TUCSON SUPPLEMENTAL RETIREMENT SYSTEM
BOARD OF TRUSTEES

Regular Meeting Minutes-Thursday, January 30th, 2014
Finance Department Conference Room, 5th floor East
City Hall, 255 West Alameda
Tucson, Arizona 85701

Members Present:	John O'Hare, Elected Retiree Representative (late) Silvia Amparano, Director of Finance Karen Tenace, Elected Representative Robert Fleming, Chairman Eric Kay, Elected Representative Lani Simmons, Human Resources Director (late)
Staff Present:	Melissa Waychoff, Administrative Assistant Michael Hermanson, Pension Administrator Silvia Navarro, Treasury Administrator Michael Jesse, Lead Management Analyst Kelly Gottschalk, Assistant City Manager Dave Deibel, Deputy City Attorney
Guests Present:	Jenefer Carlin, Retiree Representative Reed Palmer, Retiree Leslie Thompson, GRS Actuary Ed Hubert, Independent Audit & Performance Commission
Absent/Excused:	Kevin Larson, CM appointee Allan Bentkowski, Treasury Finance Manager

A. Call to order – Chairman Fleming called the meeting to order at 8:32AM.

B. **Consent Agenda**
   1. Approval of December 19th Board Meeting Minutes
   2. Retirement ratifications for the month of January 2014
   3. 12/31/2013 TSRS Financial Statements
   4. December 2013 TSRS expenses

Motion to approve consent agenda made by Silvia Amparano, 2nd by Eric Kay, motion approved 4-0 (John O'Hare and Lani Simmons late, Kevin Larson absent).

C. **Administrative Discussions**
   1. Final version of Contribution Round Up Policy, and review of FY15 Employer contribution rates

Motion to adopt modified contribution round up policy made by Karen Tenace, 2nd by Eric Kay, motion approved 5-0 (Kevin Larson absent and Lani Simmons late).

   2. Board Recommendation of TSRS Contribution Rates for FY15

Michael Hermanson introduced this item by reminding Board members that a recommendation for the FY15 Employer contribution rate needs to be made to allow the City budget planning for FY15 to proceed. After the Board approves a recommendation, staff can proceed with presenting this recommendation for Mayor & Council approval.

John O'Hare wanted to clarify; asking if changing the actuarial assumptions from the five year historical experience study would impact the contribution rate recommendation. Leslie Thompson responded it depends on which assumptions are adopted. John wanted to know if we decide on a contribution rate now, then change the actuarial assumptions; would it change the contribution rate? Mike Hermanson stated the contribution rate recommendation we need to do at this time is for FY 2015. We will not know what the FY 2016 calculated rate will be for another six to nine months when the 6/14 valuation is done, so any actuarial assumptions adopted from the experience study will be applied to future valuations, so it does not affect the contribution rates considered for FY15. John O'Hare stated that staff wanted to see a level employer funding rate; in order to project the effect for the next twenty years. Michael Hermanson stated, yes, if all assumptions used are realized, the plan will be fully funded in twenty years using a 27.5% contribution rate. Last month, the Board recommended employee contribution rates following the round up policy (members hired prior to July 1, 2006 at 5%, members hired after June 30, 2006 and before June 30, 2011 at 6.75% and members hired after June 30, 2011 at 5.50%). The charts included in the Board packets today indicate the projected funded ratio for the Plan thru 2032 with Employer contribution rates at 27.5%, 28% and 28.77%. Using level contribution rates for the entire period until 2032 puts the funded ratio of TSRS at 104.04%, 106.67% and 110.73% respectively

A motion to adopt the 28.77% rate for the next twenty years or until the fund is 100% funded and that we recommend to Mayor & Council to put it in the City Code **was made by John O'Hare, 2nd by Karen Tenace.** During discussion, Lani Simmons indicated that she believes a recommendation at 28.77% would match our current funding policy. Mike Hermanson confirmed the 28.77% is the blended the rate for the current fiscal year (FY14), using a 20 year open amortization of the unfunded liabilities, plus the Employer share of the normal cost for the Plan. Karen Tenace does not think 28.77% makes any sense, in reference to the roundup policy. Silvia Amparano prefers a 27.5% recommendation. Karen Tenace commented, the baseline (current funding policy, using the ARC) is not acceptable because the 20 year projection of the funded ratio shows a relatively flat line, and would only improve the Plan's current funded ratio at 63.3% to 71.74% by 2032. Because the 27.5% rate puts the Plan at 104% funding, Karen would prefer to use that rate. John O'Hare would like to know how much the plan lost by dropping the contribution rates for Tiers I and II. Michael Hermanson responded, contributions were reduced by $3M each from the employee side and employer side as a result of lengthening the amortization period to 20 years. John O'Hare suggested the permanent rate should be put into the City Code so that it is harder to back out of the level funding approach. The Chairman called for a vote on the motion and the **motion failed 1-5 (Kevin Larson absent).**

