♦MENDOCINO COUNTY EMPLOYEES' RETIREMENT ASSOCIATION♦
BOARD OF RETIREMENT MEETING MINUTES
♦OCTOBER 15, 2014 AT 8:30 A.M.♦

CALL TO ORDER

Shari Schapmire, Board Chair, called the meeting to order at 8:30 a.m.

ROLL CALL

Roll call was conducted with the following members present: Randy Goodman, John Sakowicz, Ted Stephens, Tim Knudsen, Bob Mirata, Lloyd Weer, Richard Shoemaker, and Shari Schapmire. Also present: Jim Andersen, Interim Retirement Administrator, Jeff Berk, Legal Counsel, and Judy Zeller, Administrative Assistant. Absent: Supervisor John McCowen and Craig Walker.

PUBLIC COMMENT: None

Supervisor McCowen entered the meeting at 8:32 a.m.

1) MINUTES OF THE BOARD MEETING HELD SEPTEMBER 17, 2014

Presenter/s: Chair Schapmire referenced the minutes of the board meeting held September 17, 2014.

Board Action: Motion was made by Mr. Weer to approve the minutes of the board meeting held September 17, 2014. Mr. Goodman seconded the motion and it was approved by the following vote: Ayes: Mr. Weer, Mr. Sakowicz, Mr. Knudsen, Mr. Stephens, Mr. Goodman, Mr. Mirata, Supervisor McCowen and Ms. Schapmire. Noes: 0. Abstain: 0. Absent: Mr. Walker.

2) APPROVAL OF CONSENT AGENDA

Presenter/s: Chair Schapmire referenced the Consent Agenda which included 2-A Retirement Administrator's report, 2-B Quarterly Trustee Education and Training Staff Report, 2-C Membership, and 2-D Retirements processed for the month of September.

Board Action: Motion was made by Supervisor McCowen to approve the Consent Agenda. Mr. Goodman seconded the motion and it was approved by the following vote: Ayes: Mr. Weer, Mr. Sakowicz, Mr. Knudsen, Mr. Stephens, Mr. Goodman, Mr. Mirata, Supervisor McCowen and Ms. Schapmire. Noes: 0. Abstain: 0. Absent: Mr. Walker.

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

None

4) DISCUSSION AND POSSIBLE ACTION REGARDING THE 2014 TRIENNIAL EXPERIENCE STUDY

Presenter/s: Paul Angelo and Andy Yeung of Segal Consulting referenced the 2014 Triennial Experience Study prepared for MCERA for the three year period ending June 30, 2014. Mr. Yeung explained that the Retirement Board must look at actuarial and economic assumptions, as well as interest rate every three years. Mr. Angelo explained the report and summarized some of the assumptions which will be changing, the most significant being the assumed rate of return and mortality. Each experience study readjusts assumptions over time and is crafted with just our data. The mortality table is standard and is produced by the Society of Actuaries.

Mr. Yeung described the salary assumption which assumes salary increases during the first five years of employment which is a much better predictor than age. New employees are more likely to terminate from employment and last period we saw a much higher rate of termination within the first five years of employment. We recommend an assumption close to the current assumption for both General and Safety members.

Mr. Angelo explained that economic assumptions are more complicated this year due to new Government Accounting Standards Board (GASB) requirements regarding accounting of administrative expenses. He referenced option A in the report which deals with changes in accounting for administrative expenses and option B which lowers the return on assets, stating that Segal recommends option B with a lower expected rate of return as there is no need for a small system to change their accounting practices. This option also leads to fewer open questions regarding legal and reporting compliance.

Mr. Angelo added that it is hard to predict long term price inflation. We use a .25 % tolerance as we cannot predict an exact average. We look at different sources and it is very subjective. Historical price inflation goes back to 1930. The National Consumer Price Index (CPI) has fifteen and thirty year averages that include the high inflation years of the 1970's and 1980's. We look at capital market rates and assumptions, the Social Security program forecast, Treasury bonds, and economist forecasts. We recommend a 3.25% rate of inflation and suspect that we will be looking at 3% soon. This is .25% less than the current assumption. This rate of inflation is used to predict cost of living adjustments as well, but does not change how we value cost of living adjustments. Inflation is assumed to be the same by Segal for all clients as it reflects broad economic data and markets.

