TUCSON SUPPLEMENTAL RETIREMENT SYSTEM
BOARD OF TRUSTEES

Meeting Minutes- January 24, 2013
CMO Conference Room, 1st Floor
City Hall, 255 West Alameda
Tucson, Arizona 85701

Members Present:	Robert Fleming, Chairman John O'Hare, Elected Retiree Representative Brandy Kadous, Elected Representative Lani Simmons, Human Resources Director Karen Tenace, Elected Representative Kelly Gottschalk, CFO and Assistant City Manager Kevin Larson, CM appointee
Staff Present:	Allan Bentkowski, Treasury Finance Manager Michael Jesse, Lead Management Analyst Dave Deibel, Deputy City Attorney Melissa Waychoff, Administrative Assistant Michael Hermanson, Pension Administrator Michael Jesse, Lead Management Analyst Silvia Navarro, Treasury Administrator Silvia Amparano, Designated for CFO Liz Miller, Deputy City Manager
Guests:	Jenefer Carlin, Retiree Representative Jean Wilkins, Retiree Representative Edward DeBaca, TSRS member Leslie Thompson (Gabriel Roeder Smith & Co.) Cassie Langford (Yoder & Langford)

A. Call to order – Chairman Fleming called the meeting to order at 8:35AM.

B. Consent Agenda
   1. Approval of December 20th, 2012 Board meeting minutes
   2. Retirement ratifications for the month of January 2013
   3. December 2012 TSRS expenses, TSRS CAFR for June 30, 2012

John O'Hare has corrections to minutes. Motion to approve consent agenda with corrections made by John O'Hare, 2nd by Brandy Kadous, **motion approved 7-0**.

C. Administrative Discussions
   1. Discussion of TSRS Member Contributions – Leslie Thompson

Mike Hermanson briefed the Board on this subject; reminding Board members that preliminary information for this topic was requested and provided last month, so that Board members would have sufficient time to ask and consider related issues; today's meeting is a follow-up and includes analysis addressing Board and staff member comments received during the interim month. Leslie Thompson is here today to discuss the information, which could affect the amortization period used for unfunded liabilities and how our contribution rates are set for members hired after July 1, 2006.

Leslie Thompson began by stating TSRS members hired before July 1, 2006 are required to make contributions to the plan set at 5% of their pay; members hired on or after July 1, 2006 pay 40% of Annual Required Contribution, which is currently 13.976% of their pay (also; those hired after July 1, 2009 can be required to pay up to 50% of the ARC, but this higher contribution rate has not been imposed). So; what we have seen here in Tucson is, the ARC screams up and member rates scream up, but member pay has stayed the same (no increases).

TSRS member contribution rates for those hired on/after July 1, 2006 are the highest seen from any of the GRS clients. The 2008 Market Meltdown impacted the trust, causing a reduction in values of $190.6 million. 15 year amortization of just the $190.6M loss would amount to 11.26% of pay, but the loss was smoothed over 5 years. Contribution rate requirements were further exacerbated by less-than-assumed returns in FY 2012.

So, what is a "good" Employee contribution policy? A "good" contribution policy funds the plan, makes the employee aware of the cost of benefits, but does not place undue burden or risk. For example, the policy could include 50% of normal cost, and can participate in plan experience (on unfunded liabilities), but if the plan is very leveraged, that policy may be asking current members to subsidize retirees and balance against a goal of minimizing take home pay fluctuations.

Judging by the TSRS experience since 2006, supporting a cap to the member contribution rates would provide employees with risk protection without driving costs up. A good way to accomplish that means changing the amortization period from 15 years to a 20, 25 or 30 year amortization period; which would move the ARC down and also move the member contribution rates down. Setting a cap on employee contributions at ½ Normal Cost would mean a rate of 6.5%, for Tier I variable rate members (members hired between July 1, 2006 and June 30, 2011) and 5% for Tier II variable rate members (members hired after July 1, 2011). If the amortization period is modified to 20 years and the cap is in place, the City contribution requirement does not go above the current level of 28.77%. This would give a slight improvement in funded ratio over time. The assumptions for investment earnings at 7.75% as well as approximately 3.5% pay increases will remain in place. John O'Hare does not think 7.75% is a safe assumption; suggesting that 6% may be better.

Kelly Gottschalk pointed out that this idea helps both the City and the employee. You do not fund the ARC according to accounting rules. With the 20 year amortization period, employees get a cap on contributions, City is less than current, but the funded ratio is not as good as it could have been. Mike added that John O'Hare had asked what the average period of service was for retiring employee's; Mike responded since 1990, the average number of years worked for all employees retiring through June 30, 2012 was 21.2.

