TUCSON SUPPLEMENTAL RETIREMENT SYSTEM
BOARD OF TRUSTEES

Special Meeting Minutes – September 11, 2013
Finance Department Conference Room, 5th floor East
City Hall, 255 West Alameda
Tucson, Arizona 85701

Members Present: Robert Fleming, Chairman
Brandy Kadous, Elected Representative
Karen Tenace, Elected Representative
Silvia Amparano, Finance Director
John O'Hare, Elected Retiree Representative
Kevin Larson, CM appointee (late)
Lani Simmons, Human Resources Director (late)

Staff Present: Dave Deibel, Deputy City Attorney
Melissa Waychoff, Administrative Assistant
Michael Hermanson, Pension Administrator
Allan Bentkowski, Treasury Finance Manager
Silvia Navarro, Treasury Administrator
Michael Jesse, Lead Management Analyst
Kelly Gottschalk, CFO, Assistant City Manager

Guests: Leslie Thompson (Gabriel Roeder Smith & Co.)
Cassie Langford (Yoder & Langford)
Jenefer Carlin, Retiree Representative
Jean Wilkins, Retiree Representative
Darren DaRonco, Arizona Daily Star
Jeanine Domicone, Guest

A. Call to order – Chairman Fleming called the meeting to order at 9:05AM.
B. Administrative Discussions
   1. Sustainable Retirement Benefits Act – Update Discussions

Mike Hermanson introduced today's agenda outline, indicating that today's meeting is structured to let our actuary review the range of actuarial projections of various funding approaches the Board has been considering, assuming that the Sustainable Retirement Benefits Act is approved by voters on November 5th. In addition to that, the actuary has been asked to provide a funding policy based upon the language contained in the Act and Leslie Thompson is here today to discuss the options.

After the actuarial discussion is completed, Cassie Langford will review a decision matrix of issues required by the Act, indicating areas where the TSRS Board has clear authority over the issue and other areas where the Board probably lacks authority. This is an important exercise for planning how to tackle the various issues, and to help staff understand the direction the TSRS Board would want to proceed. Once that is done, staff is planning to prepare the Board's recommendations on how to resolve matters and provide this to our Mayor and Council and seeking direction from them on the areas where the Board does not have authority. Mike concluded his introduction by stating, this is not a drill, the Board will need to come to rest on a recommended funding policy and needs to be comfortable with the various parts of the Act where the City needs to take a position and move forward.

John O'Hare commented we are planning for the worst case scenario if the Act does pass. As an update to the Board, John indicated arguments for the injunction request are currently being heard in an Appeals Court. It is hard to say what the Appeals court will do, it is a three judge panel and they only need to knock out a couple thousand signatures. John O'Hare and Dave Deibel both think it will be on the ballot in November. Mike Hermanson would like the Board to continue preparing, because we have the time (now) to carefully analyze the issues involved and resolve ambiguities contained in the Act. If the Act passes,

there are specific time constraints and we will not have the luxury of the time we have now to get prepared.

Cassie Langford stated if the Act passes, we have thirty days to set up the Deferred Compensation Plan for new employees. Michael Hermanson stated we need to be able to explain to the City what the Act means if it passes. Cassie Langford stated we are talking through this with the Board because the Board has the power and authority (under section 22-44(k)(4) review and provide written comments to the Mayor and City Council on all proposed ordinance and resolutions not originating from the board that amend, modify or delete provisions of the system. This means the Board is charged with making recommendations on the Act to Mayor & Council. The Chairman thinks the Board has to prepare a form that gives employees an opt-out provision and explains what they will receive from TSRS. Cassie agreed, but it is not that straightforward, it is a process with legal consequences because distributions are not allowed to active employees in our current plan document, and IRS approval would need to be received to be able to change that issue. Finally, the Board needs to develop the ongoing funding policy with actuarial assumptions so that benefits payable to members are protected.

2. Actuarial Discussion

Leslie Thompson stated the Act causes what is called a soft closure of TSRS because it mandates new hires go into a Deferred Compensation plan, while current members continue to earn benefits in the plan until they retire. The Act states the plan will be funded over total payroll, but the funding requirements are known, so the folks that drafted this part of the Act failed in providing an effective method of reducing funding requirements and there are no savings. No matter how long you spread it over the payroll; you still need the same amount of money. What matters is you fund the plan over the average working lifetime so that all benefits are funded by the time the last working member retires. It will be tougher and tougher to get money for retirees. Funding will accelerate over the average future working lifetime. But if it is not funder over the future average working lifetime, the TSRS funding will deteriorate. The Act creates lower benefits for new hires and adds risk to the payment of TSRS benefits, which increases over time.

