MINUTES

MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION (MCERA)
RETIREMENT BOARD STRATEGIC WORKSHOP

Marin Community Foundation
5 Hamilton Landing, Novato, CA 94949
Redwood Room
September 26-27, 2011

Monday, September 26, 2011
8 – 9 AM
Continental Breakfast

CALL TO ORDER Chair Richardson called the meeting to order at 9:05 A.M.

ROLL CALL PRESENT: Bolger, Brenk, Gladstern, Haim, McFarland, Phillips, Richardson, Webb (retiree alternate)

ABSENT: Given (alternate)

OPEN TIME FOR PUBLIC EXPRESSION Note: The public may also address the Board regarding any agenda item when the Board considers the item.

No public comment.

BOARD OF RETIREMENT MATTERS

9:00 AM – 12:00 PM
Proposed GASB Changes
Preliminary Experience Study Discussion
Review and Discuss Economic Assumptions
New Valuation Disclosures
Graham Schmidt
EFI Actuaries

Retirement Administrator Jeff Wickman introduced Graham Schmidt of EFI Actuaries to provide a preliminary overview of the new experience study and economic assumptions. In addition, Mr. Schmidt will address new actuarial valuation disclosures being discussed by the California Actuarial Advisory Panel and new regulations presented by the Government Accounting Standards Board (GASB).

Proposed GASB Changes
Mr. Schmidt presented the proposed GASB changes to statements No. 25 and No. 27. The first proposed change would, for financial reporting purposes, replace the Unfunded Actuarial Accrued Liability (UAAL) with the Net Pension Liability (NPL), which is based on market value

of assets instead of actuarial value. Next, for financial reporting purposes, liabilities would be discounted at the expected rate of return until assets go to zero, when the municipal bond index rate would need to be used as the discount rate. In response to Trustee Brenk's query, Mr. Schmidt stated that the proposed change would not impact MCERA because MCERA has been making the annual actuarial required contribution.

GASB is also proposing that pension systems uniformly use the entry age normal at final decrement funding method Additionally, pension systems granting an ad hoc COLA each year would need to include the annual benefit cost in their funding mechanism.

According to Mr. Schmidt, the new GASB rules would impact plan sponsors the most. The proposed rule changes would require the full liability of all benefit changes to be recognized on the employers' financial statements in the year they occur. Similarly, assumption changes for the retirement population would be recognized on all liabilities in the current year. Mr. Schmidt stated that the effect of these proposed rules would be to increase the volatility of employer expenses. GASB recognizes that Plans are funded on an actuarial basis and does not intend to establish funding rules, but intends to set rules for reflecting current liabilities and changes to liabilities on the employers' financial statements.

For the employer's balance sheet, a Statement of Net Position (GASB 63) is proposed which moves the unfunded liability from the notes to the balance sheet and shows the Net Pension Liability and deferred outflows and inflows. Mr. Schmidt discussed required financial statement disclosures such as the impact of plus or minus 1% changes in the discount rate, dollar- vs. time-weighted single year returns, and the use of end-of-fiscal-year values.

The schedule for the new GASB proposals began with exposure drafts issued June 27, 2011, a public hearing/user forum in San Francisco on October 13 and 14, and the issuance of final statements in June of 2012.

Mr. Schmidt discussed GASB's proposal to change to "entry age normal to final decrement," and stated that MCERA currently uses "entry age normal to decrement". He commented that both methods are acceptable from an actuarial standpoint and will lead to some differences over time. Mr. Schmidt recommends that, in light of the GASB proposal, effective with the June 30, 2011 actuarial valuation entry age normal to final decrement be used. Trustee Bolger inquired about the impacts of the change in methodology, and Mr. Schmidt said that, along with a slightly higher funding ratio, the methodology could produce a small reduction in employer contributions.

Chair Richardson recessed the meeting at 10:43 A.M. for a break, reconvening at 11 A.M.

Preliminary Experience Study Discussion

Mr. Schmidt provided an overview of the upcoming experience study which will look at both the economic assumptions used to finance the plan and the demographic experience of the plan membership. Mr. Schmidt reviewed the four economic assumptions that would be included in the upcoming Experience Study including inflation, wage growth, post-retirement benefit growth (COLA), and the assumed investment rate of return. He discussed in detail the impacts the preliminary recommendations would have on total plan costs as a percentage of payroll.

