TUCSON SUPPLEMENTAL RETIREMENT SYSTEM
BOARD OF TRUSTEES
Meeting Minutes from Thursday, July 24, 2008, 8:30 a.m.

Members Present: Brian Bjorndhahl, Chairman
John Moore, City Manager's Appointee
David Cormier, Finance Director
Suzanne Machain, Deputy Human Resources Director
David Cormier, Finance Director
John O'Hare, Employee Representative
Gage Andrews, Employee Representative
Paul Miner, Retiree Representative

Staff Present: Frank Kern, Board Counsel
Jacinta Figueroa, Board Counsel
Joe Ladenburg, Deputy Finance Director
Allan Bentkowski, Investment Manager
Mike Hermanson, Retirement Manager
Claire Beaubien, Administrative Assistant

Guests Present: John Behrens, Investment Analyst
Joel Peterson, Risk Management Administrator
Jean Wilkins, CTRA Representative
Raul Navarro, Retiree
James Pearson, Retiree
David Burns, Retiree
Charles Deaubl, Retiree
Lois Rios, Retiree
Jill Moreno, Employee

A. Call to order

Chairman Bjorndahl called the meeting to order at 8:31 a.m.

B. Consent Agenda
1. Approval of June 26th, 2008 Board meeting minutes
2. Service & disability retirement ratification – July 2008

Mike Hermanson distributed a revised service & disability ratification report and Paul Miner **moved, seconded** by Gage Andrews, to approve the Consent Agenda with the revised report. **Motion passed 6 to 0** (John O'Hare not present at time of vote).

C. Investment Activity / Status Report
1. Portfolio composition, transactions and performance – Allan Bentkowski reported that as of June 30, 2008, the total fund value was $650.9 million. As of June 30, 2007, the value was $692.7 million, indicating a $41.8 million decrease for this year. This decrease included a $10 million transfer out to fund additional retirements and end of service payments, etc. The high value for the year was $714.7 occurring on October 10, 2007, while the

low of $639.9 million was on March 17, 2008. At July 23, 2008 the total fund value was $640.5 million, down from June due to equity market volatility. All manager allocations are within investment target ranges. In planning for the $7m cash flow needed to service End of Service program payments in October, Allan has been discussing rebalancing issues with Hewitt to keep all the accounts balanced according to the investment policy.

Allan reported that LaSalle called capital in the amount of $127,421, pushing the funded status of this commitment to 97.35%. Of the $8.1m committed to LaSalle, approximately $215,000 remains to be funded, completing a ramp up process that has taken about three years.

Despite negative returns for June, seven of nine equity managers outperformed their benchmarks. This is good news considering the present volatility of the financial markets. Allan reminded the Board that when interviewing and comparing money managers, consideration is made for their performance in both up markets and down markets. This is why the fund is performing well on a relative basis despite negative returns. The total fund return for June was -5.11% versus the benchmark of -5.34%. Allan reported that PIMCO had a challenging June, posting a return of -2.47% versus -.54% for the benchmark. Overall bond returns were -1.35% versus the benchmark of -.80%. The total equity return for June was -7.46% versus -8.27% for the benchmark. The real estate returns are estimated - JP Morgan I&G reports quarterly, so their returns won't be adjusted until July. John Moore asked Allan about PIMCO's poor performance for June. Allan replied that there were several reasons for their underperformance: they were overweight in high quality mortgage backed securities, which was doing well until June when this sector retreated; and underweight in high yield bonds which outperformed mortgages and investment grade corporates.

Calendar year-to-date total returns were -6.07% versus -6.37% for the benchmark. Five of the equity managers outperformed their benchmarks. Total equities returned -9.88% versus -10.75% for the benchmark. Total real estate was .25% versus the estimated NCREIF benchmark of 4.86%. Fiscal year-to-date returns were at -4.69% versus a -5.07% for the benchmark. Considering the volatility of the market over the past year, the portfolio did pretty well. The total fixed assets posted a return of 7.38% versus 7.13% for the benchmark. Six equity managers outperformed their benchmarks during the fiscal year ended 6/30/08. Total equity returns were -11.49% versus -12.11% for the Equity Composite. Total real estate posted a fiscal year-to-date return of 7.56% versus 13.58% for the benchmark. Quarterly returns as of 6/30/08 showed a total fund return of -.76% versus -1.06% for the benchmark.