A 25 year amortization period works in terms of the rates, but is not sustainable because the funded ratio deteriorates over time more than the 20 year period. The same issues exist with the 30 year period. The next slide in Leslie's presentation indicates the percentage current employees are funding for their benefit, assuming they retire when they first become eligible (the estimates assume annual pay raises of 3.5% and a contribution rate of 14% for Tier I variable and Tier II):

- For Tier I members (pre July 1, 2006 hires) employees pay 24% of the cost
- Tier I variable rate employee's (hired after July 1, 2006, prior to June 30, 2011) pay for 68%
- Tier II variable rate employee's pay 93%

Kelly Gottschalk stated if employees leave after four years with no raise, their contributions to the plan were less. Kevin Larson pointed out the plan is $400M underfunded, adding that the plan needs extra help from the City for some extra funding into the plan to give some relief on what employees have to contribute. Kevin Larson is concerned we will run out of breathing room if we do not find some relief on a funding basis overall and these alternatives need to be considered. Michael Hermanson states the 20 year amortization assumption is consistent with our member retirement history and the Plan will still be positive in terms of the amount of contributions collected and withdrawals from the trust fund for benefit payments.

Brandy Kadous wants sustainability and stability for the plan; and in working with many employees he has seen this is a hardship for employees, but at the same time see's that he wants to be sensitive to the City; they never stopped contributing or shorted contributions to the plan, show their level of commitment. Brandy Kadous says the 21 year service life would match the 20 year amortization schedule; and that 7.75% is a fair number for investment returns; but, the 3.5% raises in the assumptions should not be assumed since the City is not providing raises. However, Brandy likes the recommendations. John O'Hare would like to know when this would have to be done by; Kelly Gottschalk replied the sooner the better, because they are waiting on this to set budget consideration for FY14. John O'Hare stated this has been going on since October (four months) and we just received the Board packets over the weekend and we should have more time to have more discussion on this before making a decision. Karen Tenace believes sustainability is an issue and if we cannot attract or keep new employees, that is a significant issue. It is a perfect storm for employees and not in a good way; there are no merit increases, there could be furloughs, and contribution rates go up and that is a lot of volatility as an employee and Karen Tenace is in favor of providing them some relief. John O'Hare asked Cassie Langford about all the trustees representing the beneficiaries whether elected or appointed. What happens if there is conflict in representing one group of beneficiaries versus another group of beneficiaries? Cassie Langford responded all trustees have a common interest in sustaining the system without letting anything become negative. John O'Hare stated we are lowering the benefit for the retirees. Dave Deibel stated if the Board moves to go to a 20 year amortization schedule, there would be no problem with that. Michael Hermanson stated the analysis shows even with these recommendations we are collecting enough money to stay even with cash flow. John O'Hare understands all of that but this does reduce a formula in the rules and regulations and it does reduce a benefit for retirees. Kelly Gottschalk stated no one is saying to change the formula and it does not reduce a benefit for retirees. Kelly Gottschalk would like the plan to be at maximum funding. This is supposed to be a benefit to employees, but we are telling them we will take 14% of their pay and they will get it back when they are 60 years old, until then, we are just going to hold their money. She believes this plan is no longer a benefit to the employees.

Dave Deibel suggested a motion would be appropriate. Michael Hermanson stated what he believed the motion to be: To recommend an overall change to our current amortization policy from 15 yearhttp://www.casadelosninos.org/ – open; to 20 year – open; the Tier I variable rate (applied to new hires during the period July 1, 2006 to June 30, 2011) is recommended to change from 40% of ARC concept to 50% of the Normal Cost determined for that group alone; the Tier II variable rate is similar, 50% of Normal Cost for that group alone, and Cassie Langford added we should request the City make additional contributions. **Kelly Gottschalk made the motion, 2nd by Brandy Kadous.** Chairman Fleming is concerned we will be locked into this change in the future if we find it does not work, for instance 60% of normal cost. Michael Hermanson wanted to know if we could incorporate a range to the motion and amend it by stating the 50% rate is a range of 50-100% of normal cost and the Board has the ability to recommend re-setting rates annually, but for the FY14 being considered now, would set the recommended rate at 50% of Normal Cost. Cassie Langford stated we could also set a maximum rate jump per year (similar to our current 2.5% limit); Mike Hermanson added that it would also be a good idea to set the minimum employee rate at 5%. Chairman Fleming stated adopting this motion is in effect making a recommendation to the Mayor & Council. **John O'Hare motioned** to amend this to include in the code the 20 year amortization is fixed. That motion failed for the lack of a 2nd. Brandy Kadous would like to know what the lowest percentage of the ARC has been on the City side and Michael Hermanson responded in 1996 it was 8.18% and currently it is 30.03%. John O'Hare asked what we are doing, are we going to see additional data next meeting and then discuss the data or are we going to make a decision at this time? Cassie Langford believes for the Board's recommendation we are including variable rate members and will move from a percentage of ARC to a percent of normal cost of their Tier ranging from 50-100% of normal cost as determined annually by the Board subject to an annual increase limit of 2.5% of pay and a minimum rate of 5%. John O'Hare asked if it is possible to change the amortization period for a particular Tier of the plan and Cassie Langford stated the amortization period has always been the same for all Tiers, but there could be a motion in the future for one particular Tier of the plan, that would be within the Board's authority.

