALLAN ASSOCIATES (Estimated Time 15 min.)**

BREAK (Approximately 10:25 A.M.) (Estimated Time 10 min.)

4) MONTHLY FINANCIAL REPORTS (Estimated Time 30 min.)
- Billings for fees and services
- Preliminary June 30, 2012 Financial Statement

5) BENEFITS AND OPERATIONS (Estimated Time 10 min.)
- Member retirements and withdrawals of contributions by inactive members
- Documentation Procedure

6) RETIREMENT ADMINISTRATOR'S REPORT (Estimated Time 10 min.)
- Actuarial Assumptions and Calculating Benefits
- Code Section/County Resolution Report
- Contribution Rate Correction Project
- Financial/Investment Officer Position
- MCERA response to the Mendocino County Civil Grand Jury
- Information Technology Roadmap EDMS project
- Strategic Workshop
- External Audit
- Legislative Update
  (view report at www.co.mendocino.ca.us/retirement/meetings.htm)

7) CLOSED SESSION (Approximately 11:30 A.M.) (Estimated Time 30 min.)
- Pending disability applications:
  A) Monthly update on pending applications
- Pending litigation pursuant to Government Code Section 54956.9(a) – 1 case – Kim Koskinen, Writ of Mandamus filed July 18, 2012

(Pursuant to Government Code Section 31532, individual medical records of disability applicants will be discussed during closed session and are not public information.)

REPORT OUT FROM CLOSED SESSION (Estimated Time 5 min.)

8) COMMUNICATIONS (Estimated Time 5 min.)
(view information at www.co.mendocino.ca.us/retirement/meetings.htm)

9) GENERAL BOARD MEMBER DISCUSSION (Estimated Time 5 min.)
- Conference/Training attendance

ADJOURNMENT (Approximate Time 12:15 P.M.)

(Pursuant to Government Code Section 54954, this agenda was posted 72 hours prior to the meeting.)

♦MENDOCINO COUNTY EMPLOYEES' RETIREMENT ASSOCIATION♦
BOARD OF RETIREMENT MEETING MINUTES
♦JULY 18, 2012 AT 8:30 A.M.♦

CALL TO ORDER

Bob Mirata, Board Chair, called the meeting to order at 8:33 A.M.

ROLL CALL

Roll call was conducted with the following members present: Shari Schapmire, Randy Goodman, Lloyd Weer, John Sakowicz, Ted Stephens, Bob Mirata, Craig Walker, and Tim Knudsen. Also present: Rich White, Retirement Administrator, and Judy Zeller, Clerk to the Board. Members absent by prior arrangement: Supervisor Kendall Smith and Richard Shoemaker.

PUBLIC COMMENT: None

1) PROCLAMATION HONORING JIM ANDERSEN FOR HIS SERVICE AS RETIREMENT ADMINISTRATOR

2) APPROVAL OF THE MINUTES OF BOARD MEETING HELD JUNE 20, 2012

Upon motion by Board member Schapmire, seconded by Board member Stephens; IT IS ORDERED that the minutes of the June 20, 2012 Board meeting are approved by the following vote: Ayes 8 Noes 0 Abstain 0 Absent 2.

3) DISCUSSION AND POSSIBLE ACTION REGARDING THE SCOPE OF PROFESSIONAL SERVICES RELATING TO THE COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR) FOR FISCAL YEAR ENDED JUNE 30, 2012

- **Report from Budget Ad Hoc Committee**

Presenter/s: Rich White referenced information previously distributed to the Board.

Board Action: Motion was made by Board member Walker to adopt the recommendation of the MCERA Budget & Audit Committee to contract with Gallina LLP to perform a detailed review of the Comprehensive Annual Financial Report (CAFR) for fiscal year ended June 30, 2012 at a cost of $4,950. Board member Schapmire seconded the motion and it was approved by the following vote: Ayes 8 Noes 0 Abstain 0 Absent 2.

Supervisor Kendall Smith entered the meeting at 8:46 A.M.

4) DISCUSSION AND POSSIBLE ACTION REGARDING THE ACTUARIAL VALUATION FOR JUNE 30, 2012

- **Actuarial Assumptions for Fiscal Year 2012-2013**
- **Ad Hoc adjustment to MCERA Asset Smoothing**

Presenter/s: Rich White referenced information previously distributed to the Board. Paul Angelo and Andy Yeung, The Segal Company, addressed the Board by teleconference.

Board Direction: Staff will work with Segal and Legal Counsel to obtain more information on the inclusion of Cost of Living in Optional Benefit Calculations and will report to the Board in the near future. Staff will obtain the number of members who elected optional benefit calculation in the last year, including the impact to the plan, and bring the information back to the board for future discussion. Segal will submit a scope of work outline for an analysis of the actuarial contribution rate trends for the next five years.

Board Action: Motion was made by Board member Supervisor Kendall Smith to adopt the recommended actuarial assumptions for determining Optional Forms, Annuity Benefits, and Reserves for MCERA Plan Year 2012/2013. Board member Knudsen seconded the motion and it was approved by the following vote: Ayes 9 Noes 0 Abstain 0 Absent 1.

Second Board Action: Motion was made by Board member Stephens to adopt The Segal Company recommended Ad Hoc Adjustment to the MCERA asset smoothing policy. Board member Supervisor Smith seconded the motion and it was approved by the following vote: Ayes 9 Noes 0 Abstain 0 Absent 1.

Board member Sakowicz recused himself from the discussion of the response to the Grand Jury report and left the boardroom.

5) DISCUSSION AND POSSIBLE ACTION REGARDING RESPONSE TO THE GRAND JURY REPORT

Presenter/s: Rich White referenced information previously distributed to the Board.

Board Direction: Staff will change the response as directed and will submit the response to the Grand Jury Report as required by law.

Board Action: Motion was made by Board member Schapmire to approve the response to the Mendocino County Civil Grand Jury Report pending the changes directed to staff. Board member Goodman seconded the motion and it was approved by the following vote: Ayes 8 Noes 0 Abstain 0 Absent 2.

Board member Sakowicz returned to the boardroom.

6) MONTHLY FINANCIAL REPORTS

- **Billings for fees and services**
- **Report on the adopted 2012/2013 Budget**
- **Report on 2011/2012 Budget vs actual as of May 31, 2012**

Presenter/s: Rich White referenced information previously distributed to the Board.

Board Direction: Staff and Legal Counsel will bring additional information back to the board next month regarding billing from Manatt, Phelps, Phillips dated 5/30/12.

7) MONTHLY INVESTMENT REPORT

Presenter/s: Randy Goodman referenced the Final May and Preliminary June 2012 Investment reports.

Board Direction: The Board will discuss the Alliance Bernstein billing dated 7/6/12, Cornerstone Patriot Fund LP statements, and Mondrian statements with Callan Associates at the August board meeting.

8) RETIREMENT ADMINISTRATOR'S REPORT

Presenter/s: Rich White referenced information previously distributed to the Board.

Contribution Project
A status report was given at the department head meeting held July 11, 2012 and the project continues to move along.
Automation
The project work by Linea Solutions on the Electronic Data Management System (EDMS) is underway as planned with nothing new to report at this time.
Joint Meeting with the Board of Retirement and the Board of Supervisors
Board Direction: Staff, with assistance from legal counsel, will contact the County regarding research of additional information regarding County Counsel's report presented at the December 2011 joint meeting, including all pertinent information regarding adopted resolutions, government code sections, and actuarial studies to provide certain retirement benefits. Sharing of the expense of preparing this report should be shared between MCERA and the County and should be discussed.

Public Records Act (PRA) Requests
At this time there is one PRA request that is being compiled by MCERA. This current PRA is requesting extensive information on our retirees. After written response that it would take up to ninety (90) days to produce the information, that all allowable costs must be reimbursed, and to communicate to MCERA in a letter if they still wanted us to proceed, staff has compiled the information and has notified the requesting entity of the costs of producing the data which must be paid for prior to MCERA releasing information.

Cost of Living increases in the Optional Benefit Calculations
At the June board meeting we discussed an article in the Contra Costa Times which reported on a discussion item from the Contra Costa County Employees' Retirement Association (CCCERA) on the calculation of Optional Benefit Calculations and whether or not the calculation should include the Cost of Living adjustment. The Segal Company published a memorandum that was distributed to all Administrators of 1937 Act Systems which explains the issue from their perspective. Their position is that the claim in the article that CCCERA pensioners were overpaid because of improper calculation is completely untrue. They explain that the issue is what actuarial assumptions to include when determining the actuarial equivalent optional payment amounts. The letter explains what is meant by actuarial equivalent and states that CCCERA's calculations of the optional form of payment amounts are consistent with long-established practice utilized by Segal, by predecessor actuarial firms servicing CCCERA, and by actuaries serving other similar retirement systems, and in accordance with the requirements of the statues governing these systems.

Legislative Update
Information on legislation pertinent to public pension systems and recent information on certain bills prepared by Julie Wyne, Assistant CEO and Legal Counsel of OCERS, was provided to board members with Ms. Wyne's permission. Visit http://www.co.mendocino.ca.us/retirement/pdf/current/06202012Agenda+Backup.pdf for the Retirement Administrator's report which includes complete information on the legislation.

Board member Walker recused himself from discussion on closed session items 9A, 9B, and left the boardroom.

9) CLOSED SESSION (10:50 A.M.)

- **Pending disability applications:**
  - **A) Goss, Tim (05/10/12) Sheriff SCD**
  - **B) Hudson, Gary (09/07/10) Sheriff SCD**
  - **C) Mounts, Paul (6/8/12) General Services SCD**
  - **D) Wilson, Rebecca (6/8/12) Social Services SCD**
  - **E) Yee, Peggy (06/05/12) Social Services SCD**

REPORT OUT FROM CLOSED SESSION (11:48 A.M.)

Board Direction: The Board provided direction to staff on closed session items 9D, and 9E. Staff will include only closed session items requiring action on future agendas and will provide a status report to the board during closed session on all pending closed session items, including pending disability applications.

Board Action: It was reported out at the end of closed session that the Board approved the application for service connected disability for Mr. Gary Hudson, 9B, however, the Board actually approved and adopted the proposed findings and recommendations of the Hearing Officer and granted service connected disability to Mr. Hudson by the following vote: Ayes 8 Noes 0 Abstain 0 Absent 2. There was no action taken on the other closed session items.

Board member Walker returned to the Board room.

10) COMMUNICATIONS

Presenter/s: Rich White referenced information previously distributed to the Board.

11) GENERAL BOARD MEMBER DISCUSSION

There being no further business Bob Mirata, Chair, adjourned the meeting at 11:53 A.M.

Richard A. White, Jr.
Retirement Administrator

Telephone: (707) 463-4328
(707) 467-6473
Fax: (707) 467-6472

MENDOCINO COUNTY
EMPLOYEES' RETIREMENT ASSOCIATION
625-B KINGS COURT
UKIAH, CALIFORNIA 95482-5027

Date:	August 15, 2012
To:	Board of Retirement
From:	Richard White, Retirement Administrator
Subject:	Monthly Investment Report

A. Quarterly Investment Performance Report

Recommended action: Receive and file.

