MINUTES

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

**Marin Community Foundation
5 Hamilton Landing, Novato, California
Redwood Room
October 14-15, 2014**

Tuesday, October 14, 2014

8:00 a.m. – 9:00 a.m.
Continental Breakfast

9:00 a.m.
Call to Order

Chair Piombo called the meeting to order at 9:01 a.m.

Roll Call

PRESENT: Bartfeld, Bolger, Brenk, Cooper (alternate safety) Given, Gladstern, McFarland, Piombo, Shaw (ex officio alternate), Shore, Webb

ABSENT: None

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.

9:00 a.m. – 12:30 p.m.
Governance at MCERA
Ashley K. Dunning, Partner
Manatt Phelps & Phillips

Retirement Administrator Jeff Wickman introduced two sessions on the topic of Board governance. Mr. Wickman introduced Board counsel Ashley Dunning who would provide an overview of the policies and procedures developed by the Board over the past seven years.

Ms. Dunning reviewed the history that led to MCERA's current governance policies. In California the obligation to act prudently, which may be accomplished in part through self-regulating policies and resolutions, is part of the law that governs public retirement systems. In 2007 MCERA had policies regarding conflict of interest and investments but a number of other policy areas were not yet documented. The MCERA Board undertook a concerted effort to develop appropriate policies and to document its internal controls. For example, an analysis by an external accountant resulted in development of a quarterly checklist for the financial transactions that should be reviewed by the Board. In 2009, the Board enhanced its governance structure further by establishing Finance and Risk Management and Governance standing committees.

The composition of the Retirement Board and terms of its members, as well as Board member responsibilities, are set forth by California state law, according to Ms. Dunning. The roles of the Board officers and more general rules of conduct for the Board are set forth in MCERA policies. As a way of identifying potential conflicts of interest, Board members, executive staff and certain consultants and other third party service providers are required to file Form 700, Statements of Economic Interests, a summary of which is reviewed annually by the Finance and Risk Management Committee. Currently there are three MCERA standing committees with distinct charters: Investment, Finance and Risk Management, and Governance. Ms. Dunning reviewed the functions of each committee. The public has access to MCERA Retirement Board and standing committee meetings in accordance with the Brown Act that requires public notice of meetings.

Ms. Dunning reviewed MCERA policies and their functions. Trustees individually affirm their review of key policies annually, and all policies are reviewed by the Board typically on a three-year evaluation cycle, or sooner as questions may arise. The Board monitors the Retirement Administrator performance through the establishment of annual Business Objectives and annual evaluations.

In conclusion Ms. Dunning stated that MCERA has established policies that help guide the Board in fulfilling its fiduciary duty.

Governance Practices and Approaches
Tom Iannucci, President
Cortex Applied Research

Mr. Wickman introduced Tom Iannucci, President of Cortex Applied Research, Inc., for the presentation on Governance Practices and Approaches. Mr. Iannucci works with a number of public pension plans across the United States as a consultant on governance practices.

Mr. Iannucci stated that a pension plan is a complex operation that has associated risks. The essential mission is to produce a stream of checks to retirees that are accurate, timely, cost-effective, and well-funded. The role of good governance is to operate effectively by enhancing the decision-making process to achieve good outcomes and manage risks along the way. Policies and clearly defined roles and responsibilities result in a strong framework of checks and balances that help manage risk. When problems arise, improving processes by modifying rules or authority may be needed. To meet the challenge of achieving fiduciary objectives such as loyalty to beneficiaries and demonstrating prudence, he stated, policy-focused Boards execute by following established processes. The result is enhancement of the performance of the organization and investment portfolio.

In response to Trustee Shore's inquiry, Ms. Dunning stated that secondary interests such as divestment initiatives need to conform to the primary objective of loyalty to the overall best interest of members and beneficiaries such that risk-adjusted returns are not compromised by secondary interests.

In an environment of limited resources good governance allows time to consider high-level issues within appropriate parameters, according to Mr. Iannucci. These include managing mission-critical risk and credibility risk that accompany the increasing complexity of investments, legal issues, and technology for pension systems.

Mr. Iannucci stated that the more a Board can be policy-focused, the better the mission can be fulfilled. In order to focus on what is important, Mr. Iannucci recommends identifying issues according to the following categories:

A. Important and Not Urgent
B. Important and Urgent
C. Not important and Urgent
D. Not important and Not Urgent

By focusing on Important and Not Urgent issues, Mr. Iannucci states, the Board will proactively address issues before they become problems thus meaning it will be less likely to have to deal with these issues during a crisis. Mr. Iannucci discussed the four characteristics he has observed with policy-focused Boards:

1. Focus.
2. Prudently delegate to the extent possible.
3. Build a "system" of oversight rather than rely solely on direct oversight.
4. Invest heavily in Board education and training.