A subsequent motion to recommend a 27.50% Employer contribution rate for twenty years or until the fund is 100% funded **was made by Eric Kay, 2nd made by Silvia Amparano**. For clarification, Michael Hermanson noted the concept of the Board's requirement to recommend an <u>annual</u> contribution rate as what is stated in the City code. Kelly Gottschalk agreed, stating a current Council cannot bind a future Council, even if it was added into the City Code. Reviewing the conversation, Leslie Thompson stated her concern is that we could wind up with a rate that is too low in the City Code if we tried to build restrictions into it for future years. Chairman Fleming suggested perhaps this would be a good discussion on the philosophy of contribution rates to consider at the next Board Retreat. Based on the actuarial projection using 27.5%, the rate is assumed to be unchanging, so we would not be as likely to ask for a decline in the rate in the future, but we would still need to recommend a rate in the following years. John O'Hare would like to be able to explain open vs. closed plans. Leslie Thompson stated the underlying theory of open vs. closed is, in a closed period the unfunded liability is paid off, in an open period, it is never paid off, so closed means the liability is paid off. Most plans follow the concept of "intergenerational equity" which prefers to have the current generation pay for the benefits they earned, rather than leave an unfunded liability to be paid by the next generation. **Voting on the motion,** recommending a 27.5% Employer contribution rate for for FY15, all member classes, the **motion was approved 5-1 (John O'Hare opposed, Kevin Larson absent).**

3. Actuarial presentation of DRAFT TSRS Historical Experience Study

First, Leslie Thompson acknowledges that some of the economic assumption / findings indicated in the draft of the five year TSRS historical experience study are expected to change. It will be up to the Board to decide whether to apply these findings to the plan valuations starting with the 6/30/14 year end or as late as 6/30/15. Bear in mind, a lot of clients still have reservations about following the actuary's recommendations, because the actuary's hands are fairly well tied with what the recommendations can be. An inflation assumption is currently indicated at 3.50% in the study, but Leslie thinks it should probably come down to 3.00% after hearing what is predicted for future compensation changes. The study also proposes a change in the investment from 7.75% to either 7.5% or 7.25%. Historical salary growth was hard to measure because of the pay freeze, but Leslie would reduce it from 3.5% to 3.25%. So, because City employees have not realized any measurable salary increases, Leslie would recommend reducing payroll growth slightly from 3.50% to 3.25%. Salary increases include inflation, productivity, and merit increases. Payroll growth is the growth of the total payroll.

The recommendation proposing new mortality tables is indicated, and these tables have always been based on the age of the person and their probability of death, but it has been observed that a 50 year old in 2014 has very different mortality than a 50 year old in 1950, which is the generational effect. The Mortality rate is generally improving and tables should reflect that. Retirement rates have modest updates applied; Termination rates were high in this plan period and might need to be increased for the higher turnover. Disability rates are also slightly higher than normal; Chairman Fleming would like to be able to tell Mayor & Council how much the change in assumption will cost.

Leslie Thompson looks at history for inflation and also observes the majority of what other clients are using, as shown on pages 8-11 of the study. John O'Hare thinks an argument can be made for considering (using 1963 as the start date) the average inflation rate at 4.16% based on the table on page 8. At page 12, net market returns for TSRS are indicated, showing the level of volatility since 2002. However, this is where Callan Associates will indicate what is possible to earn on the portfolio when they complete their asset liability study; they will tell us what they think the investment return assumption should be. Leslie Thompson actuarial methodology is recommending a higher inflation assumption than what all the investment consultants are assuming. The real return is 4.64% plus the 3% inflation rate, so that would put it at 7.64%. This is an arithmetic return, but one cannot just go with the arithmetic return, arithmetic means there is no volatility; so a a geometric calculation is used to account for the volatility of returns. Using the geometric approach, the real return would be 3.84% plus 3% inflation, which puts it at 6.84%. Leslie Thompson has to choose an investment return between the arithmetic and geometric return and she recommends 7.25% on the conservative end. Callan's study is not factored in yet and neither is Alpha.