2. Securities lending income summary – Allan reported that net earnings for the fiscal year through May at approximately $157,000 and total custodial fees were nearly $300,000.

3. Update on infrastructure investments – Babcock and Brown update – The market cap clause has been removed from their contract and the banking syndicate waived the right to review. This has improved the likelihood of a commitment by the next closing date of 9/30/08.

D. Post Retirement Benefit Increase Policy

1. Policy Review – Joe Ladenburg had previously distributed a memo to the Board via email regarding the draft policy for Post Retirement Benefit Increases. Joe recapped the content of the memo emphasizing that our pension funding assumptions never promised future benefit increases after retirement. He quoted from a benefits booklet dated July 1980 that said, "At your retirement, all the dollars in your TSRS "account" are used to provide an income for you as long as you live. This, together with your Social Security, personal savings other retirement savings should give you security in your retirement years. The

Plan assures you that an income will continue for life after you qualify for retirement." Mike Hermanson agreed that no increases are promised, and this is usually covered in the context of discussions about benefits with new employees. Despite the lack of increases, the City provides a benefit in the top 10% of 125 public plans in a survey from December, 2007. Of those 10%, half of them use an ad hoc approach to considering post retirement increases. He voiced some of the potential concerns with "excess" returns such as the following:

- No matter how defined, if a plan does not experience long term returns above the actuarial assumed rate, there are no excesses
- Whatever is transferred to a reserve for increases will be made up in the Annual Required Contribution (ARC) (employer and employee). Even though the policy does not permit increases from the prior year ARC, the policy will allow the ARC to remain higher than it would otherwise be if earnings were not diverted

In summary, Joe commented that if the desire is to provide post retirement increases to a fixed benefit, used in place of an ad hoc practice, this policy provides a defined, formula driven approach with the maximum 13th check adding approximately 5% to annual pension payroll expense. As written, the policy includes several protective restrictions on the magnitude of earnings that may be diverted to increases. As the policy is proposed, there is no growth in liabilities since the 13th check is an impermanent increase. Chairman Bjorndahl asked if the policy proposed is unique or do other plans have a policy similar to this one. Jean Wilkins replied that this policy was unique. Paul Miner remarked that other plans in the state have post retirement benefit increase policies but none are as well written and secure to the fund as this proposed policy. He said there are several safeguards written in to protect the fund so that it will stay healthy and viable which is a good thing. Chairman Bjorndahl agreed and remarked that the proposed policy had everything in it to protect his fiduciary responsibilities for which he was grateful.

2. Actuarial and Policy Analysis of the PRBI Plan Rules and Procedures – our actuary Leslie Thompson had provided a memorandum on the policy stating: that it is a well-articulated policy, balancing the objective of creating an automatic mechanism for the payment of benefits to retirees with the objective of maintaining the funded status of the plan. She continues with the fact that this policy details the mechanics of the ability to transfer as well as the amount that can be transferred to a detail that surpasses that of many policies that exist among public sector plans. She concludes that the policy does not present any adverse actuarial impacts to the trust.

Gage Andrews remarked that while the actuary's analysis was a positive step forward, the Board still had some decisions to make that the study group wasn't comfortable making. The first decision is the definition of "retirement date". "Retirement date" is the date at which the pension has been calculated and fixed. However, because a deferred retirement has the pension calculated prior to the effective retirement date, there is a concern that this could trigger a PRBI payment, even though the deferred retirant may not receive a pension check for years. Mike Hermanson explained that while the calculation has been made for a deferred retirant, that person would not receive a pension check until they were eligible to actually retire (magic 80 or age 62). Therefore, their effective retirement date would not be until they reach normal eligibility. Gage remarked that the language in the current proposed policy will be clarified to state when the effective retirement date is set to the date described.