The 2nd Quarter Investment Performance Report will be presented by Greg Ungerman and Greg DeForrest of Callan Associates Inc. The material is provided to the Board of Retirement as a separate report.

B. Educational presentation on Hedge Fund Investments

Recommended action: Receive and file.

Introduction:

The Board has expressed an interest in receiving education on alternative asset classes and investment strategies. This session on Hedge Fund Investing will be presented by Mr. James McKee, Senior Vice President with Callan Associates.

Jim is Director of Callan's Hedge Fund Research Group and a shareholder of the firm. Jim specializes in hedge fund research addressing related issues of asset allocation, manager structure, manager search, and performance evaluation for Callan's institutional clients.

Jim earned a B.A. in Economics/Environmental Studies from Dartmouth College in 1982. He received his M.B.A. in Finance from Golden Gate University in 1987. His graduate studies focused particularly on publicly traded securities and capital markets.

Jim joined Callan Associates in 1989. Prior to his career at Callan Associates, Jim worked with the Pacific Stock Exchange (PSE) from 1982 to 1989. Until 1985, Jim worked on the PSE's options trading floor. Thereafter, as manager of the PSE's securities research department, he was responsible for developing and monitoring new stock, bond, and option listings.

Richard A. White, Jr.
Retirement Administrator

Telephone: (707) 463-4328
(707) 467-6473
Fax: (707) 467-6472

MENDOCINO COUNTY
EMPLOYEES' RETIREMENT ASSOCIATION
625-B KINGS COURT
UKIAH, CALIFORNIA 95482-5027

Date:	August 15, 2012
To:	Board of Retirement
From:	Richard White, Retirement Administrator
Subject:	Extension of Standard Services Agreement with Callan Associates Inc.

Recommended Action: Approve the extension of Standard Services Agreement with Callan Associates Inc. for the term of October 1, 2012 through October 1, 2014.

Background:

At the conclusion of an RFP search process for investment consulting services in August 2009, the Board of Retirement approved hiring Callan Associates Inc (Callan) to provide Investment Consulting Services to MCERA. The term of consulting services contract with Callan was for three years that began on October 1, 2009 and expires on October 1, 2012. Included in the original contract was the provision to extend the contract to October 1, 2014 upon written agreement by all parties.

Callan has performed the duties and responsibilities as the MCERA investment consultant in accordance with the terms of the contract and staff is recommending that the Board approve the extension of contract for the additional two-year term.

Fees:

The original agreement with Callan provided for a general consulting annual retainer fee of $140,000 for years 1-3 and $145,600 for years 4-5. The annual retainer fee includes a list of usual consulting services to be provided to MCERA and will remain the same under the extension.

The original agreement included project based services outside of the annual retainer fee that would be provided by Callan as authorized in advance by the MCERA Board. These services will remain with the extension of the contract though the extension of the contract includes fee increases for these services.

Staff recommends approval of the contract extension with Callan Associates Inc.

Attachment

AGREEMENT TO EXTEND CONTRACT

THIS AGREEMENT TO EXTEND CONTRACT (the "Agreement") is entered into as of August __, 2012, by and among THE MENDOCINO COUNTY EMPLOYEES RETIREMENT SYSTEM ("MCERA") and CALLAN ASSOCIATES INC. ("Consultant").

RECITALS

WHEREAS, MCERA and Consultant previously entered into that certain Mendocino County Employees Retirement Association Standard Services Agreement dated as of October 1, 2009 (the "Services Agreement"), pursuant to which MCERA retained Consultant to provide certain services from October 1, 2009 to October 1, 2012 (the "Term").

WHEREAS, the Services Agreement provides that the Term may be extended through 2014 by the mutual agreement of the parties.

WHEREAS, MCERA and Consultant desire to extend the Term through October 1, 2014 at the fee levels set forth in Exhibit B to the Services Agreement.

NOW, THEREFORE, IT IS AGREED THAT:

1. Extension of Term. The Term of the Services Agreement shall be extended through October 1, 2014.

2. Fees. MCERA and Consultant hereby acknowledge and agree that, as stated in Exhibit B to the Services Agreement, the annual retainer fee paid by MCERA to Consultant for the period from October 2, 2012 to October 1, 2014 shall be $145,600 and the fees paid for additional projects outside of the retainer from October 2, 2012 to October 1, 2014 shall be as follows:

Custodian search:	$53,750
Custodian review:	$26,875
Per search fee for manager searches in excess of three:	$30,000

3. Representation and Warranties.

(a) Representation and Warranties of MCERA. MCERA has the full right, power and authority to enter into and to perform MCERA's obligations under this Agreement. All action on the part of MCERA necessary for the execution of this Agreement and the performance of MCERA's obligations hereunder has been taken. This Agreement constitutes the valid and binding obligation of MCERA, enforceable against MCERA in accordance with its terms.

(b) Representations and Warranties of Consultant. Consultant has the full right, power and authority to enter into and to perform Consultant's obligations under this Agreement. All action on the part of Consultant necessary for the execution of this Agreement and the performance of Consultant's obligations hereunder has been taken. This Agreement constitutes the valid and binding obligation of Consultant, enforceable against Consultant in accordance with its terms.

4. Fiduciary Status of Consultant: Standard of Care

Consultant acknowledges that this Agreement places it in a fiduciary relationship with MCERA. As a fiduciary, Consultant shall discharge each of its duties and exercise each of its powers under this Agreement (i) solely in the best interest of MCERA, and (ii) with the competence, care, skill, prudence and diligence under the circumstances then prevailing and that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, in conformance with the California Constitution, Article XVI, section 17, and California Government Code sections 31594 and 31595, and with the customary standard of care of a professional investment consultant providing services for a U.S. employee pension trust ("Standard of Care.") Consultant shall cause any and all of its Agents to adhere to the same Standard of Care. Consultant shall be liable to MCERA for any claim which arises from or relates to any failure by Consultant or any of its Agents to exercise this Standard of Care. Notwithstanding the foregoing, while Consultant will be providing input to MCERA for consideration in MCERA's investment decisions, MCERA acknowledges and agrees that it will retain and exercise all decision-making authority with respect to the management and administration of the retirement plan(s) funded by MCERA and investments relating thereto. In addition, MCERA acknowledges, (i) Consultant has no authority or responsibility to manage or in any way direct the investment of any assets that are the subject of Consultant's consulting services, (ii) Consultant has not and cannot make any promise, guarantee or other statement or representation regarding the future investment performance of such assets, and (iii) Consultant will not be liable for any losses or expenses incurred as a result of any action or omission by an investment manager, custodian or unrelated third party unless Consultant breached any of its duties under this agreement and there is a connection between that breach the loss or expense.

5. Miscellaneous.

(a) Governing Law. This Agreement shall be governed in all respects by the laws of the State of California, regardless of the laws that might otherwise govern under applicable principles of conflicts of law.

(b) Amendments. No amendment or modification of the terms and conditions of this Agreement shall be valid unless in writing and signed by the parties hereto.

(c) Entire Agreement. This Agreement and the Services Agreement constitute the entire agreement between the parties with respect to the transactions contemplated hereby.

(d) Successors and Assigns. Each party's rights and obligations under this Agreement may only be assigned with the other party's prior written consent.

(e) Waiver. A party's failure to enforce any provision of this Agreement shall not in any way be construed as a waiver of any such provision, or prevent that party thereafter from enforcing each and every other provision of this Agreement.

(f) Severable Provisions. The provisions of this Agreement are severable, and if any one or more provisions may be determined to be unenforceable, in whole or in part, the remaining provisions shall nevertheless be binding and enforceable.

(g) Further Assurances. Each party shall execute and deliver such additional instruments, documents and other writings as may be reasonably requested by the other party in order to confirm and carry out and to effectuate fully the intent and purposes of this Agreement.

(h) Expenses. Buyer and Seller shall each bear their own expenses and legal fees incurred in connection with this Agreement and the transactions contemplated hereby.

(i) Counterparts. This Agreement may be executed in one or more counterparts, each of which shall be deemed an original but all of which together shall constitute one and the same instrument.

[Remainder of Page Intentionally Left Blank.]

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date set forth above.

THE MENDOCINO COUNTY EMPLOYEES RETIREMENT SYSTEM

By:____________________________
Name: __________________________
Title: ___________________________

CALLAN ASSOCIATIONS INC.

By:____________________________
Name: __________________________
Title:____________________________

Richard A. White, Jr.
Retirement Administrator

Telephone: (707) 463-4328
(707) 467-6473
Fax: (707) 467-6472

MENDOCINO COUNTY
EMPLOYEES' RETIREMENT ASSOCIATION
625-B KINGS COURT
UKIAH, CALIFORNIA 95482-5027

Date: August 15, 2012
To: Board of Retirement
From: Richard White, Retirement Administrator
Subject: Monthly Financial Report

Discussion: All reports in the agenda are *preliminary reports* for June, 2012 as the final reports await further information from various entities which will not be available until the accounts are closed and finalized. The reports included for the Board of Retirement include:

A. **Statement of Changes in Plan Net Assets**: This report details a view of the current fiscal year additions to and deductions from the plan and covers the most recent monthly activity (June, 2012) and the fiscal year to date activity (Fiscal Year 2011-2012).
   a. Total contributions of $19.6 Million in the Fiscal Year included contributions paid by the active employees and the plan sponsors of MCERA. Employee contributions accounted for forty percent and plan sponsor contributions accounted for sixty percent of the total contributions received.
   b. Investment Income derived primarily from interest, dividends and capital gains and less the investment related expenses totaled $11.6 Million for the Fiscal Year which comprised thirty-seven percent of the total additions to the plan during the Fiscal Year 2011/12.
   c. Benefit payments to retirees and beneficiaries and other subsidies or refunds totaled $24.1 Million in the Fiscal Year.
   d. Administrative expenses for the totaled $698,485 which is below the statutory imposed cap of $2 Million on administrative expenses for a fund the size of MCERA.
   e. Net Assets at the end of June, 2012 were slightly higher than at the beginning of the Fiscal Year (July, 2011).

B. **Statement of Plan Net Assets**: This report details a "snapshot" of account balances for the period covered (June, 2012) and the fiscal year to date activity (Fiscal Year 2011-2012) and indicates the assets available for future payments to retirees and any current liabilities owed.
   a. Cash available at the end of the Fiscal Year amounted to $2.6 Million.
   b. MCERA total Net Assets at the end of the Fiscal Year was $313.8 Million.

C. **Cash Flow Analysis**: This report is also a "snapshot" of the cash available to MCERA during the reporting period, which in this report included the full Fiscal Year 2011/12.. MCERA uses and monitors the cash within the fund in accordance with the cash flow policy.

