

> From: Pawkarnes@[REDACTED]  
> Date: October 22, 2008 12:43:41 PM MDT  
> [REDACTED]  
> Subject: Re: SDCERS Board Oct 2008

> [REDACTED]  
> When Doug McCalla was saying that income was down 20%, I believe it  
> was investment returns and realized gains. But I am not an analyst.  
> SDCERS wasn't selling much as the market has been down and Doug  
> doesn't like realized losses.

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> At the City of San Diego Retired Employees Association, on the  
> morning of October 14th, our President reported SDCERS was down  
> \$859 million, and the fund was valued, unaudited at \$3.92 billion. I  
> don't know how the market closed that day.

>  
> Here are my notes from SDCERS notes from Sept. with more financial  
> information that ran from FY July 2007 to June 30, 2008:

>  
> Patti's Notes  
> SDCERS BOARD MEETINGS -September 17-19, 2008  
> (I attended the Audit Committee, Business & Governance Committee  
> and the full Board meeting for these notes. Notes from the  
> Investment Committee are from materials prepared for the meeting,  
> or the full Board meeting, as I did not attend that meeting. We  
> need a volunteer to attend the Investment meeting.  
> Notes do not necessarily follow the order of the committees or the  
> full Board meeting; they may be by subject. They are my  
> understanding of what happened.  
> Official CDs of SDCERS' committees and Board meetings are available

- > through the Board Secretary; visual recordings are available
- > through City Channel 24. Live streaming will be available soon.
- > Full Board meetings are on Channel 24 around 5 or 6pm, usually the
- > third Friday of the month, and usually repeat on Sundays at 1pm.)
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- > STOCK MARKET ACTIVITY- CIO, Doug McCalla's messages
- >
- > Note: Doug McCalla will be the speaker at the City of San Diego
- > Retired Employees Association's program on November 18th at Balboa
- > Parks' War Memorial Building, northwest corner of the zoo's parking
- > lot, at 11:00am. Free and open to all City retirees. Web address is
- > [www.csdrea.com](http://www.csdrea.com)
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- > Doug McCalla said when the stock market falls 4%, SDCERS
- > experiences only a half of that drop, or 2%. By comparison, he
- > pointed out that SDCERS would have lost 3% if SDCERS were only
- > invested in more conservative investments.
- > SDCERS' discipline, patience, and diversification has reduced the
- > total fund volatility. McCalla stressed that diversification is the
- > greatest defense. The goal is to reduce, not avoid risk.
- >
- > These are notes of McCalla's training for the 3 outside independent
- > Audit Committee members-
- > It is 5 times harder for SDCERS Investment people to buy when an
- > area of asset allocation has dropped, than to sell when an area of
- > asset allocation has gained value. It requires discipline to use
- > the formula for re-balancing that includes volatility. Buying low
- > and selling high in the 2000-2002 market plunge, kept losses at
- > SDCERS from being as serious as it was for other pension funds.
- > (See press release below for numbers.) "Re-balancing" last happened
- > in January, and again in July, when plan sponsors put cash into
- > SDCERS. Sometimes the wait is three years between sell high and buy
- > low opportunities. While the Board evaluates the risk-award asset
- > allocation ratio for SDCERS each year, McCalla and team monitor
- > spreadsheets each day from State Street Bank, while they contact
- > and watch 30 money managers making decisions. Cash, from sales,
- > stays with money managers for the next investment. SDCERS is not
- > market-timing. If cash is needed, SDCERS goes to Bond Managers. The
- > only signers are SDCERS staff. SDCERS weathers the market by
- > staying with the process.
- >
- > McCalla's remarks at the Business & Governance Committee-
- > The performance return report is quarterly and the balance report
- > is monthly.
- >
- > McCalla's further comments at full Board-
- > McCalla will be updating the Board monthly on the top stock
- > exposures. The greatest single holding was Qualcomm. No stock was
- > over 0.4% of the fund, or approximately \$20 million. All mortgages
- > are top tier, conforming loans (no subprime), and required 20% down.
- >
- > REPORTS FROM BOARD MEETING MATERIALS
- > Executive Summary of Staff Reports of Sept. 18, 2008
- > Sept. 4th Balance- \$4.622 billion
- > Monthly benefit payments and operating expenses were \$10 million.
- >
- > McCalla's FY 2008 Realized Rate of Return, Sept 4, 2008 report-
- > (determines 13th Check and Corbett for Dec. 2008).
- > Quarter ended 9-30-07 was +2.71%
- > Quarter ended 12-3-07 was +2.84%