The EFI preliminary recommendation is to reduce the inflation assumption from 3.5% to 3.25%. EFI data supporting the recommendation includes the 3.25% rolling historical inflation rate since 1913, and 3.1% rate since 1981. Lower inflation expectations may be found in the under-2.5% ten-year forward projections of the 2011 Q3 Survey of Professional Forecasters. Similarly, the Cleveland Fed 30-year projection shows inflation remaining under 2.5%.

Trustee Haim requested the opinion of Callan Associates consultant Jay Kloepfer, who observed that 3.25% is reasonable as it is near the long term mean. Trustee Bolger questioned whether a lower assumption may make sense. Mr. Schmidt favors the less aggressive change in order to proceed in a deliberate manner. Callan Associates uses a 2.5% inflation assumption, and many other investment experts are using lower values, according to Mr. Kloepfer. Upon further discussions about inflation values, Mr. Schmidt observed that the real rate of return has a bigger impact on overall plan funding.

Regarding the wage growth assumption, Mr. Schmidt stated that EFI recommends maintaining the current expectation of no real wage growth beyond the inflation level. Mr. Schmidt noted the continuing challenges for public employer budgets including the higher cost of employee benefits such as healthcare and pensions. The historical real wage growth average is 0.7%, and Social Security projections are 0.6 to 1.8% for real wage growth, according to Mr. Schmidt.

Mr. Schmidt presented recommended unique COLA assumptions for each category (2%, 3% and 4%) that are available. The COLA is based on the Bay Area CPI rounded to .5%, and is subject to caps with a bank accumulated when the cap is exceeded.

The recommendation of EFI is to reduce the assumed rate of investment return to 7.5% from the current 7.75%. EFI further recommends that the real return assumption of 4.25% remain the same, which is added to the 3.25% inflation assumption to arrive at the 7.5% rate of return. Mr. Schmidt reviewed the steps for calculation of expected returns, and discussed how investment and administrative expenses impacted his calculation. EFI modeled the MCERA portfolio based on asset allocations and Callan Associates capital market projections by asset class, adjusted for expenses and inflation. The result was a mean real return value of 4.1%, and a 7.32% investment return. In accordance with Actuarial Standards of Practice (ASOP), Mr. Schmidt's "best estimate" based on 25% quartile low and 75% quartile high was 4.75% – 10.00% for assumed rate of return, and 1.5% – 6.75% for the real rate of return. To test these ranges Mr. Schmidt performed simulations using assumptions from other investment consultants. That result produced a 3.05% – 4.35% real rate of return after expenses.

Finally, Mr. Schmidt provided a matrix showing the effects on the financing plan using varying rates of inflation and real return assumptions. At the recommended assumption levels, total employer and employee costs as a percentage of payroll would increase by 1.2%.

Trustee Bolger mentioned the significant discussion that has taken place regarding the use of a "risk-free" rate of return as well as amortization periods of 40 years. Counsel Dunning noted there is a limit of 30 years for amortization under the 1937 Act. As to the use of the risk-free rate, Ms. Dunning reminded the trustees of the duty to charge employers what the Board reasonably deems is necessary to fund the promised benefits on an actuarially sounds basis, but

not to overcharge the plan sponsors. Mr. Schmidt explained that the effect of funding to the risk-free rate would be an immediate spike in the employer contributions, followed by a subsequent decline over time, thus raising the issue of intergenerational equity. Trustee Haim referred to the responsibility to Plan sponsors, and said that historical investment returns should be relied upon. Mr. Schmidt advised reviewing assumptions every year based on the investment environment.

Trustee Brenk inquired about considering macro-economic changes in the U.S. economy leading to "the new normal" as posed by certain financial experts. Mr. Kloepfer replied that long-term equity returns are 10%, and that current assumptions have been adjusted to the current economic environment. Furthermore, Mr. Kloepfer observed that equity markets are expected to be volatile, and he cautioned against making major changes in assumptions in anticipation. Mr. Callahan concurred, pointing out that secular outlooks are projected over 3 to 5 years at most. He added that the capital markets are not likely to accept negative real rates of return for an extended period of time. Trustees Brenk and Bolger posed the concept of using different assumptions for short time periods of 3 to 5 years, for example. Mr. Schmidt noted that although this was mathematically possible, in his opinion it makes more sense to use a stable average instead of making major changes on a short-term basis. He stated that discretion should be exercised when considering the value and additional cost of more extended calculations.