The next consideration involves how the funding to the reserve is calculated, beginning with the establishment of whether an excess return has been realized. The current policy recommends an average assumed rate of return over a four year period. Mike walked through a comparison of the rolling average of the assumed actuarial rate and the rolling average of the actual investment returns and how those compared for the four year periods ended June 30th, 2007 and June 30th, 2008. The consensus agreed that rolling averages for both rates (actuarial assumed rates and actual investment return rates) would be used.

The next decision concerns two issues: a) whether the excess percentage calculated would be simply be applied to the retiree reserve at the beginning of the plan year; or b) whether application of the excess return should be (prorated) multiplied by the ratio of retiree reserve over the total actuarial accrued liability, multiplied by the market value of the assets at the start of the fiscal year, multiplied by 50%.

After reviewing the illustrations, Mike explained that although the draft policy was written to apply the excess calculated under method (a), the actuary had described method (b) as the more appropriate effect since it recognizes that the retiree reserve will change over time. The difference between these two issues is slight in the illustration at this time, because retiree reserves approximate one half of the actuarial accrued liability. The board conceded that the actuary's approach seemed more appropriate, but David Cormier requested additional time to consider and review the differences between these two approaches, before adding his consensus.

3. Decision Flow for Funding the PRBI Reserve – Mike went through the decision process that is applied for the determination of whether there is an excess return and how amounts are added to the reserve, considering all the triggers that are applied.

4. Determining Eligibility and Minimum / Maximum PRBI Payments – Mike quickly overviewed the methodology and amounts to be paid with the limitations applied, and how the amounts determined in the funding amount would be applied and paid to the categories of members retired 8 or more years (group A) and to members retired greater than 3 years but less than 8 years (group B), as described in the PRBI policy.

5. Illustrations of Application of Policy – John Moore had a few concerns regarding the proposed language in the policy. Under the topic "Funding the Reserve", paragraph 1, he thought it should be stated that the calculations would be done by TSRS staff, and in paragraph 2, the current language says that the Board "may review the calculations of Adjustments and Allocations after the calculations have been made to <u>validate</u> the accuracy of the calculations. John was uncomfortable with the term validate and thought is should be changed to "approve". Board consensus was that the verbiage should be changed to "approve."

6. Adoption Consideration by the Board – David Cormier reiterated his concern that he wasn't comfortable with the calculations because he didn't understand how monies could be added to the reserve in a year where the returns were down and whether the market value of the assets should be at the beginning or end of the year. He requested that this topic be revisited at next month's meeting after he was sure he understood the calculation. Paul Miner voiced concern about postponing this topic since it has been under consideration for three years. Chairman Bjorndahl concurred. Jacinta voiced concern that the IRS is proposing minimum funding requirements for pension plans. Mike remarked that the policy maintains more than the minimum 80% funding requirement and continues to require increased levels of funded ratios in the future. Discussion about how to propose this policy to Mayor and Council following the August board meeting. Frank explained the process will be in place after Mayor & Council adopt the proposed ordinance as recommended by the Board. In the proposed ordinance, a sentence was added to the effect that Mayor & Council will accept adjustments as proposed by staff. Administrative policy change will go back to Mayor & Council but adjustments do not need to go back. This policy does not have to go to Mayor & Council every year as in the past, only if there are major policy changes. Paul Miner **moved, seconded** by John O'Hare, to accept the plan as presented and recommended it be sent to Mayor & Council for adoption (with proviso's that there are

no problems with the policy following review in the coming month and John Moore asked that a final version of the policy be provided to the Board when staff has completed final review of the details discussed today, if there are any changes they will need to be discussed and approved). **Motion passed 7 to 0.**