Mr. Angelo discussed the investment rate of return, stating that it is difficult to find the real rate of return gross of expenses. Investment advisors are experts in studying this. Some actuaries may have an investment consultant who looks at capital market assumptions, but Segal uses a survey of nine different consultants. Segal does not use the assumptions made by your investment consultant, Callan Associates, because of potential changes in investment consultant firms over time. A new consultant should not force big changes in your market value of investments.

Mr. Angelo discussed confidence levels, explaining that you want to be more than 50% sure you will hit your target rate of assumption. Adoption of a 7.22% rate of return would have a 54% confidence level of meeting your target or adoption of a 7.25% rate of return would have a 53% confidence level. A 7.5% rate has a low confidence level and is not recommended.

The Board discussed inflation and the bond yield curve, investment strategy, smart beta and alpha. Mr. Andersen mentioned that he spoke with Mr. Yeung regarding the case of alpha over what is recommended and found that MCERA has moved more towards a portfolio design and benchmarks that reflect beta and further away from active management. Mr. Angelo added that it makes sense to look at the rate on a passive management basis even though you have active management. Your investment expense is low. A recommended conservative approach may read as saying there is no credit for alpha, but it could also read as saying there is no credit expected for alpha. You are doing what the standard allows you to do and not giving credit in advance and not receiving credit for expense because you pay for that differently.

Mr. Angelo explained the difference between the geometric mean and the arithmetic mean. Segal uses arithmetic. He added that over the next few years there may be a trend away from arithmetic to geometric. This is not an easy topic, but could be pursued. We may wait to let others battle the challenge first as it would be a significant change and would need a lot of technical discussion. Mr. Stephens added that Callan Associates had been asked to look at this issue in preparation of this experience study. Their recommendation was a 6.6% geometric rate of return. They did show an arithmetic rate of return, but implied that we should use geometric.

Mr. Stephens urged the Board to consider a rate of 6.75% based on the Callan Associates study which showed an expected rate of return, for MCERA's allocation model, of 6.66% (before administration and investment expense) for the next 10 years and our actual historical rate of return for the last 17 years of 6.73% (before administration expense and the skimming of "excess earnings"). Mr. Stephens further stated that he believed it would be reckless for the board to adopt a rate above the 6.75% level because of the current funding level and a higher rate would shift all risk from the participants to the plan sponsor.

Mr. Angelo stated that changing the rate of return on investments from 7.75% to 7.25% is significant. You must balance benefit payments and minimize employer contributions with some awareness of the impact on employers and active employees.

Public comment:

George Hollister, Ken Fowler, John Dickerson, Kristi Furman, John Robertson, and Richard Respini spoke to the Board regarding the Triennial Experience Study and the assumed rate of return on investments.

Mr. Andersen stated that we anticipate making a decision today because the assumptions will be included in our annual actuarial valuation report, the GASB 67 & 68 required reports, and all other financial reports, which are all connected. Completion of these reports will require qualified opinions in some cases. There was no time to solicit written input from our sponsors. Supervisor McCowen commented that the County has felt that there has not been sufficient inclusion in the discussion of funding decisions, but a delay to solicit input from our sponsors probably would not change the recommendation or decision we make today, but it would create the illusion of responsiveness and that we are aware of the impact to our sponsors. The agenda should state what the possible action might be, or outline any significant changes. More could have been done to make it clear to our sponsors and the public. A staff report that describes the funding impact between options A and B to sponsors could have been included.

The Board discussed options A and B and the anticipated cost to the sponsors. Mr. Andersen mentioned that the cost is a ballpark number and asked if, this amount is overly burdensome to the employers, they may step into the rate increase. Mr. Angelo agreed that you can't phase in assumption changes, but you can phase in the cost impact. The liability would be published at 7.25% immediately. A two year or three year phase in of the cost to employers would be amortized over eighteen years. Member rates would not be phased in. Mr. Knudsen mentioned that administrative expenses already go to plan sponsors and members, but it is buried in the discount rate. The Government Code states that administrative costs of the retirement system cannot be passed on to the employer. Mr. Angelo replied that we are indirectly passing on the cost, in the discount rate. Mr. Yeung agreed.