Counsel Dunning reviewed the need for each trustee to exercise prudent judgment and to consider the opinion of experts and the parameters provided by the actuary, particularly if an option would fall outside a reasonable range according to the recommendations of the professional consultants.

New Valuation Disclosures

The California Actuarial Advisory Panel issued a draft proposal for recommended valuation report disclosures, most of which are already included in MCERA's valuations, according to Mr. Schmidt. Additions would be volatility ratios of assets/payroll and liabilities/payroll, and the full unfunded actuarial accrued liabilities (UAAL) amortization schedule. Mr. Schmidt reviewed other items on the disclosure list. The MCERA Ad Hoc SB 867 Committee has been working with the actuary to come up with a Summary Actuarial Valuation document as a supplement to the full annual valuation report.

Chair Richardson recessed the meeting for lunch at 12:27 P.M., reconvening at 1:15 P.M.

12 – 1:30 PM Lunch on site

1:30 – 3:00 PM
Asset Liability Study
Jim Callahan, Jay Kloepfer and Kevin Dunne
Callan Associates

Jay Kloepfer, Callan Associates Director of Capital Market and Alternatives Research, reviewed the areas looked at in the asset liability study. The Fund's allocation to riskier assets is examined with regard to capital market expectations, cash flow, investment goals, risk tolerance and time horizon. The appropriate set of asset classes is also determined by the size of the Fund, liquidity needs, and administrative and legal requirements. The study encompasses policies regarding investment, funding, accounting, benefits, and spending. Mr. Kloepfer defined the rationale for conducting the asset/liability study as an evolutionary process to re-examine the long-term strategic plan. Results show whether the rate of return on investments will align with the projected liabilities. Defining risk tolerance and selecting an appropriate asset allocation are key elements, he stated.

The process of the study begins with a review of MCERA's current strategic allocation to broad asset classes and the evaluation of potential new asset classes and strategies. Then, a detailed model of Plan liabilities is constructed in accordance with the actuarial valuation. Assumptions and decision variables are confirmed, and finally, the study is presented to the Board to determine the ultimate asset allocation.

Mr. Kloepfer discussed risk elements of different assets. For example, he stated that private ownership necessitates longer time horizons due to the illiquidity of assets. Furthermore, Index funds are subject to implementation risk. Mr. Kloepfer said that fixed income serves as a short-term hedge and as a volatility buffer.

Cash flows were discussed, with Mr. Kloepfer advising that net outflow/net assets should be under 5% as a standard. Given that the Fund meets this standard currently, Trustee Brenk inquired if risk might be reassessed to allow for an increased equity allocation. Mr. Kloepfer said that is possible, but Mr. Callahan recommended considering asset classes in the aggregate as to their roles before adopting such a position. Mr. Kloepfer reviewed the Fund's performance by asset class over the past year. Equities have performed well, with international investments including emerging markets lagging.

Mr. Kloepfer reviewed the capital market projection process and projections. The investment consultant believes, based on revised GDP numbers, that growth stopped in the middle of 2010. Mr. Kloepfer said that he expects weak GDP for the year, stating that the trend in economic growth is down. There was discussion about capital market risks associated with government debt and the relative value of U.S. currency.

Mr. Kloepfer discussed projected yields of asset classes and the concept of assessing the degree to which assets correlate with one another. Fixed income and equity have been negatively correlated for the last several years, he said. The goal is to attain a set of asset classes that interact together to maximize return and provide for diversification and risk mitigation at the efficient frontier. The Fund may benefit from consideration of a broader range of classes with both more and less risk, according to Mr. Kloepfer. Rates of return for different asset mixes

were reviewed over 5 years. To analyze different scenarios, Mr. Kloepfer provided projected returns based on equity allocations ranging from 37% to 80%, with results showing that it is difficult to achieve the 7.75% assumed rate of return. Callan Associate's expected return for the current asset mix of 7.45% differs from the assumed rate of return by its shorter term outlook, lower inflation assumption, and assumed passive exposure. Mr. Kloepfer stated that the current allocation lies on the efficient frontier of risk and return.