Mr. Iannucci discussed the functions involved in each characteristic. For Focus, these include roles and responsibilities and Board operations, vendor selection process and criteria, investment policy and risk tolerance, asset allocation policy, organizational infrastructure and alignment, stakeholder relations, and Board information and reporting. From a policy perspective the Board would focus on items that are important but not urgent in each of these areas.

In discussing the appropriate focus for investment policy Mr. Iannucci maintained that asset mix explains most of the variation in returns across different funds and moreover drives 100% of the absolute level of return. He further stated that the average active manager will generate the same returns as passive management. As a result, asset mix is a more important consideration than the active/passive management debate. Therefore, he explained, Boards should spend the vast majority of the time on asset mix.

Chair Piombo recessed the meeting for a break at 10:29 a.m., reconvening at 10:42 a.m.

Mr. Iannucci emphasized the importance of a foundation built on governance resources, compensation practices and information systems that support the mission and goals. To clarify the distinction between what constitutes policy and operations, Mr. Iannucci defined policies as rules adopted to achieve long term goals. Board-level policies drive risk and performance, he stated, and staff-level procedures express day-to-day operations. The overall success of the organization, he stated, is dependent upon whether the Board is attending to policy matters the majority of the time.

Mr. Iannucci illustrated the importance of execution once the policy framework is in place with examples to distinguish policy-level discussions from operational-level discussions. Boards tend to drift into operations with a member complaint, for example, and should elevate the discussion back to the policy level if necessary.

Trustee Given observed that policies have been developed to address operational issues with respect to the roles of the Board versus the role of the Retirement Administrator. Moving forward, according to Mr. Wickman, the idea is to think more about addressing those items that are important but not urgent. Chair Piombo expressed this concept as redefining the bandwidth that we operate in, given the current policies and structure. Trustee Gladstern agreed that the current governance structure frees up time to be able to set direction and focus on larger issues.

Mr. Iannucci continued by re-emphasizing the point that spending time on important but not urgent matters can prevent them from turning into crises. He discussed the importance of a thoughtful decision-making process including staff analysis and recommendations leading to thoroughly vetted, informed decisions. Once a policy is set, each trustee needs to follow the will of the Board and avoid continually rehashing the same issue.

Mr. Iannucci discussed the second characteristic of policy-focused Boards, prudent delegation with clear parameters. Mr. Iannucci pointed to the importance of timely decision-making, knowledge and expertise to make decisions, and independent accountability. Issues can be dissected into policy, strategic, and implementation aspects to determine the level of involvement for the Board and staff.

The third characteristic is the development of systems of oversight. Mr. Iannucci referred to the Board as the risk manager and staff and advisors as performance maximizers who generate fundamental ideas. Mr. Iannucci discussed methods of oversight that retain the Board's fiduciary duty obligation. Direct observation is time-consuming and may require special expertise. A better approach is to set policies that define a general process for how things are done within defined constraints. Compliance to the policies is set and the frequency of reporting is prioritized. Reports need not be extensively nor too frequently reviewed as time is a valuable resource. This process lends transparency and value to the organization by allowing for more time for policy-level discussions.

Mr. Iannucci stated that the risk of delegating the Board's authority is managed through layers of policy that prescribe how delegated authority is carried out. These include policy controls such as monitoring compliance through committee review of reporting from vendors, auditors and staff. If this process is well designed then there is an appropriate framework for delegating authority in a prudent and effective manner.

Mr. Iannucci discussed the fourth characteristic of policy-focused Boards, investing in Board education. In order to set the direction of the organization with long-term policies, Board members need to understand what drives investment performance and what drives risk for the organization. Understanding the risk tolerance level and stakeholder dissatisfaction risk is important. Before the question of how much is allocated to each asset class is considered, it is necessary to understand why the investment portfolio is managed the way it is. Education of new Board members should take place outside of Board meetings, according to Mr. Iannucci.

Trustee Bolger noted that change is needed to make sure that the problems of the past are no longer a focus of attention. Trustee Given supported her view that change can be a positive step.

Ms. Dunning noted that the role of the Governance Committee includes a big-picture review of the governance structure of the Board and its committees, and follow up on the Governance presentation could be considered there.

In conclusion Mr. Iannucci recommended customizing education for Board members through individual needs assessment and self-paced learning. He advised reallocating resources to free up time for making important decisions and getting educated. Effective Boards, he stated, develop and implement good infrastructures and delegate to the extent possible.