E. CTRA letter dated July 15, 2008 to the Board of Trustees

Jean Wilkins, representing the City of Tucson Retirement Association (CTRA), reported that current policy was to look at CTRA's request for an increase on an annual basis to assess the asset situation. This was not put on the agenda this year because the study group was working diligently to present a proposal for a permanent Post Retirement Benefit Increase to the Board. She said that CTRA supported the proposal that was just passed. CTRA recommends that 2007's figures be used rather than 2008's numbers because they were better. CTRA also recommends that a 13th check be mailed to those entitled to one in October, 2008. Those who would qualify would be retirees who have been retired eight (8) full years and would received 100% of a single monthly check. For the retirees who have been retired at least three (3) years but less than eight (8) full years, a single check for 50% of their monthly check would be mailed in October.

Allan commented that he would recommend against approving CTRA's request, due to the negative returns the plan has posted over the last fiscal year and the remaining uncertainty expected in the coming year. Mike Hermanson wanted an effective date of the new policy, since it had not been addressed yet. Chairman Bjorndahl suggested that the Board assume using June 30, 2008 numbers and the policy approach used for a 13th check effective in October in lieu of the proposal made by CTRA. Discussion ensued. In the end, the following points were made concerning the implementation of the PRBI policy and the CTRA request for a 13th check for this year:

- The PRBI policy is effective for plan years beginning July 1, 2009 (subject to M&C approval)
- The data from the June 30, 2008 and the actuarial valuation will be completed by the October board retreat and staff will have 60 days following the acceptance of the valuation report, to determine the amount of a 13th check to be paid to retirees that have been retired for 8 years or more as of June 30, 2008
- The PRBI policy is to be utilized to determine if a full 13th check can be paid to the 8 year retirees only, by using the excess return calculation for the "additions to the reserve" but ignoring the PRBI triggers that follow that process (such as funded ratio, group A, B limits)
- The amount applied is an equal percentage to all members eligible for the payment
- The amount paid for the 2008 13th check, will be considered as an advance (a deduction) against any amounts added to the retiree reserve during the 2009 implementation
- This approach is considered to be a bridge between this year and the implementation of the PRBI policy next year, kind of an "ad hoc, non-permanent benefit increase"

Gage Andrews **moved, seconded** by Paul Miner, that a non permanent ad hoc payment is made to those retirees retired eight full years or more as an advance on the proposed policy amount based on the most recent year end, June 30, 2008. This ad hoc payment would be deducted from any amount added to the reserve in 2009. **Motion passed 7 to 0.**

F. Update on Investment Advisory Committee

John O'Hare pointed out that this item was scheduled for August. For clarification, John asked if the Board would be comfortable if he canvassed the Tucson Society of Chartered Financial Analysts in the spirit of including investment professionals from the community. The question that needs to be asked to these individuals is what value are they going to add to the process that we currently have? Draft language for the plan document had been included in the packet to suggest that the responsibility for investments remains with the Board, but to seek suggestions from this advisory group. Frank Kern reminded the Board that the committee has been administratively, if not technically, written out of the (plan document) because it has not been used. Even though Due to a technical oversight, it was never removed officially John Moore stated that Hewitt is our consultant and we should be following their suggestions and not “muddying the waters”. In debating the issues, John O’Hare pointed out that the Arizona Foundation at the U of A has an advisory committee and John thought that he might contact them and see how they utilize their committee. Gage reiterated that he would like someone advising the Board on asset allocation, asset liability study, risk tolerance because he had not seen evidence of this being done in the past. John O’Hare remarked that since we have had Hewitt as a consultant for 10 years. John believes that perhaps it is time to see if there is a better alternative available.