Attachments

MENDOCINO COUNTY EMPLOYEES' RETIREMENT ASSOCIATION
STATEMENT OF CHANGES IN PLAN NET ASSETS
FOR THE TWELVE MONTHS ENDED JUNE 30, 2012
(PRELIMINARY)

	CURRENT MONTH	YEAR TO DATE
ADDITIONS		
CONTRIBUTIONS		
EMPLOYER	$ 1,537,228.45	$ 11,811,075.95
PLAN MEMBERS	3,017,382.54	7,840,566.96
TOTAL CONTRIBUTIONS	**4,554,610.99**	**19,651,642.91**
INVESTMENT INCOME		
RENTAL INCOME, NET OF EXPENSES	15,037.99	45,643.75
INTEREST	(2,454,722.19)	(2,941,427.24)
DIVIDENDS	872,466.58	7,260,964.72
CAPITAL GAINS	(2,871.97)	7,632,950.96
LESS INVESTMENT EXPENSE	(129,828.90)	(316,274.46)
TOTAL INVESTMENT INCOME	**(1,699,918.49)**	**11,681,857.73**
TOTAL ADDITIONS	**2,854,692.50**	**31,333,500.64**
DEDUCTIONS		
BENEFIT PAYMENTS, SUBSIDIES, & REFUNDS	(2,270,471.97)	(24,180,109.76)
ADMINISTRATIVE EXPENSES	(587,664.87)	(698,485.07)
TOTAL DEDUCTIONS	**2,858,136.84**	**24,878,594.83**
INCREASE (DECREASE) IN NET ASSETS	**(3,444.34)**	**6,454,905.81**
NET ASSETS		
BEGINNING OF YEAR	**313,855,532.32**	**307,397,182.17**
END OF YEAR	**$ 313,852,087.98**	**$ 313,852,087.98**

MENDOCINO COUNTY EMPLOYEES' RETIREMENT ASSOCIATION
STATEMENT OF PLAN NET ASSETS
JUNE 30, 2012
(PRELIMINARY)

ASSETS		
CASH AND EQUIVALENTS		
GENERAL CASH	$ 2,628,981.06	
TOTAL CASH AND EQUIVALENTS		**2,628,981.06**
CURRENT ASSETS		
RECOUPMENTS	2,653.49	
TOTAL CURRENT ASSETS		**2,653.49**
PROPERTY AND EQUIPMENT		
EQUIPMENT	3,786.40	
TOTAL PROPERTY AND EQUIPMENT		**3,786.40**
INVESTMENTS, AT COST		
BONDS	87,511,500.33	
INTERNATIONAL EQUITIES	77,645,417.14	
SMALL CAP EQUITIES	21,383,960.85	
MID CAP EQUITIES	36,105,372.85	
LARGE CAP EQUITIES	59,821,498.23	
REAL ESTATE	29,150,974.67	
TOTAL INVESTMENTS, AT COST		**311,618,724.07**
TOTAL ASSETS		**$ 314,254,145.02**
LIABILITIES		
CURRENT LIABILITIES		
ACCOUNTS PAYABLE	$ 142,052.25	
FEDERAL WITHHOLDING	11,735.55	
WAGE ATTACHMENTS	176.74	
BUCK SETTLEMENT RESERVE	248,092.50	
TOTAL CURRENT LIABILITIES		**402,057.04**
TOTAL NET ASSETS		**$ 313,852,087.98**

MENDOCINO COUNTY EMPLOYEES' RETIREMENT ASSOCIATION
CASH FLOW ANALYSIS
FOR THE TWELVE MONTHS ENDED JUNE 30, 2012

		CURRENT MONTH		YEAR TO DATE
ADDITIONS				
CONTRIBUTIONS				
EMPLOYER		1,537,228.45		11,811,075.95
PLAN MEMBER		3,017,382.54		7,840,566.96
TOTAL CONTRIBUTIONS		**4,554,610.99**		**19,651,642.91**
INVESTMENT INCOME				
RENTAL INCOME, NET OF EXPENSES		15,037.99		45,643.75
INTEREST		(2,454,722.19)		(2,941,427.24)
DIVIDENDS		643,429.94		1,712,901.16
CAPITAL GAIN		0.00		71,349.29
LESS INVESTMENT EXPENSE		(129,828.90)		(316,274.46)
TOTAL INVESTMENT INCOME		**(1,926,083.16)**		**(1,427,807.50)**
TOTAL ADDITIONS		**2,628,527.83**		**18,223,835.41**
DEDUCTIONS				
BENEFIT PAYMENTS AND SUBSIDIES		(1,959,352.80)		(23,058,357.58)
REFUNDS/ADJUSTMENTS OF CONTRIBUTIONS		(311,119.17)		(1,121,752.18)
ADMINISTRATIVE EXPENSES		(587,664.87)		(698,485.07)
TOTAL DEDUCTIONS		**(2,858,136.84)**		**(24,878,594.83)**
OTHER INCREASES/(DECREASES)				
ACCOUNTS RECEIVABLE		120.61		59,033.82
ACCOUNTS PAYABLE		153,964.54		112,290.79
BUCK SETTLEMENT		(47,339.70)		248,092.50
SALE/PURCHASE OF INVESTMENTS		(2,441,513.72)		7,674,837.55
TOTAL OTHER INCREASES/(DECREASES)		**(2,334,768.27)**		**8,094,254.66**
INCREASE (DECREASE) IN CASH	**$**	**(2,564,377.28)**	**$**	**1,439,495.24**
SUMMARY				
CASH AT END OF PERIOD	$	2,628,981.06	$	2,628,981.06
CASH AT BEGINNING OF PERIOD		5,193,358.34		1,189,485.82
INCREASE (DECREASE) IN CASH	**$**	**(2,564,377.28)**	**$**	**1,439,495.24**

Richard A. White, Jr.
Retirement Administrator

Telephone: (707) 463-4328
(707) 467-6473
Fax: (707) 467-6472

MENDOCINO COUNTY
EMPLOYEES' RETIREMENT ASSOCIATION
625-B KINGS COURT
UKIAH, CALIFORNIA 95482-5027

Date: August 15, 2012
To: Board of Retirement
From: Richard White, Retirement Administrator
Katy Richardson, Sr. Retirement Specialist
Subject: Retirement application required documentation

Recommended action: Approve procedural change of documentation required at time of retirement application.

Background

Current MCERA practice requires a member to provide documentation to prove date of birth and proof of legal marriage or registered domestic partnership dependant upon certain factors, such as the retirement option chosen. For example, when choosing the Unmodified Option, MCERA does not require the member to provide a copy of the spouse's Birth Certificate but we do require this document when an Optional Benefit 2 Formula is chosen.

Another example of our current practice is to require proof of registered domestic partnership at the filing of a retirement application (where applicable) but we do not require proof of marriage.

The current MCERA practice is cumbersome, confusing to our membership and not consistent with the practice of other 1937 Act Retirement Systems and CalPERS. Staff is recommending that the Board approve a procedural change on the required documentation a member must submit to MCERA at the time of submitting the application to retire. Additionally, subsequent to the Board approval of this procedural change, staff will review and update the files of the retiree members to ensure that the documentation in the files is consistent with the newly adopted procedure.

Recommended Operations Procedure: At the time a member submits an application for service retirement, the member is required to submit the following documents to MCERA:

- Age verification:
  - The member's birth certificate or passport. (Photocopy is acceptable)
  - The birth certificate or passport of the member's spouse or domestic partner, if eligible for a monthly benefit upon the death of the member. (Photocopy is acceptable)

    - The birth certificate or passport of any person the member names as a beneficiary to receive a continuance upon the member's death. (Photocopy is acceptable)

- Registered Marriage Certificate or California Certificate of Domestic Partnership:
    - A photocopy of registered marriage certificate or California Certificate of Domestic Partnership, to determine eligibility for the unmodified option. The member must be married, or registered with the State of California as domestic partners, for at least one year prior to retirement to be eligible for the unmodified continuance.
    - The Social Security number and birth date of any eligible beneficiary named by the member must also be provided.

<u>Fiscal Impact:</u>

There is no fiscal impact to implementing the procedural change.

<u>Alternative recommendation:</u>

The Board could continue with the current practice at MCERA but it should be noted that a lack of documentation or incorrect documentation could result in a miscalculation of member and/or spousal benefit amounts which could have a fiscal impact on the system.

Richard A. White, Jr.
Retirement Administrator

Telephone: (707) 463-4328
(707) 467-6473
Fax: (707) 467-6472

MENDOCINO COUNTY
EMPLOYEES' RETIREMENT ASSOCIATION
625-B KINGS COURT
UKIAH, CALIFORNIA 95482-5027

Date: August 15, 2012
To: Board of Retirement
From: Richard White, Retirement Administrator
Subject: Retirement Administrator Report

Activities:

I have listed some noteworthy activities which I have participated in since your last Board of Retirement meeting.

- Jim Andersen and I attended the Board of Supervisors meeting on July 24, 2012 and discussed the MCERA response to the Mendocino County Civil Grand Jury reports with the Board of Supervisors during their discussion regarding their required response.
- I attended the County of Mendocino Department Head Meeting on August 8, 2012.
- I attended the Mendocino County Board of Supervisor Meeting on August 14, 2012 to be available for questions regarding the Financial/Investment Officer position.

The following is a summary status report on items of interest for the Board of Retirement:

A. Actuarial Assumptions and Calculating Benefits

The Board will recall that at the July 18, 2012 meeting, you approved the actuarial assumptions for determining optional forms, annuity benefits and reserves as recommended by The Segal Company ("Segal"). These assumptions were implemented as of July 1, 2012 (effective pay period #13) into the Retirement Allowance Program (RAP), which is the program used by MCERA to calculate a member's retirement benefit. These assumptions were incorporated into the RAP program coincident with the effective date of the contribution rates calculated using the new assumptions for the 2012/2013 fiscal year, which were approved by the Board of Retirement based upon the June 30, 2011 actuarial valuation. Therefore, as of July 1, 2012 the assumptions used to calculate optional forms of benefit, annuity benefits and reserves in RAP are the same assumptions as those used to determine the current contribution rates effective on that date (except that they have been converted to a unisex basis for RAP purposes).

The Board of Retirement should note that the assumptions used in the RAP program to calculate the optional forms of benefit, annuity benefits and reserves prior to July 1, 2012 were those in effect as a result of prior Board approval, and they do not appear to have been updated in RAP since at least 2007 or before.

This would mean that the pre- July 1, 2012 assumptions used for optional benefit purposes in RAP had not been updated to keep them consistent with the assumptions used for liability valuation purposes in any subsequent valuations performed by the prior actuary for a period that may go back as far as 1999.

However, Segal has noted that this situation is similar to other 1937 Act systems. It is their opinion that "retroactive action" is NOT required by the Board of Retirement, as it is their consistent experience with other similar systems that the assumptions used for optional benefit purposes are in effect until a formal change in the assumptions has been adopted by the Board, and there is no specific requirement to keep them consistent with the valuation assumptions.

Going forward, Segal suggests that the Board of Retirement consider adopting "a formal process to update the benefit program assumptions to be consistent with any assumptions adopted for valuation purposes, and to make the new assumptions effective on the date that the new member and employer contribution rates go into effect." Staff can bring this policy back to the Board of Retirement for formal action, if desired.