- > Quarter ended 3-31-08 was +0.24%
- > Quarter ended 6-30-08 was +0.83%
- > Total for fiscal year was +6.76%
- >
- > From Financial Statement Account Variance Analysis for the month
- > ended July 31, 2008 and July 31, 2007-
- > Fund balance up \$232,758,733 or 5.55% since previous year.
- > Balance July 31, 2008 was \$4,427,097,046.
- > Balance July 31, 2007 was \$4,194,338,313.
- >
- > SDCERS Board's Press Release -
- > Steve Meyer read the whole release into the record. Below are
- > highlights from Sept. 17th "SDCERS Maintains Its Long-Term Focus
- > Despite Wall Street Woes". Contact is David Wescoe, SDCERS'
- > Administrator/CEO.
- > "SDCERS has weathered turbulent economic times in the past and will
- > weather these as well. Because any public pension plan such as
- > SDCERS is investing for the long-term, periods of short-term
- > underperformance are offset by years when marketing performance is
- > better, such as fiscal year 2007 when the Fund was up +16.25%.
- > Sound, well-diversified investment strategies have enabled SDCERS
- > to ride out difficult times and to consistently deliver on its
- > obligation to pay benefits. The worse investment strategy is to
- > overreact to short-term issues, which always translates into
- > selling low and buying high. This is a bad policy that SDCERS does
- > not follow."
- > "SDCERS' investment return for the quarter ended June 30, 2008 was
- > +0.19%. For the fiscal year ended June 30, 2008, the portfolio's
- > preliminary return was -4.64% (non-public real estate lag one
- > quarter for pricing and appraisal data). For the three and five
- > fiscal years ended June 30, 2008, SDCERS annualized return were
- > +7.77% and +10.76%, respectively. For all of these periods,
- > SDCERS' investment performance has ranked in the top half when
- > compared to other public pension plans. For the ten-year period
- > ended June 30, 2008, which includes the 2000-2002 bear market (the
- > worst such period since the Great Depression), SDCERS' annualized
- > investment return was +7.94%, which ranks in the top 3% of public
- > pension plans. Over this ten-year period, Trust Fund assets have
- > more than doubled from \$2.13 billion to \$4.69 billion."
- > "SDCERS' investment report for the quarter ended September 30, 2008
- > and final fiscal year 2008 performance results will be available in
- > October."
- >
- > VISIT SDCERS WEB SITE at [www.sdcers.org](http://www.sdcers.org) for updated information.
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- > ASSUMED RATE OF RETURN REDUCED:
- > 5 YEAR REVIEW OF ACTUARIAL ASSUMPTIONS IN EXPERIENCE STUDY-
- > The Board adopted the complete package of assumption changes that
- > Cheiron, SDCERS' actuary, recommended. (There were more adjustments
- > than investment return and inflation than are included here.) The
- > expected investment return (sometimes called the discount rate or
- > assumed rate of return) was reduced to 7.75% from 8%. And the
- > inflation rate was reduced to 4% from 4.25%. Cheiron thought this
- > "balancing" would result in annual costs close to last year and was
- > more conservative for the plan sponsors. Board President Hebrank
- > added that the City is aware of Cheiron's proposed change.
- > Steve Meyer said he doesn't think that he has ever seen an
- > experience study that didn't recommend 7.75%. Cheiron added that
- > SDCERS' investment consultant has estimated a 7.8% total return.
- > Mark Hovey, SDCERS' CFO, noted that assumption changes are
- > amortized over 30 years. A Board Member added that amortization of