Asset allocations were discussed. Trustee Bolger questioned the 12% real estate target allocation. Mr. Callahan stated that it is on the high side to provide for diversification in the Woodmont portfolio. There was discussion that the 12% real estate allocation may benefit by including real assets. Responding to Trustee Brenk's inquiry, Mr. Callahan said that fund of funds are appropriate entry vehicles into alternative assets.

Mr. Kloepfer discussed factors affecting a change in assumptions and advised resisting altering asset mixes based on short-term events. Trustee Phillips recommended increasing volatility in order to achieve the assumed rate of return over the long term, which he said ultimately may result in less risk. Within the equity class, Mr. Phillips noted that large caps represent 60%, and he posed the option of decreasing large cap assets and increasing small cap. Mr. Callahan advised that as equity represents most of the portfolio risk, the issue becomes one of diversifying risk into other assets that may achieve the assumed return. In summary, Mr. Callahan emphasized that there should be further diversification into other assets. Trustee Haim voiced his preference for caution regarding changing the asset mix. Other options discussed, were the concept of lowering the assumed rate of return for two years, and increasing private equity commitments.

Mr. Kloepfer noted that many plans have begun to look at higher risk asset classes. He recommended considering other real assets such as long/short hedge funds. Mr. Callahan stated that Callan has hedge fund expertise and recommends fund-of-funds vehicles. Trustee Bolger expressed concern about potential negative publicity regarding hedge funds.

Mr. Kloepfer provided simulated market values compared to the actuarial liability and funded status over time. The results were presented for best and worst-case scenarios. In order to achieve the current financing targets Callan Associates recommends a strong orientation toward equity assets. Mr. Kloepfer repeated that the real estate allocation should be broadened to include real assets, and equities should be diversified. He advised increasing the non-U.S. allocation by expansion into global equities and emerging markets as the path to capture more growth. Mr. Callahan observed that there is an argument that large U.S. companies will be taking advantage of international growth over the long term.

Trustee Haim supported Callan's recommendations to reduce risk by diversifying asset allocations and considering alternative investments. Trustee Phillips advised that ultimately there is lower risk in growth investments.

3:00 – 4:00 PM
Real Asset Sectors
Sarah Angus, Jim Callahan and Kevin Dunne
Callan Associates

Mr. Dunne presented real asset sector alternatives by complexity and liquidity. He also reviewed correlations of real assets to inflation. Sectors discussed include inflation-linked bonds, timberland, and public and private real return strategies. Discussions included energy, infrastructure, and agriculture.

According to Mr. Dunne, the benefits of U.S. Treasury Inflation Protected Securities (TIPs) include a low default rate and, as long as embedded yield is positive, returns over time regardless of inflation. TIPS yield less due to less risk, according to Mr. Dunne, and bond yields are expected to be challenged going forward. MCERA's fixed income managers can invest in TIPS but do not have a significant allocation there, he stated. Discussions included the liquidity of TIPS, their longer duration than regular Treasurys, and their low correlation to commodities.

Callan Associates real assets specialist Sarah Angus reviewed characteristics of the timberland asset class. The purpose is to grow and harvest timber over time. She indicated that interest is growing in the international timber markets. She reviewed types of timber and uses for different regions. More mature timber has higher value, and timber prices are linked to economic activity. There is growth in Brazil, with new demand coming from China and India. Canadian timber is owned largely by the government. Ms. Angus reviewed sources of return – 50% from biological growth, 25% from timber prices, 10 to 25% from land appreciation, and the remainder from leasing – and showed their low correlation to numerous other markets including the capital markets. Investment vehicles are similar to those in real estate, including separate accounts and commingled funds. Trustee Bolger inquired about current investors, which include endowment foundations and also public funds. The expected investment period of three years and lag in appraisals was discussed.