The ACT provides new members with a DC plan benefit only. If offering new employees a benefit that is comparable to our current compensation is important, then the structure should offer the possibility for employees to accumulate normal costs from the defined benefit plan (which is approximately 12% of payroll). John O'Hare stated the City could decide to go with a 3% Employer contribution, or a 3% match, but this is speculative and is unknown if the City would want to ask for many scenarios, such as 3% and 3% or 7% and 7%, etc. Leslie notes, a deferred compensation plan puts all the investment return risk on the member, so if you consider that professionally managed investments in our defined benefit plan will earn 7.75%. Without professional management, studies indicate earnings from a defined contribution plan will typically earns 3-4% less than a professionally managed plan. The point is, the design of the contributions to the defined contribution plan should consider a lot more of the cost would need to be replaced other than just the normal cost to make up for the earnings shortfall experienced by novice investors.

Leslie continued; as we know, providing comparable funding for the Defined Contribution plan will be more expensive than keeping the Defined Benefit plan open, unless the City chooses not to put anything into the Deferred Comp plan. That concept will be successful if we have a huge run up on assets, but the probability of that is low. Also, the Act allows members to opt out; but that does affect funding much, so it doesn't actuarially impact TSRS too much.

The most conservative funding option recommended by the Actuary, which protects TSRS member benefits best is a 10 Year Level Dollar Amortization; and that would increase funding requirements from current contribution rate of 32.32% (total, ER + EE) to 51.58%. Aggressive funding is the only way to get traction for improving the plan's funded ratio quickly. If that was the funding policy, the Plan would be funded 97.7% by 2037. The average future working lifetime of our current actives is approximately ten years before they become eligible. The cost advantage to the City is, a 100% funded ratio offers the least expense possible because all that would need to be paid is normal cost. Cassie Langford stated from a fiduciary perspective we should target 90-100% funded. Leslie Thompson stated some plans aim for 110-120% funded to protect the plan from bad investment loss years.

Kevin Larson pointed to the figures compared on slide 8, showing that a 7% Deferred Comp Employer contribution with aggressive funding would have the "mortgage" paid off in 25 years at 97.7% funded; whereas without the aggressive funding, the Defined Benefit plan is only be funded at 67.9% in 25 years.

Kelly Gottschalk suggested we have someone come in to talk about the City buying a bond at 5% for $30M. This might be worthwhile at another Board meeting or at the Retreat. John O'Hare asked Leslie Thompson if she could calculate the slide on page 8 at 3% and 3%. She responded she could make several different scenarios with numbers. Leslie stated she did not see anything in the Act that would keep the Board from accelerating the funding to protect the plan benefits.

3. Legal Discussion

a) If the Act Passes

Cassie Langford reviewed the decision matrix, stating the Board needs to be in a position to submit written recommendations to Mayor & Council at the time the Act passes (if it passes). The Act will likely be on the ballot November 5, 2013 and within 30 days of the enactment the City must offer a Defined Contribution plan to new employees. The implementation is contingent upon any necessary Federal approvals and Cassie recommends an IRS approval. The effective date is not defined in the Act, but for new hires the effective date is 30 days out. Dave Deibel stated an employee or retiree group could file an injunction and a TRO could be issued. It would keep the status quo going and freeze everything, so the dates could get pushed out. Status quo includes allowing new employees onto the plan as it exists. Cassie recommends there is no opt out option (as provided in the Act) until the Board has obtained IRS approval. Mayor & Council needs to adopt a Deferred Comp plan and close TSRS. There could be an injunction about the Deferred Comp plan, but TSRS could be closed. There could be an injunction that allows them in the TSRS plan and then they have to go out once the Act is adopted. In short, something needs to be done within 30 days of the Act passing. Cassie Langford recommends the Board be in the position to submit recommendations to Mayor & Council at the time of the vote. The Board has a global decision to consider and determine what the Board's roles should be regarding the Act.

The Board could recommend they only handle TSRS issues or they could also handle oversight for the Employer contributions made to the Defined Contribution plan. The current Deferred Comp Board of trustees does not function to handle issues related to City contributions, so that would be different for them. The TSRS Board lacks the authority to act, but the TSRS Board has the ability to make recommendations. At the 30 day mark, Mayor & Council would recommend a soft close to the TSRS plan since active members continue to participate. Cassie stated the Act's intention is not to change the rights for employees already in the TSRS plan. The impact for TSRS is the cash flow change caused from projections of reduced contributions from new employees and requires consideration in the funding policy the Board will recommend for the ongoing functioning of the TSRS plan.