Salary assumptions show big pay increases and with the pay freeze, the City has not even come close. Michael Hermanson imagines the umber for the history of the City of Tucson is less than 1%, which means that the City of Tucson pay rate increases have not kept up with inflation. So, if price inflation (overall salary increases) are less than 1%, and nothing has been provided for other raises related to productivity (0%), and merit at (0%), that's a long way from a 3% salary increase assumption. John O'Hare believes the Cost of Living Adjustments have really lagged. Kelly Gottschalk does not think there will be a change for FY15 or FY16, but maybe in FY17 or FY18; we could even see a negative change for FY 15 or FY 16. Leslie Thompson is concerned the salary assumptions are not low enough, and at a 3% salary assumption seems generous.

Mortality has a probability at every age. 172 deaths were expected for men, but there were actually 189 and now there will be 153 expected. The men are dying faster than the tables indicate they should be. There were 58 deaths for women and 62 expected, with the new assumption, 64 are expected. Men and women combined results are a better margin for mortality. Leslie Thompson has to stay ahead of the mortality improvement and for retirees, it is roughly a 2 to 1 male and female mix. The men are all gone by age 100 and the females are all gone by age 105. Disability rates were 24 versus the prediction of 9.7; the new prediction is 17. Early retirements were 30 and with 24.8 expected; the new expected is 26.4. Regular retirements were 128, but expected 218 and now expected is 184. Terminations in first 5 years of employment were 441 and 321 were expected and now the expected is 370. Terminations for more than 5 years of service were 335 and 219 were expected and now the expectation is 288. The refund assumption was 55% would take a refund. Leslie has changed the assumptions to rates by age and has lowered the assumptions.

Leslie recommends we stay with the current 5 year smoothing period used for investment returns. Inflation added 2.21% to the calculated contribution rate. John O'Hare would like to see us go to an investment actuarial assumption rate of 7.5%. The mortality, disability, termination, retirement, sick leave, and inflation would raise the contribution rate and salary increase would decrease the contribution rate. Callan will play a role in deciding inflation and there would need to be a discussion around salary scale in order to move forward. Michael Hermanson stated the Board will have those conversations with Callan and will get the information to Leslie Thompson. The demographic assumptions are what they are, but the economic assumptions need input from Callan. Michael Hermanson recommended we pull out the raw assumptions and lay them out on a page and give them to Callan. Chairman Fleming is looking for the best estimate if we go from 7.75% this year to 7.25% next year; he is looking for an estimated number what it will cost so that he can tell Mayor & Council. Leslie pointed to the summary of the cost impact following page 31, but it was not indicated. Her recollection indicated she thought it was approximately $2.5M-$3M. Silvia Amparano asked if both rates could be shown.

4. Highlights from Opal and Callan Conferences

John O'Hare attended the OPAL Conference in January 2014. There were 35 speakers and 375 attendees; about half were trustees of public funds. The defined benefit plans will continue to be under attack and the case must be made for DB plans with the public. In the future we may see more DB/DC hybrid plans. There has been some interest in real asset classes due to there being more opportunity there and the correlation with the stocks and bonds. The Board's consultant and managers should have plans for the next crisis coming up (such as what happened in 2008) and that it is important when hiring new managers that they have new ideas instead of just presenting us with what everybody else has. Some people are recommending funded rates of 100% to 120%. There are also legal issues such as cases going on here in Arizona. The State Supreme Court is sitting on the TSRS case and another one from this summer. John O'Hare has attended this conference for several years because it is usually close and there are usually a lot of trustees there.

Michael Hermanson went to the Callan University Client Conference in January 2014 and there were about 500 clients and associates there. There were a lot of speakers providing talks about economic reality, geo-politics and the current political climate, but they have a lot investment discussions or strategies on the agenda, which I would have preferred. Among the speakers, David Gurgen, was a political advisor to the Reagan and Clinton administrations, and is frequently seen on CNN and Face the Nation; there were others as well, including a philanthropic discussion presented by Mrs. Calvin Hill and a discussion of the state of our national security from former CIA chief and Defense Secretary Leon Panetta. The venue was very nice, but Michael Hermanson would prefer having more investment discussion from the Callan conference.