Trustee Haim discussed potential risk factors such as political and regulatory risk regarding de-forestation. Ms. Angus commented on environmental risks such as fire and natural disasters and country risk; for example, she stated that Russia is enacting high tariffs. Economic risk includes overpaying, price volatility, and illiquidity, she stated. The consultant expects supply constrictions in the sector.

Trustee Haim was excused from the meeting at 4 P.M.

Loss of purchasing power is leading to interest in real assets, according to Mr. Dunne, who presented information on both public and private real return strategies seeking returns above inflation. Benefits of public management include diversification and rebalancing; considerations include short track records and wide variation in implementation. Private managers provide fund-of-fund investments based primarily on energy resources such as oil and gas and also provide diversification. Considerations are similar to those of the public vehicles. Detailed data

on energy and commodity historical correlations and returns were presented, along with key benefits and considerations.

Also discussed were infrastructure opportunities and strategies. Benefits include rapid growth, longevity, cash flow; considerations involve the importance of the General Partner and the limited number of managers with experience and performance history.

The trustees considered the information provided and discussed alternatives. Trustee Phillips observed that fund of funds make sense but lack of an established track record, and he inquired about access to infrastructure funds. Mr. Callahan said that the consideration is whether to buy existing assets for cash flow or to buy for future development which entails more risk. It is a relatively new asset class with high leverage, according to Mr. Dunne. Mr. Callahan agreed that the ability to enter and exit investments is an important feature of the investment. Trustee Gladstern expressed concerns about privatizing infrastructure, and Trustee Webb agreed that risks of pollution and exploitation should be avoided. Trustee Richardson observed that infrastructure investments create jobs.

In summary, Mr. Dunne offered to provide further research, and he recommended reconsideration of the 12% real estate allocation. Trustee Phillips recommended retaining the real estate allocation and instead divesting equities by 5% to be replaced with a new asset class of real assets. Mr. Phillips believes that further diversification is needed in the portfolio, and Trustees Webb and Richardson concurred that real assets were a viable alternative.

Chair Richardson recessed the meeting at 4:44 P.M.

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RETIREMENT BOARD STRATEGIC WORKSHOP

Marin Community Foundation
5 Hamilton Landing, Novato, CA 94949
Redwood Room

Tuesday, September 27, 2011
8 – 9 AM
Continental Breakfast

Chair Richardson reconvened the meeting at 9:08 A.M.

9:00 – 11:00 AM
Investment Risk Analysis
Dave Hansen
Tim Holmes
Scott White

David Hansen of SF Sentry Securities reviewed the firm's preliminary risk analysis of the MCERA portfolio. Previous to the workshop SF Sentry has been presenting preliminary data to the Ad Hoc System Risk Committee. The purpose of the analysis is to measure risk on an ongoing basis in order to provide the Board with meaningful data about the structure of the portfolio and potential changes the Board may want to consider. Data is collected from MCERA managers and summarized on a quarterly basis. The Ad Hoc committee is recommending continuation of the program beyond the initial three-month contract.

Mr. Hansen discussed preliminary results in terms of the variance of the portfolio from the S&P 500. Such variances show that the portfolio is being actively managed, he stated. An overweight to the S&P in Consumer Discretionary and underweight to Energy is apparent, he said. Based on this information, he stated, potential new asset classes may or may not be appropriate. Tim Holmes noted that modeling the financial holdings can asses risk associated with different interest rate environments.

Mr. Holmes reviewed the process of data aggregation from the custodian, comingled funds and the futures overlay program. Challenges include unique coding of securities in commingled funds. Mr. Holmes also discussed factors such as total market exposure versus portfolio value based on futures activity, bond transparency, and trade settlement issues. Mr. White stated that establishing a rule for settlement date versus trade date can resolve current issues.

Mr. Hansen discussed quantitative analyses by managers, asset classes, liquidity, and geographic region. He also reviewed portfolio holdings reports and sector holdings relative to benchmarks. Qualitative reports include rate of change analysis, showing monthly changes in holdings by sector and capitalization, and Value at Risk (VaR) reporting. Mr. Holmes explained that VaR is a monthly measure of potential loss with a 95% to 99% confidence range. The rate of change is important in order to determine changes in the risk profile, he explained. Mr. White explained that events are time-weighted, and the VaR is a tool used daily by a major investment firm.