The Act anticipates one single Deferred Compensation plan that looks like a 401K plan and the contributions the City makes must be 100% vested. The City currently has a 457 plan that collects voluntary employee contributions, and because of annual contribution limits it would affect the amounts an employee could defer if the Employer contributions were made to the same plan. The City could set up a 401A plan separately for City contributions, and remove the contribution limit problem from the 457 plan.

The Act states the new 401K type plan must be administered by a Board appointed by the Mayor & Council. There are a lot of options on the governance here. Chairman Fleming stated it cannot be the TSRS Board based on the language in the Act. Cassie stated the TSRS Board could partner and make recommendations to the new Deferred Comp Board of Directors. Chairman Fleming stated the TSRS Board does not want to run a 401A plan. Chairman Fleming would like to see a clear separation of the Boards. There could be a situation where the TSRS Board needs 32% and the Deferred Comp Board needs 7% and these would be competing against each other. The opt-out process is under the TSRS Board's purview under the scope of the Act. The Act states the Board of Directors are basically hiring a Deferred Comp plan. The Act also states opting out means you have to irrevocably "relinquish" everything you have earned in the TSRS plan. They are not making an exception for employee contributions here, so if an employee made this choice, no money would go to the deferred comp plan as might be expected, so that makes it a lot less likely that people will opt out. This issue needs to go to the IRS. TSRS has never required the forfeiture of an employee dollar. This makes Cassie think TSRS cannot allow any opt outs until the IRS approves this. There is no transfer or rollover ability here. There is only a three month window

for opt outs. The TSRS Board could say it is not appropriate for a member to relinquish a benefit, to provide the employee more protection and seek IRS approval. Lani Simmons stated there will be employees who just no longer want to contribute to either plan. Chairman Fleming noted that if the Board so chooses, they do not have to do any of the requirements from the Act; it would be on the City to make those decisions, so in a certain sense this could be meaningless exercise.

The Act will have spousal consent issues and employees on QDRO's as well. The opt-out process would need to be constructed as the Act requires. Those are other area where federal approval will be needed or the tax status of TSRS will be jeopardized. Without IRS approval, TSRS could not allow opt outs. The opt-out goal in the Act is based on the theory that employees will want to be in the Deferred Comp plan. Employees need to be educated about what opting out means and opt-out form would need to disclose all of that. Kelly Gottschalk is questioning if the TSRS Board needs to come up with a better opt-out option. Cassie does not see an advantage to locking non-vested employees into TSRS long-term, but there should be an opt-out option in which case they can get a refund of their pension contributions from TSRS. We have to follow the Act unless the IRS says we cannot (on the opt-out issue).

So, for now, the plan is to bring back a draft of recommendations for Mayor and Council to provide direction on; because we are required to under the Code. Chairman believes comments should be expansive, but recommendations should be related to TSRS only.

John O'Hare stated Councilman Steve Kozachik is proposing we get more experts to comment on this matter because City employees making recommendations on their own pensions could be biased. Jean Wilkins will have an article in the CTRA newsletter suggesting the retirees communicate about this to everyone they can.

b) Legal Analysis

Motion to enter Executive Session made by Silvia Amparano, 2nd by Lani Simmons; John O'Hare asked what the items are for Executive Session and Cassie Langford responded she was providing her feedback on the potential legal actions regarding the Act, motion passed 6-1 (John O'Hare opposed). Motion to exit Executive Session made by John O'Hare, 2nd by Brandy Kadous, motion approved 7-0. Motion to instruct counsel to move forward as indicated in Executive Session made by Karen Tenace, 2nd by Kevin Larson, motion approved 7-0.

C. Future Agenda Items

1. Regular Meeting Dates September 26, October 25 Annual Retreat

Michael Hermanson is considering changing the date for the annual retreat to October 30, 2013 because the Chairman will not be available October 25, 2013 and neither is Kevin Larson. Kevin Larson suggested moving the date to after the election in November, possibly November 8, 2013. Lani Simmons stated after the election makes more sense for November 8, 2013. Mike added he would find out if the facility is available and narrow the optional dates in the next couple days.

2. Alternative Meeting Dates – Special Meeting in mid-October

Michael Hermanson stated with the large body of work to be done, there is a possibility an additional Special Meeting will be scheduled for October 16, 2013.

D. Adjournment – **Chairman Fleming stated we are adjourned at 11:32AM.**

Approved:

Robert Fleming — 10/3/13 Date
Chairman of the Board

Michael Hermanson — 09.26.13 Date
Plan Administrator