B. Code Section/County Resolution Report

The Board directed staff at the July, 2012 meeting to contact the Office of County Counsel to discuss the Code Section/County Resolution report which was received at the December 12, 2011 joint meeting of the Board of Supervisors and Board of Retirement. Staff is in contact with County Counsel and we are working together to coordinate our efforts with this project.

C. Contribution Rate Correction Project

The County of Mendocino (Auditor/Controller) completed the issuance of checks to County employees (active, deferred and retired) who overpaid contributions into MCERA. The process of contacting those members who under contributed is underway. The Superior Court is working on completing this project as well. Staff continues to assist our plan sponsors with their efforts as all parties move towards the completion of this matter.

D. Financial/Investment Officer Position

Staff and Human Resources completed the classification specifications for the recently approved full-time MCERA Financial/Investment Officer position which was approved by the Mendocino County Civil Service Commission at the July 18, 2012 meeting. Human Resources made excellent progress completing the necessary steps and has placed the position on the August 14, 2012 agenda of the Board of Supervisors. Recruitment for the position will begin after the necessary approvals have been completed. The class specification is included for your review.

E. MCERA response to the Mendocino County Civil Grand Jury

The Board of Retirement approved the MCERA response to the Mendocino County Civil Grand Jury at the July 18, 2012 meeting and directed staff to make certain changes prior to submitting the report in a timely manner to the Grand Jury. Staff completed changes to the response and submitted it to the Grand Jury on July 20, 2012. The final response is included in this agenda item.

The Mendocino County Board of Supervisors approved their required response to the Grand Jury at the July 24, 2012 meeting, which is also included in this agenda item.

F. Information Technology Roadmap EDMS Project

The project of the imaging of member and administrative files and the storing of these images is continuing along the anticipated timeline. Communication between staff and Linea Solutions is good. The first phase of the project is the design of the system and includes identifying the document storage and management solutions available to MCERA, both within the County of Mendocino existing infrastructure and outside the county IT system.

G. Strategic Workshop

Staff is continuing to develop the agenda and details for the Board Strategic Workshop which will take place over the course of two-days, Wednesday, October 17, 2012 AND Thursday, October 18, 2012.

At this point, due to a number of important matters which require action by the Board of Retirement, it is anticipated that the Board will hold its regularly scheduled monthly meeting on the morning of Wednesday, October 17. Due to the matters before the Board, should the Board not desire to hold this scheduled meeting, it will be necessary for the Board to select another date for the October Board of Retirement meeting.

The agenda for the Strategic Workshop is to conduct Part One of the strategic workshop on the afternoon of October 17th and Part Two on the following morning. The two-session schedule is designed to be the most productive use of the Board's time. The preliminary agenda is included in the agenda packet.

MCERA is proud to have the strategic workshop facilitated by Nancy A. Williams the practice co-leader of Hewitt EnnisKnupp's Fiduciary Services practice. Nancy's biographical sketch is included in the agenda packet.

H. External Audit

MCERA's external auditor, Gallina LLP, has begun the audit engagement process which included an on-site visit during the week of August 6, 2012 to gather information, reports and data needed from the system and the County for the preparation of our annual audit.

I. Legislative Update

The Legislature:

The Legislature returned from summer recess on August 6th to a light week of hearings. Notably absent in the hearing calendars are pension bills. While there is the odd bill that is being heard on pensions, the bulk of the reform bills are still being held in anticipation of the report from the Conference Committee. Democratic leaders have yet to release details of their pension reform proposal in response to Governor Brown's proposal. While both Governor Brown and Democratic leaders have promised to finalize their pension reform proposals this legislative session, time is running short. Committee hearings cannot be scheduled after August 17th. Bills cannot be amended after August 24th and August 31st is the last day for each house to pass bills. The bills passed by the Legislature go to Governor for signature or his veto, which must take place by September 30, 2012.

Ballot Initiatives:

There is a single Ballot Initiative in the signature gathering stage at this time, with a deadline of October 4th to gather 807,615 signatures before it will qualify for the ballot. It contains the text of the Governor's pension reform proposal as introduced in Assembly Bill 2224, Assembly Constitutional Amendment 22, Senate Bill 1176 and Senate Constitutional Amendment 18.

The Legislative Update was prepared by Julie Wyne, Assistant CEO & Legal Operations of OCERS and is used with her permission.

Adopted by Civil Service/Pending with BOS adoption

MENDOCINO COUNTY GOVERNMENT
CLASS SPECIFICATION

CLASS TITLE: RETIREMENT ASSOCIATION FINANCIAL/INVESTMENT OFFICER
DEPARTMENT: EMPLOYEE'S RETIREMENT ASSOCIATION
REPORTS TO: RETIREMENT ADMINISTRATOR
CIVIL SERVICE: YES

CLASS CODE: C39D
FLSA STATUS: N
DATE: 7/12
BARGAINING UNIT: CONFIDENTIAL

JOB SUMMARY:
Under direction of the Retirement Administrator, performs highly complex financial / accounting work in support of Mendocino County Employees' Retirement Association (MCERA) in accordance with the County Employees' Retirement Act of 1937; prepares monthly financial statements and annual reports, monitors investments, recommends cash and investment strategies, performs annual year-end closing functions and financial statements, coordinates with independent financial auditor and actuary; performs other responsible fiscal, budgetary and administrative work as required.

DISTINGUISHING CHARACTERISTICS:
The Retirement Association Financial/Investment Officer is a single incumbent class responsible for the accounting and financial systems and for assisting the Retirement Administrator in monitoring, reviewing, analyzing and problem-solving matters related to the management and allocation of MCERA's assets and investments. This class differs from the Retirement Administrator in that the latter is responsible for the overall function of MCERA. This class differs from other County Accounting and Auditor classes by virtue of its responsibility for the specialized pension accounting and investment functions which comprise the independent County Retirement system operating under the 1937 County Retirement Act.

SUPERVISION EXERCISED:
No supervision is exercised. Incumbent may have responsibility for training and technical oversight of the work staff, may serve as lead worker.

EXAMPLES OF DUTIES: *Duties may include but are not limited to the following:*

- Assist the Retirement Administrator with asset allocation rebalancing, updates to investment policies and objectives and the periodic review and monitoring of asset classes, sub-asset classes and investment manager risk; monitors and reports on changes in capital markets, earnings, fees and legal requirements related to MCERA's investment matters.
- Monitor and analyze the performance of MCERA's investments in public and private markets; make recommendations regarding investments and assets.
- Prepare monthly financial statements, monitor investments, review and reconcile investment statements, reconcile employee reserve accounts, recommend cash and investment management strategies.
- Prepare annual financial statements and coordinate with independent financial auditor and actuary in the development of Audited Financial Statements and Actuarial Valuation and Review. Make recommendations to the Retirement Administrator regarding recommendations in the Auditor's Management Letter.
- Prepare annual State Controller's report, Comprehensive Annual Financial Report (CAFR), Popular Annual Financial Report (PAFR) and other required reports.
- Assist the Retirement Administrator with reporting requirements related to the Comprehensive Annual Financial Report, the annual Actuarial Valuation Report and the Quarterly Performance Report.
- Perform financial analysis and/or provide data at the request of the Retirement Administrator or the MCERA Board.
- Assist in the design, development, recommendation and implementation of investment related operational and internal control policies and procedures in accordance with the goals and guidelines established by the MCERA Board.
- Interpret and apply complex statutory and regulatory provisions relating to the Retirement Association including the 1937 Act Retirement System Laws.
- Maintain confidential information in accordance with legal standards and /or County policy and regulations.
- May act on behalf of or perform some duties of Retirement Administrator in the Retirement Administrator's absence.
- Performs other related duties as assigned.

MATERIAL AND EQUIPMENT USED:
Personal Computer and/or Terminal
General Office Equipment

MINIMUM QUALIFICATIONS REQUIRED:

Education and Experience:
Possession of a Baccalaureate degree from an accredited college or university with a major in Business, Public Administration, Accounting or Finance, or closely related field; and four(4) years of progressively responsible professional level accounting or auditing experience, preferably in a California government agency retirement system. (Additional qualifying experience may be substituted for up to two years of the required education on the basis of two years experience for one year of education.)

Licenses and Certifications: None required; CPA preferred

KNOWLEDGE, SKILLS, AND ABILITIES:

Knowledge of:
- County Employees Law of 1937, principles and operations of retirement systems and related laws.
- Governmental Accounting Standards Board (GASB) Statements, Interpretations, Technical Bulletins and Concept Statements.
- Governmental accounting practices, actuarial principles and accounting standards related to pension systems.
- Investment categories and transactions, asset allocation and financial management procedures and practices.
- Modern portfolio theory and application.
- Risk monitoring and management methods and techniques.
- Analytical techniques commonly used in the management of equity and fixed income portfolios.
- Economic and market conditions and trends and their effect on short and long term investment strategies.
- Administrative principles and practices including goal setting and implementation.
- Modern principles, practices and legislative trends relative to County government and government officials.
- Laws, policies, and procedures applicable to assigned work.
- Record keeping, report preparation, filing methods and records management techniques.
- Computer applications, hardware, and other general office equipment related to the performance of the job.

Skill in:
- Time management and project prioritization.
- Researching, compiling, analyzing, and summarizing a variety of complex financial and statistical data.
- Preparing clear and concise financial and statistical reports, correspondence and other written materials.
- Communicating clearly and effectively, both orally and in writing.

Mental and Physical Ability to:
- Understand, interpret, and apply provisions of Federal and State Laws and regulations.
- Understand and assess the quality, accuracy and reliability of manager and consultant reports and the application of such data.
- Formulate and make recommendations on investment policies and strategies.
- Analyze data, interpret policies, procedures and regulations, and develop appropriate conclusions.
- Set up, maintain and verify complex, financial accounting systems.
- Prepare and present reports on portfolio performance and investment activity.
- Establish and maintain effective working relationships with all work-required contacts including the general public.
- While performing the essential functions of this job, the incumbent is regularly required to sit, use hands to finger, handle, or feel objects, to reach with hands and arms, and speak and hear.
- Lift, carry, push/pull or move objects weighing up to 20 pounds.

Working Conditions:
- Work is performed in a normal office environment with little exposure to outdoor temperatures or dirt and dust.
- The incumbent's working conditions are typically moderately quiet.

This class specification should not be interpreted as all-inclusive. It is intended to identify the essential functions and requirements of this job. Incumbents may be requested to perform job-related responsibilities and tasks other than those stated in this specification. Any essential function or requirement of this class will be evaluated as necessary should an incumbent/applicant be unable to perform the function or requirement due to a disability as defined by the Americans with Disabilities Act (ADA). Reasonable accommodation for the specific disability will be made for the incumbent/applicant when possible.