The Board discussed the potential burden to the sponsors and supported the concept of a phased in agreement for the sponsors' cost. Mr. Andersen mentioned that work on the valuation study must begin immediately. Mr. Yeung recommended giving direction to the actuary to prepare the valuation and then prepare a side letter regarding the plan to phase employer contributions for approval. Mr. Weer commented that the County budget is heading to stability with some reserves, but we cannot take this hit (burden) in one year. We need to make this affordable and something we can plan and budget for. A two year phase may work.

Supervisor McCowen added that the decision could be made in December when we approve the annual valuation report.

Board Direction: Segal Consulting will begin work on the annual valuation report immediately and will prepare a side letter regarding an employer cost phase in approach for two year and three year periods which will be presented to the Board in December.

Board Action: Motion was made by Supervisor McCowen to adopt option B which was recommended in the 2014 Triennial Experience Study. Mr. Sakowicz seconded the motion and it was approved by the following vote: Ayes: Mr. Weer, Mr. Sakowicz, Mr. Knudsen, Mr. Goodman, Mr. Mirata, Supervisor McCowen and Ms. Schapmire. Noes: Mr. Stephens. Abstain: 0. Absent: Mr. Walker.

5) DISCUSSION AND POSSIBLE DIRECTION REGARDING TRUSTEE EDUCATION AND TRAVEL REPORT

Presenter/s: Mr. Andersen referenced the Trustee Education and Travel Report stating that the current policy requires adoption of specific travel and training opportunities each budget cycle. Staff will bring this back for Board adoption next month. Today we are looking for recommendations from the Board. The fall State Association of County Retirement Systems (SACRS) Conference is coming up and we need to determine attendance.

Mr. Sakowicz asked for a training budget comparison to other retirement systems. Mr. Knudsen asked about going over your individual budget. Mr. Andersen explained that the figures are projections based on experience and an attempt to provide twenty-four hours of training to board members. These are estimates to provide training within the $20,000 budget.

Board Direction: Staff will provide a training budget comparison to other retirement systems for board discussion in the future.

6) INVESTMENT REPORT

Presenter/s: Mr. Andersen referenced the monthly Investment Report.

7) FINANCIAL REPORT

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

Presenter/s: Jim Andersen referenced the monthly Financial Report.

8) DISCUSSION AND POSSIBLE ACTION REGARDING ADOPTION OF REGULATIONS REQUIRED BY DETERMINATION LETTER AND VOLUNTARY CORRECTION PROGRAM PROCESS

Presenter/s: Jim Andersen referenced information regarding adoption of Model Regulations required by the Determination Letter from the Internal Revenue Service (IRS) following the Voluntary Correction Program (VCP) process. He stated that adoption of the regulations are a part of the VCP and a follow through on what you promised to do.
Hanson Bridgett has been monitoring compliance issues and has provided all of the required updates for you. The 401(h) Policy drew the most attention and was already adopted by the board in 2011. We have also provided a historical diagram as to how contributions were processed for Retiree Healthcare. The recommendation is to adopt resolution 2014-08 which includes all of the required regulations and direct staff to implement the regulations appropriately.

Mr. Stephens asked to bring the excess earnings policy back for review.

Board Direction: Staff will bring the excess earnings policy back for board review in the future.

Board Action: Motion was made by Mr. Mirata to approve Resolution 2014-08 which includes all regulations required by the IRS Determination Letter. Mr. Goodman seconded the motion and it was approved by the following vote: Ayes: Mr. Weer, Mr. Sakowicz, Mr. Knudsen, Mr. Stephens, Mr. Goodman, Mr. Mirata, Supervisor McCowen and Ms. Schapmire. Noes: 0. Abstain: 0. Absent: Mr. Walker.

9) GENERAL BOARD MEMBER DISCUSSION

Ms. Schapmire mentioned that she spoke with Sulema Peterson, SACRS Administrator, recently about the Board's letter regarding sustaining Defined Benefit plans. Sulema thought our letter was the best written out of the 20 retirement systems. Mr. Andersen added that the memo from SACRS distributed today utilized much of your comments and wording.

Mr. Sakowicz mentioned a recent town hall meeting to discuss the Federal level of concern regarding defined benefits.

On October 22, 2014 there will be a special board meeting for Retirement Administrator interviews.

ADJOURNMENT (11:25 a.m.)