Chair Piombo stated that the Board's governance model has been enhanced through an evolutionary process and he encouraged the Board to consider potential next steps.

Chair Piombo recessed the meeting for lunch at 12:45 p.m., reconvening at 1:30 p.m.

12:30 p.m. – 1:30 p.m.
Lunch (on site)

1:30 p.m. – 4:00 p.m.
Real Estate and Real Asset Portfolio Options
Jim Callahan, Executive Vice President
Callan Associates

Jim Callahan, Callan Associates Executive Vice President, stated that currently real estate assets are targeted at 15% of the Fund and consist of two core real estate managers, AEW and UBS, and the Woodmont private real estate portfolio that is being liquidated. Concurrently commitments have been made to the two core real estate managers to reach a 12% interim target as capital flows from the disposition of the private real estate portfolio. A relatively small portion of real estate assets is in two value-added vehicles that are being wound down. When the real estate target was raised from 12 to 15%, part of the discussion was to diversify from the private real estate portfolio. With real estate assets below target and in transition, the question is whether other real assets should be considered. In addition, Mr. Callahan advised that it is appropriate to reconsider the 15% target for real estate since public plans of similar size have lower targets ranging from 7 to 10% for real estate.

Trustee Shore posed liquid versus non-liquid assets as a way of defining asset classes. Mr. Callahan responded that different prisms are appropriate and can include inflation hedges and absolute return vehicles that adjust frequently to market conditions. Real estate provides for return and is also a good long-term inflation hedge, he said.

Jay Kloepfer, Callan Associates Executive Vice President, stated that inflation matters because it has an impact on all asset classes. Fixed income assets perform poorly under inflationary conditions because the present value of future interest payments is eroded. For inflation-linked bonds where the coupon automatically adjusts to inflation, there is no performance history during periods of rising inflation. Since equities over the long term are a claim on the underlying economy, sooner or later their value keeps up with inflation. There are no assets that are directly correlated with inflation.

Mr. Kloepfer explained that the potential for a rise in inflation has led to an interest in real assets. Currently inflation is still below 2% and there may be deflation outside the U.S. However, economic theory says that if the market is flooded with money as has been done by government policies, then asset prices will go up. Since there is no growth in Europe where a third recession is a possibility, a takeoff in inflation would likely be three or four years in the future.

Trustee Shore observed that factors such cheap labor in Europe may counteract a threat of inflation. In response Mr. Kloepfer noted there can be policy failure when policies are made for political reasons. He indicated that the Federal Reserve Bank ("the Fed") is more worried about deflation than inflation and therefore is leaning to inflationary policy as opposed to raising interest rates that would not be good for economic growth. Mr. Callahan added that dedicating a small portion of the portfolio as an inflation hedge would be a reasonable approach as inflation forecasts are creeping up. Furthermore, he explained, diversifying the Fund to address potential economic environments will smooth the expected return.

Asset classes that would perform well in periods of high inflation include inflation-linked bonds (TIPS), infrastructure, real estate, timberland, farmland, energy, commodities and equities. Mr. Kloepfer indicated that such assets would perform satisfactorily if there is no inflation. With respect to market conditions Mr. Callahan observed that we are in a global world with a flow of capital that is different from the past.

In response to Trustee Bolger's inquiry, Mr. Kloepfer explained that higher inflation would increase the cost of debt. Responding to Trustee Gladstern's inquiry, Mr. Kloepfer said that some real assets may benefit from global warming. Mr. Piombo indicated a preference to retain the 15% real asset allocation because it was the basis for coming up with the asset allocation and assumed rate of return. Mr. Callahan emphasized the importance of revisiting asset allocation as market conditions evolve.

Mr. Kloepfer discussed investment vehicles such as financial assets backed by real assets and direct ownership of real assets. Another option would be a diversified public real asset portfolio for which Mr. Kloepfer provided 10 year compounded expected returns and standard deviations. He pointed out that diversifying across four real asset classes produces a return similar to real estate with lower volatility and would therefore be beneficial for the investment model. Trustee Given observed that REITs may not be appropriate since there is already an allocation to real estate and expressed a preference for a less expensive passive index fund for real assets.

Chair Piombo recessed the meeting for a break at 2:59 p.m., reconvening at 3:10 p.m.