Trustee Phillips, referring to 12-standard deviation events in the volatile 2008 stock market, stated that modeling such events would be beneficial. There was discussion about the nature of statistical analysis and the manner in which outlier events are incorporated. Trustee Phillips observed that there is both art and science in modeling.

The trustees considered the benefits of the system risk studies and discussed their questions about the program. Trustee Phillips advised that having a report by a third party to analyze the portfolio is good practice. In explaining the value of the risk studies to Trustee Brenk, Mr. Phillips stated that the reason for such studies is the Board's fiduciary duty to understand and be able to discuss the nature of the portfolio risk with the public, and he stressed the importance of that process. He also observed that reducing volatility quarter to quarter is an important consideration for a public fund. Mr. Phillips recalled when fixed income values dropped 25%, and he said that risk analysis provides another way of analyzing the potential risk of individual securities. Trustee Richardson suggested that the process will be evolutionary, with the Board discovering over time that fewer managers may be needed, for example. Trustee Bolger agreed that the risk studies will help to be better informed.

Trustee Haim presented matters for consideration before proceeding with the risk studies, such as whether policies need to be revised to accommodate a contract with SF Sentry. Mr. Haim said the trustees and staff need to assess whether and how they will be able to take appropriate action in the context of a catastrophic event. Trustee Brenk observed that, if the Board is aware that measures of risk are available, the question may arise why they are not used. He said that there is a question as to whether the cost is worthwhile, adding that it is reasonable to look at the data for a period of one year in order to make the determination.

Counsel Dunning advised that the prudent course of action is to investigate options that allow the Board to enhance its ability to manage the fund.

Chair Richardson recessed the meeting for a break at 10:50 A.M., reconvening at 11:00 A.M.

Following further discussions, Trustee Phillips requested that consideration of the Ad Hoc System Risk Committee's recommendation to extend the system risk studies for one year be agendized for the October Board meeting. Trustee Haim requested a staff recommendation explaining the structure of the implementation and a summary report due to the complexity of the subject matter.

11:00 AM – 12:00 PM
Pension Legislation and Initiative Update
Ashley Dunning
Manatt Phelps Phillips

Counsel Ashley Dunning reviewed bills before the California Legislature and other pension reform matters.

AB 309: This enrolled bill addresses section 7500 of the Government Code regarding removal from office of public officers. It provides that ex-officio and appointed officers may be removed from office if they appear on the Excluded Parties List System maintained and disseminated by the federal General Services Administration.

AB 506: This enrolled bill regarding municipal bankruptcy puts stricter State conditions to require mediation and sets financial condition thresholds that must be met prior to filing for bankruptcy.

AB 873: This enrolled bill pertains to post-separation employment for State Retirement System Board and staff. It prohibits Board members and executives from appearing before CalPERS or CalSTRS to influence specified actions for four years after leaving service. It also restricts consulting and placement agent activities.

AB 1247: This enrolled bill modifies the prior year's AB 867 on financial reporting for CalPERS. First, CalPERS must report annually re assumptions. Next, the calculation of contribution rates is modified to include return assumptions 2% above and below the assumption used by the Board**.** Trustee Haim observed that while there is a risk that the assumed rate of return may not be achieved, it is based the best information available. Trustee Brenk responded that the calculation is reasonable and would give plan sponsors additional information on which to base budgetary decisions going forward.

SB 398: Regarding external investment managers and placement agents, this bill clarifies further the definition of placement agents and lobbyists as they pertain to individuals who communicate with California's public retirement systems about their investments. Enactment of this bill would lead to an amendment to MCERA's policy regarding disclosure of payments to placement agents, she advised.

SB 203: This legislation was approved by the Governor on July 26, 2011, and amends the '37 Act to support full Board activities of alternate Board members. Furthermore, it requires the system to hold an election to fill vacancies in elected positions at the earliest possible date.

Initiatives proposed by the California Foundation for Fiscal Responsibility (CFFR) include one which would changes the benefit formula for new employees, with those hired after July 1, 2013, eligible for a defined contribution plan. It also caps the defined benefit pension at the defined benefit formula offered to federal workers on January 1, 2011. The pension would be payable when employees reach the Social Security retirement age, now 62 years old.