- > the UAAL is still 20 years. Trustee Bill Sheffler reminded Trustees
- > that employee contribution rates could be affected, along with
- > employer annual contributions.
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- > ASSUMED RATE NO LONGER LINKED TO DROP INTEREST
- > Active DROP- Due to the IRS requiring specific interest rates, the
- > City Council voted, in 2008, to put the specific interest rate for
- > DROP into SDCERS' Board Rules. ( MOUs are not in the Municipal
- > Plan, and are not considered a SDCERS plan document by the IRS.)
- > Trustees may update interest rates via the Board Rules. Currently
- > Board Rules state the interest on active DROP is 8%. DROP interest
- > rates are reviewed annually by Trustees in November.
- >
- > Retired DROP- Interest rates are permanently set when active DROP
- > goes to retired DROP, per the IRS.
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- > WHEN RECUSING IS NECESSARY
- > Elaine Reagan, General Counsel, said that if Trustees fail to
- > recuse and instead vote on a contract in which they have a conflict
- > of interest (such as DROP interest, when the Trustee is active
- > DROP), they are subject to civil and criminal penalties and void
- > the vote of the Board, as well as risk losing their own contract
- > (DROP).
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- > AUDIT COMMITTEE
- > The Audit Committee's Chair, Armon Kamesar, began the meeting with
- > a quote from Dickens- "It was the best of times and the worse of
- > times".
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- > Audit Investment training by Doug McCalla- See McCalla's comments
- > at the beginning of my notes.
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- > 2007-2008 CAFR:
- > Outside Auditor, MGO will start the 2007-2008 audit for the CAFR on
- > Sept. 22nd. Internal Auditor, Bob Wilson reported to the Board
- > that MGO is expecting to send an opinion letter the week of Nov.
- > 17th. The CAFR is on schedule for the first time in five years.
- > The Audit Committee may meet in November, after all, to review the
- > draft CAFR, rather than wait until their regularly scheduled
- > 10:00am Wednesday, December 17th meeting. Watch for a new date/time.
- >
- > The audit will cover actuarial information, fair value for
- > investment portfolio, retirement benefits, and test mid-November
- > credit quality. (Due to the market conditions, MGO feels it will be
- > challenging to evaluate the market value of SDCERS' assets. SDCERS'
- > change to market value will reduce MGO's work. Formerly SDCERS used
- > book value.) It will also evaluate SDCERS' approach to significant
- > risk of material misstatement due to error or fraud, SDCERS'
- > approach to internal controls, consideration of materiality, and
- > governing body.
- >
- > Driven by national problems of the late 1990's and early 2000's,
- > and new this year, MGO will be documenting SDCERS' Internal
- > Controls of significant transaction streams: investment, benefit
- > payments and financial reporting. While still short of SEC
- > regulation standards, MGO will look at SDCERS' evaluation of the
- > organization's risks, and the corresponding controls that SDCERS'
- > has put into place. They plan to use a matrix check off. MGO may,
- > or may not test the controls. MGO will report on negative
- > exceptions to any of the required steps. MGO said that SDCERS is
- > already 5 or 6 steps of the curve because it has already



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- > Former Spouses Excluded From Surviving Spouse Continuances
- > Board approved by 12-0 to approve staff recommendation. Applies to
- > future retirees. Contact SDCERS for more information.
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- > Some Board Rule and Charter Changes Were Delayed By Board
- > \* Changes that were adopted: Added language for Administrator to
- > set the agenda. Travel Policy now varies from the City. Marketing
- > was already included under Conflict of Interest Policy. Board
- > Communication Policy minor changes. Public Records requests'
- > directions already in law, and will be overseen by SDCERS legal
- > staff to assure compliance with the Code.
- >
- > \* Returned to staff for more research and comparing to other systems:
- > 1) How do other pension systems handle the hiring of outside
- > Counsel/consultants for opinions?
- > Staff suggested substantive changes included increasing the
- > Administrator/CEO authorization from \$10,000 to \$50,000, and the
- > "Board President's authorization was deleted, with any requests
- > over \$50,000 requiring Board approval".
- > Board discussion: Do committee chairs, Board Presidents and/or
- > Administrator/CEOs have authority? Sullivan asked what if a
- > Committee wants a legal or fiduciary opinion? Elaine Reagan,
- > General Counsel, recommended always going through staff to avoid
- > unnecessary expense. Does the Administrator have final approval? Jo
- > Anne SawyerKnoll, and President Tom Hebrank argued for emergency
- > authority for situations that are unexpected and asked who is
- > successor to the Administrator/CEO for decision making. Elaine
- > Reagan answered that it depended on which department of SDCERS had
- > that expertise. (If you missed Wescoe's comments in these notes, it
- > was because he was out of town for the meeting and weekend.)
- > Looking at it from another side, the Board asked, for example: if a
- > Board President, who does not have day to day knowledge, should
- > have authority up to \$50,000? They asked if a future Administrator/
- > CEO would have a personal reason to withhold hiring of outside
- > counsel, was on vacation or medically unavailable, and it was
- > difficult to gather the full Board? Reagan argued that if the CEO
- > refused, that there would be bigger problems than just hiring an
- > outside legal opinion, and that Fiduciary counsel was on retainer
- > already.
- > Hebrank wanted to be sure there were not too many restrictions and
- > asked if the Board President only had authority to run meetings?
- > The suggestion was perhaps to have both the President and
- > Administrator/CEO to sign off. Joe Flynn is interested in following
- > this item when it comes back from staff.
- > 2) Who has authority to settle claims or lawsuits? How much rests
- > with the Board and how much with the Administrator? "No substantive
- > changes other than increasing the Administrator/CEO's settlement
- > authority from \$5,000 to \$20,000" and re-incorporating guidelines
- > from adoption in October 1998. What do other systems do?
- > 3) How members may appeal staff benefit decisions, at first though
- > the Member Services Director and then to the Administrator/CEO, up
- > to the Business & Governance Committee. "Members will be advised of
- > their appeal rights at every step throughout the appeal process."
- > Board referred this back to staff for more information.
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- > LEGAL- Legal trials can now be followed on SDCERS' web site.
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- > Chief Compliance Officer, Roxanne Story Parks' report-
- > 1) Group Trust: IRS' Determination Letter, is expected soon.
- >