Grand Jury Report

RESPONSE FORM

Grand Jury Report Title : MCERA Evaluation

Report Dated : April 18, 2012

Response Form Submitted By:

Mendocino County Employee's Retirement Association
625 B Kings Court
Ukiah, CA 95482

Response MUST be submitted, per Penal Code §933.05, no later than:
August 8, 2012

I have reviewed the report and submit my responses to the FINDINGS portion of the report as follows:

☒ I (we) agree with the Findings numbered:
1, 2, 3, 4, 7, 12, 14, 15, 16, 18, 19

☒ I (we) disagree wholly or partially with the Findings numbered below, and have ***attached, as required***, a statement specifying any portion of the Finding that are disputed with an explanation of the reasons therefore. 10, 11, 13, 17, 20, 21, 22, 23, 24, 25

I have reviewed the report and submit my responses to the RECOMMENDATIONS portion of the report as follows:

☒ The following Recommendation(s) have have been implemented and ***attached, as required***, is a summary describing the implemented actions:
1, 7

☐ The following Recommendation(s) have not yet been implemented, but will be implemented in the future, ***attached, as required*** is a time frame for implementation:
____

GRAND JURY REPORT
RESPONSE FORM
PAGE TWO

☐ The following Recommendation(s) require further analysis, and ***attached as required,*** is an explanation and the scope and parameters of the planned analysis, and a time frame for the matter to be prepared, discussed and approved by the officer and/or director of the agency or department being investigated or reviewed: (This time frame shall not exceed six (6) months from the date of publication of the Grand Jury Report)

____

☒ The following Recommendations will NOT be implemented because they are not warranted and/or are not deemed reasonable, ***attached, as required*** is an explanation therefore:

2, 8

I have completed the above responses, and have attached, as required the following number of pages to this response form:

Number of Pages attached: 6

I understand that responses to Grand Jury Reports are public records. They will be posted on the Grand Jury website: www.co.mendocino.ca.us/grandjury. The clerk of the responding agency is required to maintain a copy of the response.

I understand that I must submit this signed response form and any attachments as follows:

First Step: E-mail (word documents or scanned pdf file format) to:

- The Grand Jury Foreperson at: grandjury@co.mendocino.ca.us
- The Presiding Judge: grandjury@mendocino.courts.ca.gov

Second Step: Mail all originals to:

Mendocino County Grand Jury
P.O. Box 939
Ukiah, CA 95482

Printed Name: RICHARD A. WHITE, JR
Title: RETIREMENT ADMINISTRATOR

Signed: Richard A. White Jr. Date: JULY 20, 2012

Richard A. White, Jr.
Retirement Administrator

Telephone: (707) 463-4328
(707) 467-6473
Fax: (707) 467-6472

MENDOCINO COUNTY
EMPLOYEES' RETIREMENT ASSOCIATION
625-B KINGS COURT
UKIAH, CALIFORNIA 95482-5027

Date: July 18, 2012

Subject: Response to the Grand Jury

Findings (1-4, 7, 10-25):

1. MCERA is responsible for the investment of retirement funds.

Agree.

2. The County, under the direction of the BOS, is responsible for negotiating public employee benefits.

Agree.

3. In 1998, retiree health benefits were discontinued for new employees after the date of the resolution.

Agree. Retiree health benefits were discontinued by the Board of Supervisors by Resolution 98-147 for new employees hired after Sept. 1, 1998, as specified in the resolution.

4. The County continues to partially fund non-Medicare eligible retirees.

Agree. MCERA's response is to the best of its knowledge. The County's funding of non-Medicare eligible retirees is not a MCERA function. This should be verified with the County.

7. COLA increases are allowed up to 3% per year.

Agree. To clarify the Grand Jury's finding, MCERA assumes the finding refers to pension COLA as defined by Government Code Section 31870.1.

10. The Buck Consulting firm and MCERA collaborated in 2005 on questionable actuarial practices to justify "excess earnings" of $9.6 million.

Disagree. MCERA actions in 2005 related to excess earnings were based on the advice of accounting and actuarial professionals who, at that time, advised that these actions were in accordance with accepted principles. MCERA has since hired new actuaries and accountants who recommended different methodology and practices. MCERA has followed this new advice. MCERA also was advised that there are differences between State law and IRS rules relating to retiree health benefits that we must reconcile. This led the Board of Retirement to initiate a review by the IRS to determine if MCERA's actions were in compliance with IRS tax laws, and if not, to guide us in a Voluntary Correction Program (VCP) to come into full compliance. We are also working with the law firm of Hanson Bridgett, experts in tax law as it pertains to public pension plans, to review the $9.6 million allocation of excess earnings and help us work with the IRS toward compliance if necessary.

Note: MCERA disagrees with the characterization implied by the Grand Jury's choice of words in this finding, which could be misconstrued by the reader as wrongdoing.

11. Some of the 2005 "excess earnings" were diverted to fund health care.

Partially disagree. Excess earnings were allocated to fund retiree health care in 2005/06 based on advice from MCERA's actuary as described in Finding #10. MCERA disagrees with the characterization implied in the language of the finding.

12. Ultimately, this $9.6 million was written off as a loss in FY 2010-11.

Agree. The $9.6 million in unrealized earnings was written off as a result in a change in accounting and actuarial methodology, consistent with the practices of many retirement systems and in accord with professional advice.

13. The IRS is currently reviewing the county's diversion of "excess earnings" as part of the Volunteer (sic) Correction Program (VCP). The VCP is associated with the maintenance of the tax-exempt status.

Partially disagree. MCERA has initiated a review by the IRS and enlisted the help of its actuary, accountants, and legal counsel. We await updates and a response by the IRS, but have not yet been advised by the IRS on its review or its timeline. MCERA is committed to working closely with the IRS if a review finds any corrections need to be made. See response to Finding #10 for further detail.

14. In February 2007, the BOS and the Board of Retirement Ad Hoc Committee recommended hiring an independent MCERA administrator.

Partially agree. The BOS and Board of Retirement did recommend hiring a professional administrator to enhance the financial expertise and management of the system, and to strengthen policies and procedures at MCERA. The position was filled but is not fully independent, as it reports to the Board of Retirement.

15. The MCERA Administrator was hired in October 2008.

Agree. That administrator has since retired and a new administrator joined MCERA in June, 2012.

16. The new administrator position was created to establish an organization with supporting policies and procedures that increase the effectiveness and transparency of MCERA.

Agree. This was an important consideration in hiring the administrator and has yielded the desired benefits. The investment in a professional staff has greatly strengthened practices and procedures, and increased the effectiveness and transparency of MCERA.

17. The hiring of the full time director and staff increased the MCERA salary costs from $167,000 a year in 2007 to $322,000 a year in 2010.

Partially disagree. The salary and benefit costs associated with the hiring of full-time professional staff have increased since the independence of MCERA. Please refer to the response to this finding of the Grand Jury by the Mendocino County Board of Supervisors for additional information on the actual line item expenditures. See our response to Finding #16 for additional comment on this finding.

18. The creation of an independent MCERA has increased the effectiveness and the cost of its operation with the creation of Comprehensive Annual Financial Reports (CAFR), a web presence, and televised meetings.

Agree. This response assumes that the Grand Jury refers again to the professional administrator as independent in presenting this finding. We again note that MCERA's administrator reports to the Board of Retirement. The "creation" of the administrator position has resulted in the benefits listed in this Finding. See also response to Finding #16.

19. Since 2008, the following changes have been made through a formal Request for Proposal (RFP) process:

In October 2009 the financial consultant Peter Chan was replaced by Callan Associates.

Agree.

In March 2011 the actuarial consultants Buck Consulting was replaced by Segal Company.

Agree

In July 2011 the audit consultant Jim Sligh was replaced by Gallina LLP.

Agree

20. MCERA's unfunded actuarial accrued liability (UAAL) as of June 30, 2010 was $91,784,613. In this year's actuarial valuation, the UAAL has increased to $124,912,676.

Partially disagree. This response assumes that by "this year's actuarial valuation," the Grand Jury refers to the valuation of FY 2010-11, ending June 30, 2011. MCERA agrees that the UAAL numbers stated in the finding are exactly as presented in the last two actuarial valuations. However, we believe it is important for the reader to understand that an increase in the UAAL of $9,034,607, or 27% of the increase, is due to the actuary's reclassification of some future year liabilities (normal cost) to historical liabilities (UAAL). It is ultimately a change in methodology that takes into account costs that previously were considered future costs but are now being realized as past year costs. Therefore, they are now calculated as part of the outstanding UAAL.

21. The revised GASB reporting standards, to be implemented in 2013, will reflect a current financial market value of pension assets and liabilities.

Partially disagree. The revised reporting standards (GASB 67 for plan reporting and GASB 68 for employer reporting) will become effective in 2013/2014 for the plan and in 2014/2015 for the employer. Even though the new standards mandate reporting based on market value of pension assets, plan liabilities continue to be valued using long term actuarial assumptions (i.e., no market value of liabilities). While the new GASB statements are intended to bring financial reporting standards for the plan sponsors more in line with Generally Accepted Accounting Principles (GAAP), recognizing changes in assets and liabilities more closely to the year in which they are incurred, MCERA believes that the Grand Jury's statement reflects only one of many reporting requirements proposed by the GASB. In addition, the new GASB statements allow some changes to be recognized over a specified time period of more than one year.

22. MCERA liquidates investment assets on an "as needed" basis to meet pension requirements.

Disagree. The MCERA board has adopted a cash management and portfolio rebalancing policy which requires a cash management plan be adopted prior to the beginning of a new fiscal year and the preparation and presentation of monthly reports on the sources and uses of cash. The Grand Jury's use of the term "as needed" could be misconstrued to suggest that such sales occur as a spontaneous response to a situation, which is not the case.

23. Decision making information has not been readily available to MCERA due to failure to produce cash flow reports.

Disagree See response to Finding #22.

24. The CAFR is produced a full year after the financial reporting period, too late for planning purposes.

Partially disagree. While monthly planning and decisions are greatly aided by the information received in regular cash flow reports and other staff reports and input, the CAFR is expressly useful for long-term planning. Because it includes voluminous reports on the economy, audits, actuarial, and other complex financial information, it cannot be captured reliably in a short period after the close of a year.

25. MCERA has lowered its 8% projected investment return rate to 7.75%, which has a 54% probability of fulfillment over the next 28 years.

Partially disagree. After an experience study in the fall of 2011, MCERA did agree with the recommendation of its actuaries to reduce the anticipated return on its investments from 8% to 7.75%. The Retirement Fund is a very long-term enterprise in which sound planning must assess our needs and project earnings on investment over many decades in the future. It is critical that people understand that it is just as misleading to project our fiscal growth using an artificially-low average rate of return (as occurs during a recession), as it is to project an artificially high rate of return (as the economy produced in some years of the last decade). Despite the volatility of the economy and other factors, MCERA's experts have advised, and we agree, that long-term experience and future economic modeling tells us that 7.75 % is an appropriate median rate of return for the future and that over a 15-year period there will be a 54% chance that MCERA will achieve an average return on its investments of at least 7.75%..

Note: It is also important to note that the Board of Retirement closely monitors many indicators and its investments and can adjust the projected rate as conditions and data warrant.