Another CFFR initiative would change contribution sharing between employees and plan sponsors by requiring current and future employees to pay half the cost of pension and retiree health benefits. Ms. Dunning said that efforts to change the way pensions are paid for in some instances create a vested rights problem because calculation of employee contribution rates is part of the '37 Act. Other provisions prohibit retroactive benefit increases, and new employees may not receive lifetime medical benefits prior to age 65.

Finally, Ms. Dunning reviewed a "California Pension Reform" 2012 initiative to limit sponsor pension contributions to levels in the private sector of about 5%. Trustee Haim said there is an issue of vested rights with this proposal, and Ms. Dunning explained the concept of vested rights and how it protects pension funding from diversion for other purposes. Ms. Dunning also discussed the state of the law on the subject and the strength of legal cases on vested rights. She discussed cases that define the difference between vested retirement rights and employment benefits that are not vested Any new law that attempts to deprive MCERA of the funding the MCERA Board deems the retirement system requires to remain actuarially sound would likely be deemed in violation of the contracts clause of the California Constitution.

Chair Richardson recessed the meeting for lunch at 12:20 P.M., reconvening at 1:05 P.M.

12 – 1:30 PM
Lunch on site

1:30 – 3:00 PM
Disability Presentation
Ashley Dunning
Manatt Phelps Phillips
Jeff Wickman
MCERA

Counsel Ashley Dunning said that portions of the disability presentation were discussed at the Spring SACRS conference. Ms. Dunning explained that disability retirement is part of the defined benefit plan, which allows qualifying disabled members who have not attained the requirements for normal retirement to retire at 50% or 33% of final compensation, for service or non-service-connected retirement, respectively. Five years of service is required to qualify for non-service connected retirement.

The '37 Act, and case law developed under it, govern disability retirement. The award of a disability retirement allowance under other acts, such as Workers Compensation laws, does not compel the Board of Retirement to grant disability retirement under the '37 Act.

Ms. Dunning described the factors determining disability retirement as based on the following questions: 1) Is the applicant incapacitated? 2) Is the incapacity permanent? 3) Did employment substantially cause the incapacity?

Incapacity is the substantial inability of the applicant to perform his or her usual duties given reasonable accommodation. Usual duties include those performed regularly or frequently, and may not be, necessarily, essential functions. Reasonable accommodation applies to light duty cases; however, case law has established that a member cannot be required to accept a lower level position. Counsel Dunning stated that if reasonable accommodation can be provided by the employer, then the applicant does not qualify for disability retirement.

The question of permanence is complicated by the fact that it is not defined by the '37 Act, according to Ms. Dunning. It may, therefore, be helpful, according to Ms. Dunning, for the

Board to consider developing a policy to define "permanently incapacitated." Definitions of "permanent" that have been adopted by other public retirement systems, and that are found in Black's Law Dictionary and in Workers' Compensation regulations were reviewed by counsel, who indicated that a hybrid definition is one potential approach.

Ms. Dunning advised that the question of what is permanent has arisen where doctors have not been able to state whether an issue is permanent. Trustee McFarland pointed out the Social Security makes a redetermination after one year. Trustee Haim expressed a preference for establishing a definition of the term "permanent".

Trustee Phillips was excused from the meeting at 1:35 P.M.

As to whether the disability may be considered service connected, Ms. Dunning stated that the employee has the burden of proving the link of the injury to the job, for which there must be a competent medical opinion. Trustee Brenk referred to the concept of substantial contribution and there was discussion about levels of contribution. For Safety members, there are exceptions to proving this link which are the four presumptions in the '37 Act of heart, cancer, blood-borne disease, and exposure to biochemical substances. The presumption eliminates the need for the applicant to establish the link between the injury and the job; however, the MCERA process has included evidence to show the link between the job and the injury, in any event, because the presumptions are rebuttable.

Ms. Dunning also discussed instances in which recusal of a Board member from deliberations on a disability case would be appropriate.

There being no further business, Chair Richardson adjourned the meeting at 2:45 P.M.

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Gerald Richardson, Chair

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Attest: Jeff Wickman
Retirement Administrator