5. Carpet expenditure request

Silvia Amparano would like to add a reception desk for Pension to the 5th floor and replace the carpet because there is asbestos under the carpet. Silvia would like TSRS to pay ¼ of the $80k tab, or $20,000. **Motion to approve carpet expenditure up to $20K made by Karen Tenace, 2nd by Silvia Amparano, motion approved 5-1 (John O'Hare opposed, Kevin Larson absent).**

6. Briefing on HCR 2001

Michael Hermanson indicated that HCR 2001 has been introduced to this year's state legislature, proposing to amend the Arizona Constitution to remove the constitutionality questions of whether increasing contribution rates for current members in a pension plan; or to reduce member benefits if these changes are consistent with generally accepted actuarial standards and are in the interest of the financial stability of the public retirement system. Mike then referred to the TSRS history of this question, indicating that when we asked our outside counsel if TSRS could increase current member contributions from active members, the answer was no and was the reason we created a variable contribution rate formula for employees hired after June 30, 2006. John O'Hare heard that it was placed in the hopper last year and that it did not go anywhere and hopefully it will not go anywhere this year. Kelly Gottschalk added the Mayor & Council did vote to oppose this. It would potentially mean our members across the board could be asked to pay a higher contribution rate, including our legacy members. The reduction in member benefits is a vague statement, and could be applied to current employees (and possibly retirees). Michael Hermanson thought it might allow the plan to pare back benefits on a forward basis.

7. Briefing on Independent Audit Performance Commission review of TSRS funding policy

Michael Hermanson introduced Mr. Ed Hubert, attending today's meeting as a member of the Independent Audit Performance Commission. Mr. Huber indicated there were two principal questions to be answered by a sub-committee as: 1. To validate and verify the methodology used to determine projected funding rates for the pension plan; 2. What would have occurred if the Ballot initiative had passed, what effect that would have on TSRS funding rates for the future. The sub-committee will probably meet again in March and are supposed to complete their report by May 2014.

D. **Investment Activity Report**

1. TSRS Portfolio composition, transactions and performance review[1]

Mike Hermanson quickly reviewed the reports, indicating that none of the managers are outside of their range, but some Equity managers are moving closer to the upper end of their range; not surprising the opposite is occurring with Bond allocations dropping to 21.7% vs. the 21% minimum allocation. Real Estate appears to be rebounding slightly to 7.4% of their maximum allocation at 10% of the portfolio.

Reviewing Fiscal YTD returns (skipping calendar YTD returns): The TSRS total portfolio returned 12.70% vs. the Custom Plan Index of 10.36%; Total Fixed returned 1.70%, exceeding the 0.44% benchmark from the Barclays Aggregate. Total Equities posted an 18.39% return vs. the Equity Composite at 16.92%. Real Estate returned 6.38% vs. NCREIF ODCE at 3.56% (but the NCREIF is only though 9/30/13). Aberdeen returned

8.84% during the FY vs. a 15.33% return for the benchmark of MSCI All Country. Infrastructure exceeded the benchmark at 6.02% vs. 1.78% for CPI+4%.

Noting the correspondence concerning T. Rowe Price, there has been a portfolio manager change, but no additional information was available.

2. Asset Liability Study (progress report) – Michael Hermanson indicated that Callan has been collaborating with the Actuary as Historical Experience study was drafted; and has begun the Asset Liability study for TSRS. Callan will here at the next (Feb. 27th) meeting to begin discussions with the Board and is expected to complete their study in May.

E. **Articles for Board Member Education / Discussion**

1. HCR 2001 (*Proposed State of Arizona Constitutional Amendment, 51st legislature, 2014*)
2. Detroit Retirees Put on Notice in Bankruptcy Ruling (*Bloomberg Dec. 3, 2013*)
3. Police Salaries and Pension Push California City to Brink (*The New York Times, Dec. 27, 2013*)
4. Detroit manager freezes pension fund, creates 401k – type plan (*Reuters Jan. 6, 2014*)

F. **Call to Audience** – Jenefer Carlin is speaking for CTRA about the last quarterly statement in December that was missing information and Michael Hermanson responded Jessie Sanders is aware. Chairman Fleming suggested Jenefer Carlin provide Michael Hermanson with the information on the form that is missing.

G. **Future Agenda Items**

1. 2/27/2014 meeting: Callan Associates to present 12/31/13 quarterly performance review and discuss key findings of TSRS Asset/Liability study; continue discussion of reporting considerations by TSRS Investment Managers
2. 3/27/2014 meeting: Investment Manager Reviews for Pyramis & Causeway
3. Philosophy of contribution rates discussion
4. Final Results – Actuarial Historical Experience Study, Asset Liability Study from Callan Associates
5. John O'Hare would like an update on having the materials posted on the web site and an update item on the ESS system.

H. **Adjournment - Chairman Fleming stated we are adjourned at 10:40AM.**

Approved:

	2/27/14		02-27-14
Robert Fleming Chairman of the Board	Date	Michael Hermanson Plan Administrator	Date