Recommendations (1, 2, 7, 8)

1. MCERA have a thorough understanding and a documented account of all fixed monthly pension costs.

The recommendation has been implemented. MCERA staff produces a statement of plan net assets and statement of changes in plan net assets for the Board on a monthly basis to ensure that the Board has comprehensive information needed to make sound policy decisions. The statements include administrative and investment expenses. In addition, staff provides the Board with a report of all material expenditures during the past month and answers any questions the Board may have relative to those expenditures. Finally, staff is now providing the Board a monthly cash flow analysis which includes all material sources and uses of cash for the month, year to date, and projected for the balance of the year.

2. MCERA encourage the BOS to revisit pension benefits to renegotiate and reduce benefits for new hires.

The recommendation will not be implemented. This is the role of the Board of Supervisors, not MCERA. The role of MCERA is to invest and safeguard assets to be used in meeting long-term pension liabilities, and to administer the pension program.

7. MCERA produce reports that facilitate better financial management to sustain principle (sic) assets and eliminate the need to sell off investment assets to pay for obligations.

The recommendation has been implemented. The Board of Retirement adopted a cash management and portfolio rebalancing policy that includes: (a) adoption of a cash management plan for the upcoming fiscal year; (b) monthly cash management reports; and (c) quarterly rebalancing of investments to targeted levels. The Board's policy recognizes the need to maintain sufficient cash on hand to meet ongoing obligations while meeting its fiduciary responsibility to invest funds in a manner that provides the greatest likelihood of meeting long-term goals for return on investments. The flexibility to sell select investment assets can be a vital strategy in allowing the Board to meet its obligations, or to reinvest its assets for greater return as markets may indicate.

8. MCERA participate in the early trial implementation of the revised GASB 25 offered by the IRS.

The recommendation will not be implemented. First, the GASB 25 was not an IRS program. It has since been restructured under the title GASB 67, and the elements and implementation of GASB 67 continue to be debated. It is envisioned by the GASB that retirement systems with larger portfolios of assets under management be first to implement the final requirements before the required implementation dates as specified in the response to finding 21. In part this recognizes the resources of larger systems and plan sponsors to test implementation of such a significant change in financial reporting. Smaller systems, like MCERA, can benefit from the lessons learned by larger systems. The benefit of learning from larger systems will likely result in a more effective and efficient implementation of the GASB 67 and, thereby, a cost savings to both the plan sponsor and the retirement system.

Grand Jury Report

RESPONSE FORM

***Grand Jury Report Title* :** *MCERA Evaluation*

Report Dated : April 18, 2012

Response Form Submitted By:

John McCowen, Chair
Mendocino County Board of Supervisors
501 Low Gap Rd, Room 1010
Ukiah, CA 95482

Response MUST be submitted, per Penal Code §933.05, no later than:
August 8, 2012

I have reviewed the report and submit my responses to the <u>FINDINGS</u> portion of the report as follows:

☒ I (we) agree with the Findings numbered:
2, 3, 4, 7, 14, 15, 16

☒ I (we) disagree wholly or partially with the Findings numbered below, and have ***<u>attached, as required</u>***, a statement specifying any portion of the Finding that are disputed with an explanation of the reasons therefore.
5, 6, 8, 9, 13, 17

I have reviewed the report and submit my responses to the <u>RECOMMENDATIONS</u> portion of the report as follows:

☒ The following Recommendation(s) have been implemented and ***<u>attached, as required</u>***, is a summary describing the implemented actions:
3, 4, 6

☒ The following Recommendation(s) have not yet been implemented, but will be implemented in the future, ***<u>attached, as required</u>*** is a time frame for implementation:
5

GRAND JURY REPORT
RESPONSE FORM
PAGE TWO

☐ The following Recommendation(s) require further analysis, and ***attached as required,*** is an explanation and the scope and parameters of the planned analysis, and a time frame for the matter to be prepared, discussed and approved by the officer and/or director of the agency or department being investigated or reviewed: (This time frame shall not exceed six (6) months from the date of publication of the Grand Jury Report)

____

☐ The following Recommendations will NOT be implemented because they are not warranted and/or are not deemed reasonable, ***attached, as required*** is an explanation therefore:

____

I have completed the above responses, and have attached, as required the following number of pages to this response form:

Number of Pages attached: 1

I understand that responses to Grand Jury Reports are public records. They will be posted on the Grand Jury website: www.co.mendocino.ca.us/grandjury. The clerk of the responding agency is required to maintain a copy of the response.

I understand that I must submit this signed response form and any attachments as follows:

First Step: E-mail (word documents or scanned pdf file format) to:

- The Grand Jury Foreperson at: grandjury@co.mendocino.ca.us
- The Presiding Judge: grandjury@mendocino.courts.ca.gov

Second Step: Mail all originals to:

Mendocino County Grand Jury
P.O. Box 939
Ukiah, CA 95482

Printed Name: John McCowen

Title: Chair, Mendocino County Board of Supervisors

Signed: John McCowen

Date: 7/31/12

ATTEST:
Carmel J. Angelo, Clerk of the Board
Mendocino County Board of Supervisors

[signature] DEPUTY

Finding 5: The Mendocino County Board of Supervisors has no specific information as to employment levels as of April 18, 2012, and therefore is unable to agree with this finding. The Board of Supervisors has verified that as of April 14, 2012, there were a total of 1021 permanent and 86 extra help employees.

Finding 6: The Mendocino County Board of Supervisors has no specific information as to the number of retirees as of April 18, 2012, and therefore is unable to agree with this finding. The Board of Supervisors has verified that as of March 31, 2012 there were 1188 retirees and as of April 30, 2012, there were 1208 retirees.

Finding 8: The Mendocino County Board of Supervisors disagrees in part with this finding. The current Board of Supervisors is not familiar with the thought processes of the Boards that issued Pension Obligation Bonds in 1996 and 2002, but the reasons stated are commonly cited as justification for the issuance of POBs.

Finding 9: The Mendocino County Board of Supervisors disagrees in part with this finding. The statement that "this year's POB deficit is $82.98 million" is incorrect. The figure cited is an outstanding principal amount that will be fully amortized in fiscal year 2026-27.

Finding 13: The Mendocino County Board of Supervisors disagrees in part with this finding. The finding refers to "the county's diversion of excess earnings," but only MCERA, not the County, has had the authority to declare and divert excess earnings.

Finding 17: The Mendocino County Board of Supervisors disagrees with this finding. The County of Mendocino budgets on a fiscal year basis so it is not possible to determine expenditures for any given calendar year. As shown in the County of Mendocino adopted final budget books, actual line item expenditures for MCERA staff Total Salaries and Employee Benefits for fiscal year 2006-07 were $188,105; for fiscal year 2007-08 - $259,000; for fiscal year 2008-09 - $372,377; for fiscal year 2009-10 - $429,811; and for fiscal year 2010-11 - $364,855.

Recommendation 3: This recommendation has been implemented and reflects current practice and is ongoing. A member of the Board of Supervisors is appointed to the Retirement Board as a voting member and is responsible for reporting back to the Board. The Board also receives the annual report on the Actuarial Valuation, including a presentation in open session from the actuary and the Retirement Administrator and additional pension and retirement related items throughout the year.

Recommendation 4: This recommendation has been implemented and reflects current practice and is ongoing. Workforce reductions and wage concessions have significantly reduced pension liabilities.

Recommendation 5: This recommendation has been implemented and reflects current practice and is ongoing. The Mendocino County Board of Supervisors, through collective bargaining negotiations, has secured the right from seven of eight bargaining units to implement a new retirement tier for new hires. This recommendation will be fully implemented following the successful conclusion of negotiations with all bargaining groups.

Recommendation 6: This recommendation has been implemented and reflects current practice and is ongoing. The Mendocino County Board of Supervisors continues to pursue opportunities to increase pension fund sustainability.

Mendocino County Employees' Retirement Association
Strategic Planning Session
October 17 & 18, 2012
Agenda DRAFT

Agenda – Wednesday, October 17, 2012

1:00 p.m.	**Welcome & Introductions** Opening Remarks Review of the Agenda
1:15p.m.	**Overview of Strategic Planning Process**
2:00p.m.	**Examples of Mission Statement, Vision & Core Values** **Examples of Goals** **Examples of Objectives**
2:15 p.m.	**SWOT Analysis**
3:00p.m.	**Environmental Scan**
4:00p.m.	**Identification and Discussion of Critical Issues**
5:30p.m.	**Closing Remarks & Adjourn for the Day**

Agenda – Thursday, October 18, 2012

8:30a.m.	**Recap of Previous Day's Work**
8:45a.m.	**Clustering of Issues**
9:15a.m.	**Discussion of Possible Goals** **Discussion of Possible Objectives**
11:30 a.m.	**Next Steps in Strategic Planning**
11:45a.m.	**Adjourn Strategic Planning Session**

Hewitt ennisknupp

An Aon Company

Nancy A. Williams

Nancy Williams is the practice co-leader of Hewitt EnnisKnupp's Fiduciary Service practice. She has over 30 years of experience as an attorney, pension fund executive, trustee and a consultant. During that time she has worked with over 100 public funds (state and local retirement systems and state investment boards) in the U.S. and several national pension systems in other countries. Many of her clients have been public entities in California.

Prior to joining the firm in 2005, Nancy was the National Governance and Policy Unit Leader at Mercer Investment Consulting, and prior to that, the National Public Sector Practice Leader at Mercer Human Resource Consulting. In addition to her experience at Mercer, Nancy served as the Deputy Director and General Counsel for the Colorado Public Employees' Retirement Association. She was also the General Counsel to the State Teachers Retirement System of Ohio and a trustee on public retirement boards early in her career.

Nancy holds a B.S. degree from Ohio State University and a Juris Doctor degree from Capital University Law School where she was an editor of the Law Review. Some of Nancy's affiliations include: Founder and Past President of the National Association of Public Pension Attorneys (NAPPA), Advisor to the Commissioners on Uniform State Laws (Model Public Pension Fund Management Act), Advisor to the CFA Institute, Past Executive Board Member of the National Conference of Public Employee Retirement Systems (NCPERS), Advisor to the National Association of Corporate Directors, Past Committee Member of the National Council on Teacher Retirement, Advisory Committee Member of the National Association of State Retirement Administrators, and Public Employees Committee Member of the International Foundation of Employee Benefit Plans.

Nancy is licensed to practice law in California, Colorado and Ohio but currently serves clients as a governance consultant with an emphasis on strategic planning, policy development, board self-evaluations, executive director and other staff evaluations, organizational reviews, fiduciary audits, new trustee orientations and ongoing trustee training, including fiduciary training.

Richard A. White, Jr.
Retirement Administrator

Telephone: (707) 463-4328
(707) 467-6473
Fax: (707) 467-6472

MENDOCINO COUNTY
EMPLOYEES' RETIREMENT ASSOCIATION
625-B KINGS COURT
UKIAH, CALIFORNIA 95482-5027

Date: August 15, 2012
To: Board of Retirement
From: Richard White, Retirement Administrator
Subject: Communications to the Board of Retirement

Recommended Action: Informational Item Only

Discussion: Included in this item for the Board of Retirement are articles and items of interest which relate to public pension funds and are presented to the Board as informational items.