The Board agreed the motion is:

1) Recommend an overall change to our current amortization policy from 15 year – open; to 20 year – closed;
2) Recommend adoption of FY14 rates for all members hired after July 1, 2006 by changing how that rate is determined; moving from a percentage of ARC methodology to a percent of Normal Cost determined for members of each Tier; the member contribution rate will be based on a range of 50-100% of the

normal cost as determined annually by the Actuary for that group, subject to a maximum annual increase of not more than of 2.5% of pay, and not less than a stated minimum rate of 5% of pay;
3) the Board requested Staff and the Actuary to continue studying additional funding opportunities for the Plan (from the Employer side), and to provide those recommendations for the Board's consideration at a future meeting

Chairman Fleming asked if the motion was approved, all members voted verbally yes (passed 6-0, Kevin Larson not present during vote). To determine if there was any dissension, the Chairman asked all members to raise their hands, motion approved 6-0 (Kevin Larson left early).

Break at 10:40AM. Meeting was called back to order By Chairman Fleming at 10:52AM.

2. Adoption of TSRS Contribution Rates FY14

The motion in the previous agenda item recommended setting the rates as described. Leslie indicated the normal cost for those hired after July 1, 2006 but before July 1, 2011 at ~13%, normal cost for those hired after July 1, 2011 are ~10%.

3. Discussion of TSRS Retiree Return to Work Issues – Cassie Langford

Michael Hermanson reminded the Board this discussion was a follow-up from preliminary information reported at the December meeting. Since then, Mike requested reports from all of our outside temporary employment agencies, all contract employees working for the City currently, and from the Information Technology Department to run a study on whether retirees have been rehired. Various specifics were applied to the information received, including analysis of whether these retirees had actually separated from service for 12 months. The results were 15 retirees were rehired through temp agencies (some have not observed the one year requirement) 6 individuals rehired by City as independent contractors (one has breached one year requirement).

Cassie Langford requested the Board consider going into Executive Session for this discussion. Motion to move into Executive Session made by Dave Deibel, 2nd by Karen Tenace, **motion approved 7-0.** Executive Session entered at 8:40AM. Motion to exit Executive Session made by Brandy Kadous, 2nd by Kelly Gottschalk, **motion approved 7-0.** Exited Executive Session at 9:15AM; no further discussion.

4. Discussion of Board Member Annual Education Requirements, approval process for expenses, Business cards for TSRS Board members

John O'Hare stated the Annual Education Requirements could be moved to next month's meeting.
Michael Hermanson would like the Board members to follow the City's policy for travel and Michael Hermanson can provide this policy or any documentation requirements needed by individual board members requesting to attend educational seminars in the future. John O'Hare requested business cards; Michael asked if any other Board members needed them to please contact his office.

5. Annual Disability Audit Results for 2012

Fifty disability retirement members were audited; all responded. Four members indicated they had some level of earned income, but none exceeded the maximum allowed, so no benefit adjustments are proposed for this year's Audit. End of Report.

D. Disability Applications

1. Pete Scalzo

Motion to enter Executive Session made by John O'Hare, 2nd by Karen Tenace, **motion approved 6-0**. Entered executive session at 11:00AM. Motion to exit Executive Session made by John O'Hare, 2nd by Kelly Gottschalk, **motion approved 6-0. Kelly Gottschalk motioned we deny application, Karen Tenace 2nd, motion passed 6-0.**

E. Investment Activity Report Administrative Discussions

1. Portfolio composition, transactions and performance review

Allan Bentkowski indicated the value of the TSRS portfolio at December 31, 2012 was $606.7M; compared to $599.6M as of November 30, 2012. As of January 23, 2013, the value was $617.8M, which is a fiscal year high. Allan thinks the run up in value is due primarily to more certainty in the marketplace. During the month of December, $2.0M was moved out of the portfolio into the investment pool to pay monthly pension benefits. That transfer was accomplished by moving $1M out of Pyramis, $500K out of PIMCO StocksPlus, and $500K out of Causeway. Except for Macquarie and SteelRiver, all manager account balances are within the investment policy allocation ranges.