- > 2) Preservation of Benefits: IRS' Private Letter Ruling on is also
- > expected soon for the three plan sponsors' preservation of benefits
- > (for those receiving higher pensions than the IRS allows). The
- > Council will have 60 days to act and may need support of retirees.
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- > 3) Roxanne's Draft Policy on SDCERS' Compliance Program will be on
- > the Business and Governance's agenda for October.
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- > INVESTMENT COMMITTEE- Steve Meyer Chair
- > Cash Overlay: Clifton Group approved for "cash overlay", using the
- > residual cash, which is available between investment transactions,
- > to buy futures to securitize that cash. In the short run, futures
- > may go down, but expect good results in the long run. Benefits also
- > include keeping more eyes on money managers.
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- > SDCERS' Small Cap Tilt: SDCERS invests in a higher percent of small
- > cap than most pension systems, which has resulted in 3.25% over the
- > normally expected bench market. While small cap may not perform for
- > 5-7 years, the longer return is more than makes up for the wait.
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- > Private Equity (non- publicly traded companies): Cory Buuhoan,
- > SDCERS' Investment Officer, reported that the next step is to hire
- > a Private Equity Generalist. This is a fortuitous time to enter
- > private equity, as turbulent times make for opportunities with the
- > better firms.
- > McCalla added that SDCERS will start to invest now, and will
- > diversify, by spreading additional private equity buying over many
- > years into the future.
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- > ERROR ELIMINATION WITH TECHNOLOGY
- > New technology is expected to catch incorrect over/under payments.
- > (In the meantime, remember to check your data online at SDCERS.)
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- > RECIPROCITY
- > Non -agenda comment on reciprocity with other agencies: Member was
- > not informed that there was a time limit for requesting
- > reciprocity, and he missed the deadline by 22 days. Fourteen of
- > those days were lost due to the system processing. Cynthia Queen,
- > Membership Services Director, told the Board that she is meeting
- > with the member and researching with legal, etc. in hopes of
- > finding a solution.
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- > SDCERS 1st ANNUAL MEETING
- > Attendance was approximately 150 at Balboa Park Club on September 9th.
- > Cynthia Queen, Member Service Director posted the event on SDCERS'
- > web site six weeks in advance. (CSDREA estimates 1/3 of its members
- > have computers.)
- > (Patti's Notes from the event are posted separately from this.)
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- > MEMBERSHIP SERVICES
- > Cynthia Queen is busy filling five Public Information Clerk
- > positions to answer your more detailed questions, as well as, help
- > you with the Member Portal on the web. She mentioned two other
- > vacancies in her report as well. No wonder she looks so busy.
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- > Play online games for FREE at Games.com! All of your favorites, no
- > registration required and great graphics – check it out! ([http://](http://pr.atwola.com/promoclk/10000075x1211202682x1200689022/aol?redir=)
- > [pr.atwola.com/promoclk/10000075x1211202682x1200689022/aol?redir=](http://pr.atwola.com/promoclk/10000075x1211202682x1200689022/aol?redir=)