Chairman Bjorndahl commented that it appears to be three different topics discussed here simultaneously. First, there is an investment advisory committee that has been proposed to resurrect. Gage has proposed a different version of an investment advisory overlooking our investment consultant. Finally, John Moore believes that we should maintain a status quo with Hewitt as our paid investment consultant. Chairman Bjorndahl recommended that this item should be brought back on a future meeting’s agenda and a written proposal should be presented at that meeting with written ideas on how the group should be developed. That way this issue can be resolved amicably and finally. He said that the idea of possibly replacing Hewitt should be put on another agenda, since John O’Hare has brought the subject up on numerous occasions. Allan remarked that, trying to act proactively, he discussed this subject with a few members of the community, Kevin Larson, CFO of Unisource Energy and Patrick O’Connor, CIO of the University of Arizona Investment Foundation. Both of these people are amenable to attending a meeting to offer their experience. John O’Hare commented that there are other people in the community who would be interested in participating in this group.

G. Election Committee Report

Gage Andrews reported that observing the election committee suggestions made by John O’Hare and other members that have previously served, he had provided a summary included in the Board packets. This summary outlines his committee’s strategy for recruitment of prospective candidates to fill the vacancy that will be open in January, 2009 at the end of John O’Hare’s term. One of the things his committee has attempted to do is move the process up significantly to allow the prospective candidates an opportunity to view first hand what is involved in this position.

Gage announced that the other members of his committee are Suzanne Machain and Gary Lowe. He has also called for a “new member orientation” committee that consists of Mike Hermanson, Allan Bentkowski and Jacinta Figueroa. During the discussion, Gage asked John O’Hare, outgoing employee representative to the Board, if he would also participate. John accepted the invitation.

Gage’s timeline for the recruitment process included a citywide announcement which contained a description of the board member’s responsibilities, provided qualifications that were required, listed the next TSRS Board meetings and included a calendar of events. The recruitment period would end on August 29, 2008. The committee would then review applications and prepare a final ballot for Board approval, with an election following. This would allow the newly elected member to attend the October retreat as a non-voting, uninstalled member and gain experience by attendance.

H. Annual Retreat Agenda

Mike reminded the Board that the October retreat will be held at the Arizona Inn. Possible items for the agenda are as follows:

- Hewitt – investment policy/strategy presentation with tie-in to the asset liability study
- Fiduciary responsibility & liability
- IRS legislative activity update

Mike said that he is open to suggestions for the agenda through September. He requested that suggestions be emailed to him not later than September 30th.

I. Legislative Issue Updates

1. Normal retirement age update – effective Jan. 1, 2009
2. Market value liability approach for pension reporting
3. New IRS requirements for QOSA, QJSA
4. IRS Determination Letter

Frank Kern reminded the board that most of the amendments made in the past have been added from Board actions concerning benefit programming changes. What is different today is the IRS is getting involved with public pension policy. For example, there are new IRS requirements concerning the normal retirement age. There is also a qualified joint survivor annuity and qualified optional survivor annuity requirements. These items are being studied for inclusion in a re-write of the plan document so that by the end of the calendar year we are in a position to send it to the IRS for a determination letter. All of this is so that the plan can be approved and ready for IRS audits of governmental pension plans expected next year. The deadline for the determination letter is 1/31/09 but he is planning to have it completed by 9/30/08. At this time, it is not expected that a normal retirement age will be included in the plan rewrite, due to the controversy surrounding that issue.

J. Future Agenda Items – see attached listing

- Investment Policy Review – August or September
- Written suggestions for the Investment Advisory Group issues stated in the minutes
- Consideration of alternative investment consultants – timing to be determined
- Rebalancing issues to be considered
- Hewitt – will be at the August meeting to present the PRIME report
- Possible Employee Candidates to attend August meeting

K. Call to Audience

John Moore announced that he had accepted a position with a company in Dallas that will require his resignation from the board. Therefore, his last Board meeting will be in August, 2008.

L. Adjournment

Gage Andrews **moved** to adjourn**, seconded** by John Moore. **Motion passed 7 to 0.** Meeting adjourned 11:22 a.m.

Approved:

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Brian Bjorndahl, Chairman	Date	Michael Hermanson, Retirement Manager	Date