1. Poole, J. (2012, July 20). County pension fund faces $13 million loss. The Willits News (willitsnews.com).
2. Janus Capital Management LLC. (2012). Can't Sleep? Take the Money Out of Your Mattress. Jim Goff, CFA, Director of Research.
3. Munnell, A. (2012, July 31). Weak Economy Slaps 401(k)s. Smart Money.com.
4. Advisor One. (2012, July). Realistic Planning: There's More to Life Than Retirement. In The Public Eye (www.iwpubs.com).

County pension fund faces $13 million loss

By Jennifer Poole/TWN Staff Writer The Willits News
Posted:

WillitsNews.com

County pension fund faces $13 million loss

Although the numbers aren't final yet, Mendocino County's pension fund investments like CalPERS, the state retirement fund had a very bad year in fiscal year 2011/12.

The pension fund investment looks like it will close the fiscal year with a $13 million loss, missing its target of a 7.75 percent investment return.

"We'll get a final report next month," said Richard White, the new administrator for the Mendocino County Employees' Retirement Association, who started work in June.

"But it looks like we'll be consistent with the big boys." White went on to reference CalPERS, the California Public Employees' Retirement System, which reported returns of only 1 percent for fiscal year 2011/12 and CalSTRS, the California State Teachers' Retirement System, which reported returns of 1.8 percent. Both large pension funds CalSTRS is the largest pension fund in the United States, and CalPERS is the second-largest have a 7.5 percent target for returns. Newspaper reports about the CalPERS returns have used the words "dismal," "paltry" and "measly."

Mendocino County's county employees do not participate in CalPERS. Mendocino County is one of 20 counties that established its own pension fund under the County Employees' Retirement Law of 1937.

Preliminary June numbers show Mendocino County's pension fund will end the 2011/12 fiscal year with a total of $339,738,600 in managed investments, down from $352,826,321 at the start of the fiscal year.

Real estate and international stocks seem to have taken the biggest hit. Some examples: the county's investment in RREEF Infrastructure's Commingled Fund, $13,567,707 at the start of fiscal year, was down $7,225,557. The county had $17,012,890 invested in the Harbor International Fund, and that was down $2,027,508 as of the end of the fiscal year.

Asked about the poor returns after the meeting, retirement board member Ted Stephens, an investment advisor himself, said he was confident the county's investments weren't doing any worse than the rest of the market. Stephens, a critic of the retirement board, was appointed to MCERA last year by the board of supervisors.

"This last 10 years has been terrible," Stephens said. "There's nothing we're doing out of the ordinary."

"Some would say this is 'the new norm,' Stephens said, "and some would say the recent returns are not indicative of what we'll see going forward. I have a high degree of confidence that we'll reach those numbers [the target returns] over the long run."

The retirement board's new actuaries, the Segal Company, hired last year, have given a 54 percent level of confidence that those targets would be met over time.

Stephens also said he had confidence that the county's investments were properly diversified and vetted, with the help of financial consultants Callan Associates, hired in October 2009 to replace longterm advisor Peter Chan, and that the county would reach its investment targets over the long term.

But retirement board members agreed there was no question that contribution rates by the county and by employees would have to go up again.

Stephens did question whether the "very, very complicated" actuarial science really can be accurate enough to depend on, as far as promising defined benefits to pension recipients, based on long-term returns from investments.

"A guaranteed benefit going to the participants is a noble cause," Stephens said, "but in the long run, there's a question that has to be answered about whether the science is good enough to accurately predict the consequences" of different kinds of investments.

[redacted]

Director of Research Insight, June 2012

Can't Sleep? Take the Money Out of Your Mattress

There is a frequently played television advertisement in the United States for a financial advisory firm. It shows a half dozen pacing husbands telling their relaxed wives that the sky is falling, with the wives responding "What are you going to do, put our money under the mattress?" and "The last I checked, the sky was not falling."

I have written frequently in these letters that pessimism was too high, the economy would come back, corporate profits were strong and equities were undervalued. I also blamed government for most of our problems. There hasn't been a year in the last five when at some point macro conditions weren't highly uncertain and true crisis seemed at hand.

We are in one of those periods now. I won't tell you (again) that the macro doesn't matter because the markets are reacting to it. But let me say this: The wives are right. The last time I checked, the sky was not falling.

When I picked stocks as a portfolio manager, I sought companies that would do well regardless of the economic cycle, partly because predicting macroeconomic and market cycles is so difficult. But the massive intra-year swings of the last five years have made that approach harder to conduct, and raised the questions of individual company fundamentals vs. macroeconomic downturns and of the appropriate time horizon for equity investors.

Yes, the macro matters. No, Chicken Little, it's not all bad news.

Fifteen years ago, the common belief was that the United States was losing its competiveness globally, with wage rates and other costs that were simply too high. US companies repeatedly moved production overseas and America entered a long season of stagnating wage rates. The US evolved into a "services economy" as it became less competitive in manufacturing.

In the past five years, since the housing bubble popped and the financial crisis began, America hit the reset button. We scaled back our expectations about incomes, owning vs. renting, the size of our homes and how many cars we need. Some people even moved in with mom and dad. Americans are doing a great job of adjusting to their new reality. They are happy by and large. Corporations are also adjusting well, taking advantage of cheap natural gas and lower wage rates to invest in United States production and in some cases moving non-US production back home. The financial crisis has left too many out of work and the recovery is still slower than many expect, but the steady headwind of manufacturing jobs leaving the US has turned into a mild tailwind. It took many years, but the US is again ready to compete well in global production.

Europe has for the past three years been the primary global villain. Once again its spring fling with dysfunction derailed a promising start to the year and forced investors and corporations back to risk-averse stances. All eyes are on Europe: How bad will it be and how much of a bite will it take out of markets and economic growth in the rest of the world?

There's no question it will be bad, but I will avoid talking about how Europe and the euro will play out. I simply don't know!

How much attention should we pay to the macro? Over what time frame does it matter? Many bears suggest the central bank printing presses will lead to runaway inflation, rendering paper money nearly worthless. These doomsayers usually have a strong allocation to gold and, quite possibly, an ample store of canned goods and ammunition. A short-term focus on the macro and the government's response dominate their views.

In the most impactful study I read over the past few months, two researchers, Carmen Reinhart and Kenneth Rogoff,* looked at the long-term impact of high government indebtedness. Using 150 years of data, they analyzed what has happened in developed nations when debt-to-GDP rises above 90% for at least five years. An important takeaway was that such a problem is not fixed quickly.

---

*Reinhart, C., Reinhart, V. and Rogoff, K. 2012. Debt Overhangs: Past and Present. NBER Working Paper No. 18015.

The good – or at least better – news is that GDP growth in those nations generally remained positive, but averaged 100 basis points below their long term trends (2.5% vs. 3.5%). Below-trend growth for that many years meant the economy ultimately operated at 25% below potential. That slack in the economy meant inflation stayed low, despite the roar of the printing presses.

As a long term growth investor, I found these results freeing, unifying the macro and micro, the short-term condition and the long-term consequences. It answered the big macroeconomic questions about inflation fears and global fiscal imbalances with the pursuit of a long-term, stock-by-stock investment view. We love finding companies enjoying competitive advantages, strong management and a growth runway that allow them to create long term value for investors. While moderate growth may not be a tide that lifts all boats, moderate growth with low inflation is a great environment for investing in long-term value creators. That and the low starting point for equity valuations around the world leave me bullish about the coming decade.

Pull the cash, gold, canned goods and ammunition from under the mattress. You can sleep better and still invest in equities. The sky is not falling. It's an acorn, only an acorn.

Sincerely,

Jim Goff, CFA
Director of Research

What you might not know. Interesting data points I find worth sharing:

Adapting and Strengthening in the United States

- **Consumers** are benefitting from lower food and energy prices and, due to declining mortgage rates, all-time highs in affordability of housing. Consumer net worth is up $11 trillion, or 23% from its 2009 low.

- In March the amount of **US electricity** generated from coal hit a forty year low of 34%; electricity generated from natural gas surged 40% year over year. The Financial Times reports that, "Shale gas has led to a big drop in carbon emissions, as generators switched from coal to gas." In 2008, there were estimates that the US had 12 years of natural gas reserves. Estimates today suggest sufficient natural gas supplies for at least 100 years. Shale gas is becoming a more popular fuel for truck fleets, displacing diesel.

- Signaling some of the recovery in **US housing market**, homebuilding stocks are up 25% year to date. The US homeownership rate fell to its lowest level in 15 years in the first quarter, despite improving affordability. The housing market has room to run. Housing has gone from a drag of about 1% on GDP growth in 2008 and 2009 to contributing 0.5% to GDP growth in 2012.

- **Old People Rule!** Too many Baby Boomers are unprepared for retirement and are staying in their jobs longer than expected. The number of people over 55 with jobs increased by 1.69 million over the past year, while the number of job holders aged 25 to 54 years increased by just 322,000 – even though the labor force in the younger group is three times as large as in the older set. In fact, since the start of the recession in December 2007, those 55 and older have gained a net 3.9 million jobs, even as total payrolls fell 4.2 million.

Economics and Markets

- Why have **corporate profits** been so much stronger than GDP growth? Manufacturing dominates the equity markets while the service sector dominates GDP. 80% of US private sector jobs and 60% of US GDP come from services where the recovery has been slow.

- One difference in this year's "sell in May and go away" selloff is that equity risk premiums going into the downturn are much higher than in 2010 and 2011, meaning the starting **valuation of stocks** this spring was lower.

- In 2010 and 2011, **inflation** was surging, particularly in emerging markets, with global CPI increasing from 2% to 4%. Global inflation has slowed to 2.7% and will likely continue to slow.

- In 2010 and 2011, there was a **global tightening cycle** in many countries, such as China, and global short term interest rates increased by roughly 100 basis points. Today, it is just the opposite with approximately 200 stimulative policy initiatives over the past nine months and a 50 basis point decline in global short rates.

- At 8.6% of gross domestic product, the **US budget deficit** is just under Greece's (at 9.1%) and equal to Spain's. US debt, at 103% of GDP, is just below Portugal's and 58% larger than Spain's. The US is now paying about $250 billion a year in interest on its debt. If interest rates were normalized, that figure would climb to about $600 billion.

- Sixty percent of S&P 500 stocks have a **dividend yield** above that of US treasuries.

- It may be surprising to some that the **MSCI Europe** index is actually up ~5% year to date through the end of the second quarter.

Odds and Ends

- CNBC' viewership is down 10% year over year. Are individual investors giving up?
- Money raised on equity markets by corporations has reached a seven-year low.
- The Financials Times published a major article titled "The Death of Equities?" reminiscent of the 1979 Business Week article entitled "The Death of Equities," which presaged a 20 year bull market.
- Seven of the 10 richest counties in the United States are located in suburbs of Washington D.C.
- When Nixon, Reagan, Clinton and Bush were re-elected, the unemployment rate in the month of May averaged 6.0% and was sequentially flat to down 0.3%. When the elder Bush and Carter failed in their re-election bids, unemployment averaged 7.5%, increasing 0.2-0.6% in the month of May. President Obama may be nervous with the unemployment rate increasing 0.1% in the month of May to 8.2%.
- For the first time since 1949, the nominal value of winning Nobel Prize has been reduced, by 20%.