<u>Calendar Year to Date</u>

Reporting portfolio performance, Allan indicated during the month of December 2012, the TSRS portfolio returned 1.53% vs. the Custom Plan Index at 1.08%; also, for the month of December: Total fixed accounts returned 0.52% vs. -0.14% for Barclays Aggregate benchmark; Total equities returned 1.73% vs. 1.87% for the Equity Composite; Total Real Estate returned 0.75% vs. the NCREIF ODCE (not available as yet); Total Infrastructure returned 4.58% vs. the benchmark of CPI+4% at 0.06%. (Macquarie returned 8.96%, and SteelRiver returned 0.00% for the month).

On a Calendar Year to date basis, Total Portfolio returns were 15.07%, outpacing the Custom Plan Index at 12.46%. Most managers outperformed or met benchmarks except Champlain.

<u>Fiscal Year to Date</u>

On a fiscal year to date basis thru December, the total portfolio has returned 6.98% vs. the Custom Plan Index at 5.83%; also on a Fiscal year to date basis, Fixed accounts returned 4.42% vs. the Barclays Aggregate at 1.82%; Total equities returned 8.24% vs. the Equity Composite at 8.33%; Champlain lagged 4.53% vs. 8.62% for their benchmark; Aberdeen lagged at 10.27% vs. 13.69% for their benchmark.

<u>Champlain</u>

Allan provided a brief history on Champlain: Originally, the Board selected them because they were 100% employee owned and they were a smaller firm and their expense ratios were the second lowest. Risk vs. return over a 3 yr, 5 yr, 7 yr, and 10 yr period and Champlain came out on top in all cases, in essence the Board liked them most because they were less volatile than the others. Of the 5 managers in up-markets, Champlain ranked fourth and for the same 5 managers in down-markets they were number one.

Champlain is underperforming their index right now, but a 2 year period of time is really too soon to make any call about whether to seek alternatives to this manager; even if we had them for a period of three years, they would not be on our watch list (yet). Next month, we will hear more about Champlain from Hewitt and their quarterly PRIME report. Based on our understanding of Champlain's investment discipline, we would not expect them to stay even in market environments where the benchmark is up 15%+ on a calendar year basis; which has been the case during 2009, 2010, and 2012. The organization continues to add talent with the addition of Jason Wyman and is one of Hewitt's preferred mid cap managers, and they would strongly discourage making changes (especially at this point in the market cycle).

2. Status of Investment Consultant RFP, assignment of RFP review task force

Allan Bentkowski stated the RFP was mailed out in December, and the response deadline is January 31, 2013. At this time, we need to form a committee to work on evaluating the responses that will be received, with a goal of narrowing down to a short list of the best candidates to be interviewed by the Board. After asking for volunteers, Karen Tenace, Kelly Gottschalk (unless Kevin Larson can participate), and John O'Hare will serve on this committee along with Allan Bentkowski and Michael Hermanson and Michael Jesse.

F. Articles for Board Member Education / Discussion
   1. Reports relevant to Amortization periods, Funding Ratios and Arizona Plan Comparisons
      a. Staff Report to the New York State Senate Select Committee on Budget and Tax Reform – Pension Amortization: Smoothing the Way or Stretching the Limits? (December 2010)
      b. Public Fund Survey – Actuarial Funding Ratio, Contribution Rates, Plan Comparisons
   2. Pension Funding Guidelines - Draft Best Practice (GFOA CORBA Committee, Dec. 2012)

G. Future Agenda Items
   1. Intern from the Eller School of Management at the U of A
   2. Benchmarks for the actively managed funds
   3. Reconstituting advisory committee in City code
   4. Follow-up staff and actuary recommendations for improving the funded status of the plan (part of the January 24 motion passed by the Board under agenda item C-1)

John O'Hare would like these items to only be 5 minutes long for next meeting.

H. Call to Audience – John O'Hare would like to attach the handouts to the minutes so people know what we are discussing.

I. Adjournment - Chairman Fleming stated we are adjourned at 11:45AM.

Approved:

Robert Fleming Chairman of the Board	Date 3/21/13	Michael Hermanson, Plan Administrator	Date 3.21.13