ENCORE // **JULY 31, 2012, 2:01 PM**

Weak Economy Slaps 401(k)s

By Alicia Munnell

The release of the Federal Reserve's 2010 *Survey of Consumer Finances* (SCF) is a great opportunity to reassess how families are doing with their 401(k) plans. The SCF is a triennial survey of a nationally representative sample of U.S. households, which collects detailed information on households' assets, liabilities, and demographic characteristics. The 2001, 2004, and 2007 surveys showed some improvement in terms of 401(k) participation, contribution levels, investment choices, and cashing out. But median holdings of those approaching retirement remained low even at the peak of the market in 2007. Not surprisingly, the picture is bleaker in 2010.

Shutterstock.com

401(k) plans shift the responsibility for retirement saving from employers to individuals. An individual must decide whether to participate, how much to contribute, how to invest those contributions, whether to roll over or cash out balances when switching jobs, and – at retirement – when and in what form to withdraw the funds. People tend to make mistakes at every step along the way. In response, Congress enacted the Pension Protection Act of 2006 to make 401(k)s work better through automatic enrollment, automatic increases in the default contribution rate, and default enrollment in balanced funds, which are typically Target Date Funds that automatically reduce equity holdings as participants approach retirement.

Whereas, in the wake of the Pension Protection Act, the 401(k) system was starting to function better, the 2010 SCF suggests that progress has slowed in the weak economy. Despite the increase in auto-enrollment, the percent of eligible employees not participating ticked up. At the same time, contributions slipped and leakages through cash outs and hardship withdrawals increased.

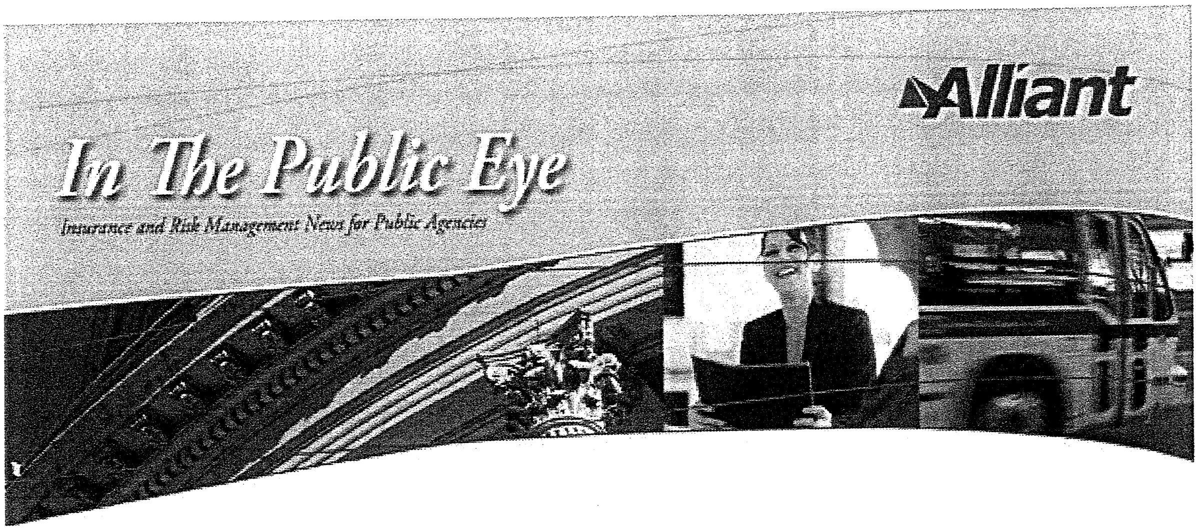
Combine these trends with financial turmoil, and it is not surprising that median 401k)/IRA balances have changed little since 2007, despite the likelihood that members of the new cohorts have spent more of their working lives covered by a 401(k) plan. A typical household approaching retirement (age 55-64) had only \$120,000 in 401(k)/IRA holdings. (IRAs are included because these balances consist primarily of rollovers from 401(k) plans.)

Households 45-54 actually had lower balances in 2010 than in 2007 – \$70,000 versus \$75,000, and younger households held only \$35,000 in 2010 compared to \$44,000 in 2007. These numbers are not adjusted for inflation. With prices rising more than 5 percent between the 2007 and 2010 SCF, balances have fared even worse in real terms.

The 401(k)/IRA balances of \$120,000 for those households approaching retirement will produce only a modest supplement to Social Security. If a couple purchases a joint-and-survivor annuity, they will receive \$575 per month. This \$575 is likely to be the only source of additional income, because the typical household has virtually no financial assets outside of its 401(k) plan. Many participants are likely to be surprised and disappointed when they find out how little their 401(k) plans provide.

The answer to the 401(k) challenge is twofold. First, 401(k) plans need to function better. Despite the Pension Protection Act, the share of plans with auto-enrollment appears to have stabilized at around 40 percent. And employers typically auto-enroll only new employees, so the effect on participation is very gradual. Moreover, auto-enrollment only works if it is combined with auto-escalation in the default contribution rate. Unfortunately, only 34 percent of plans with auto-enrollment have automatic escalation, which means that many who are enrolled stay at low contribution rates. Hence, the best way to make 401(k) plans work better is to make auto-enrollment and auto-escalation in the default contribution rate mandatory.

Second, even with automatic provisions, the combination of 401(k) plans and Social Security is unlikely to do the job. The time may have come to consider returning 401(k) plans to their original position as a supplement on top of Social Security and employer-sponsored pensions. Given the demise of traditional employer pensions, such a rearrangement would require a new tier of retirement accounts. This additional protection would be helpful to those reliant solely on Social Security and to those with 401(k) plans where – for one reason or another – balances end up being very modest.



Realistic Planning: There's More to Life Than Retirement

July, 2012

Advisor One

On the day I write this column, I made my last payment towards the education of my children. Had I paid via actual paper draft rather than electronic transfer, I would have waited to receive the cancelled check back and framed it. All three of my kids have now graduated with honors from fine universities and have done so without any debt. All of them have gotten good and fulfilling jobs. None of them has moved back home.

Woo-hoo!

Providing college for them was a key goal for my wife and me and I am (obviously) proud that we have accomplished it and even prouder of the accomplishments of our children. My wife and I have plenty of reasons to be proud. We might even throw a party to celebrate. But achieving this goal came at a cost. Our retirement planning is not where we would like it to be, and we are not alone in that.

The Retirement Confidence Survey (RCS) from the private, nonprofit Employee Benefit Research Institute has gathered opinion data from workers and retirees as to what they believe their financial status to be for over 20 years. The most recent survey results, published in March, once again show that worker confidence in having enough money to live comfortably throughout retirement is not very high.

Only 14% of people are "very confident" about their retirement prospects (compared with 27% as recently as 2007) while 23% say they are not at all confident about having a comfortable retirement.

People recognize the trouble they are in, and with good reason.

According to the EBRI Survey, 35% of all workers think they need to accumulate at least $500,000 by the time they retire to live comfortably in retirement. Another 18% feel they need between $250,000 and $499,999, while 34% think they need to save less than $250,000 for a comfortable retirement. At current rates, $500,000 purchases roughly $2,750 per month in guaranteed income for a 65 year-old male. Accordingly, there is very good reason to believe that people greatly underestimate the amount of money they will need to retire comfortably. This is yet another unintended consequence of the Fed's zero interest rate policy and the "war on savers" it has produced.

But even with these misplaced expectations (again according to EBRI data), only two-thirds of workers report that they have saved for retirement, down from 75% in 2009, and only 58% (down from 65% in 2009) are currently saving for retirement. Fully 60% of workers report less than $25,000 in total savings and investments, and 34% had to dip into savings this past year to make ends meet. Even for those who are focused upon retirement planning, life sometimes "gets in the way."

Much retirement planning advice focuses on saving more and saving earlier. It's terrific advice. Not nearly enough of us save and not nearly enough of us save enough. But this advice isn't always realistic and often comes couched in unjustified criticism.

The first major financial goal my wife and I set after we were married was to buy a house. We wanted our own home near good schools before we had children. Interest rates were high, unlike now, so there were relatively safe, liquid and convenient ways to save that provided excellent returns. But real estate values were climbing rapidly and mortgage rates were high. After a couple of years of very diligent saving — and nothing to retirement savings above the level needed for the 401(k) employer match, we were able to save enough and make a down payment to buy our first house.

One might quibble with that choice, and fewer young couples would likely make a similar choice today given the current real estate market, but it was a reasonable choice under the circumstances. The house offered us a place to raise our children in a good environment near family and other support systems. It was the right decision for us.

Obviously, young families are expensive, and ours was no exception. Retirement planning continued to mean little more than the company match until later, after college planning was more firmly grounded. Providing for our children — including college — was simply a more urgent concern for us. Many retirement planning advisors insist that college assistance should only come after maxing out the 401(k) each and every year, but we were not willing to go that route to the expense of our children's prospective education. Our priorities were (and are) different. Again, one may disagree with that choice, but it was an entirely plausible one, especially since I do not ask anyone to feel sorry for me or to prop me up financially on account of it.

I do not fall into this camp, but many workers are also incredibly discouraged about the prospect of saving and investing generally, including for retirement. According to the EBRI Survey, just 16% of workers are very confident that their investments will grow in value going forward. The secular bear market for stocks we have seen since the turn of the century and, much more recently, exceedingly low yields on bonds have resulted in some very disillusioned investors. That is a perfectly understandable reaction, especially given the findings of behavioral finance and the biases that so frequently beset us.

Many alleged experts in retirement planning — and I include myself in this group — are far too willing to offer advice without seeming to recognize the competing interests faced by those hoping to plan well. Much of what is called advice is really hectoring about the need to save more and to save more sooner and does not seem to recognize that alternative choices are not necessarily or entirely wrong.

A more realistic approach to retirement planning will not be all that different substantively — in general, people *should* save more and start saving sooner. But a better approach will meet the people who need good advice "where they live" without judgment or condescension, while remaining forthright about the challenges that await.

Not everyone with a less than perfect retirement plan gets into that situation on account of foolish decisions. My wife and I made some difficult choices. We remain convinced that, for us and for our family, they were the right choices. We are now ready to give retirement planning a much higher priority. It would have been better for our retirement plan had we done more and done it sooner, but thankfully we are in a position where we can still be cautiously optimistic about our retirement prospects.

Not everyone can give retirement planning the kind of focus and attention that they might otherwise like to. Per EBRI, 42% of workers identify job uncertainty as their most pressing financial concern, 20% report that their debt levels are a major problem and an additional 42% describe debt as a minor problem. Others have faced real economic, familial or health-related hardship. Some of us had what to us were more pressing priorities. We knew the risks we were taking and accepted them.

More realistic retirement planning will seek to offer the best and most creative approaches to the vexing problems we face without presuming that we have been irresponsible because our planning is not yet as advanced as it might be.

Return to Article Index

Forward this article to a colleague

Address To Recipient Name

Subject

Message

Send Reset