Mr. Kloepfer presented four options for real asset allocations ranging from 7% to none and the effect on total fund expected return and risk. A representative real asset portfolio would be composed of TIPS, commodities, REITs and natural resource equities. Dedicating a portion of the portfolio to real assets would serve to diversify the portfolio and provide returns similar to real estate with meaningfully less risk, according to Mr. Kloepfer. In response to Trustee Bolger's inquiry on the accuracy of projected returns, Mr. Kloepfer stated that over the past 10 years asset class returns are close to those projected.

Mr. Callahan stated that there has been demand from defined benefit plans to diversify with real assets. Different strategies for implementing real assets, such as public versus private and their liquidity characteristics were reviewed. In response to Trustee Shore's inquiry, Mr. Callahan said there could be four passive ETFs that would be coordinated by staff and the custodian. Regarding implementation, Mr. Callahan presented options varying from conservative to aggressive and tactical for various active managers. Passive real asset options were presented that include two managed by State Street Global Asset Management and Black Rock.

In summary, Mr. Callahan stated that investing 5% of the Fund in real assets would provide components of assets not in the Fund and the potential for protecting against inflation. Trustee Brenk inquired about investing in bank loans which Mr. Callahan said have performed well over the past several years and correlate well with inflation. Mr. Callahan introduced Avery Robinson, Callan Associates Vice President, to review real asset alternatives.

Trustee Bolger was excused from the meeting at 3:55 p.m.

Mr. Robinson reviewed a range of real estate and other real assets and their characteristics. He discussed expected returns for real estate asset classes ranging from core to value-added and opportunistic strategies. Characteristics of TIPs, REITs and commodities were discussed. Mr. Robinson discussed the illiquidity, limited universe and environmental risk associated with farm land. The correlation of timber with housing starts was noted. In response to Trustee Brenk's inquiry, Mr. Robinson indicated that infrastructure involves more capital than is appropriate for MCERA. Implementation considerations were reviewed by Mr. Robinson, such as the size of the investable universe and liquidity profiles.

In conclusion, Mr. Callahan recommended Option 2 whereby 5% of the Fund would be allocated to real assets and the real estate target would be reduced to 10% and include a new core plus manager. Chair Piombo invited discussion of these recommendations and options for investing in real assets. In response to Trustee Given's inquiry, Mr. Callahan recommended investing in an existing passive real asset vehicle and initiating a search for a core plus manager. Mr. Wickman summarized the four real asset investment alternatives and expressed a preference for Option 4. For the real estate allocation the Administrator said the question is whether to stay with core managers AEW and UBS or add a third core plus manager.

Based on discussions Mr. Wickman stated that Callan Associates was directed to present real asset investment alternatives for Option 1, with targets of 7% for real assets and 8% for real estate with no additional real estate manager, at the December 11, 2014 Investment Committee meeting.

4:00 p.m. – 4:30 p.m.
Closing and Follow-up Items from Today's Agenda

See discussion above.

Chair Piombo recessed the meeting at 4:50 p.m.

Evening Recess

Wednesday, October 15, 2014

8:00 a.m. – 9:00 a.m.
Continental Breakfast

Chair Piombo welcomed attendees to the second day of the Retirement Board's Strategic Workshop. At the invitation of the Chair there was no public comment and Mr. Piombo introduced actuary Graham Schmidt for the funding policy and experience study presentations.

9:00 a.m. – 10:30 a.m.
Funding Policy Issues
Graham Schmidt, Actuary
Cheiron

Mr. Schmidt stated that direct rate smoothing, a new method for determining contribution rates as a replacement for asset smoothing, will be explained as part of today's presentation. Both approaches have the goal of producing stable and predictable contribution rates. Direct rate smoothing can enhance volatility control in the event there are assumption changes, according to Mr. Schmidt.

Mr. Schmidt discussed MCERA funding policy objectives, guidelines, and components. Funding objectives include securing the funding promise, reducing contributions, providing predictable contributions, and promoting intergenerational equity. Benefit security is the number one goal and therefore the more assets in the trust the more secure the benefit. Trust assets are dependent on the sponsor's ability to pay contributions. With greater benefit security more conservative assumptions such as shorter amortization periods may be used. In response to Trustee Bolger's inquiry Mr. Schmidt stated that the credit worthiness of plan sponsors is not part of the funding analysis process.

Mr. Schmidt explained the advantages of the pension system's long-term funding model over an individual saving for retirement. Over time investment returns allow for lower contributions to fund benefits. The pension plan is a permanent participant in the investment markets and therefore uniquely positioned to take advantage of size and limited liquidity needs to maximize earnings. There is additional risk associated with investment returns. Part of funding policy is balancing investment volatility over the long term to provide for predictable contributions. For this purpose smoothing mechanisms are used such as longer amortization periods and slower reactions to assumption or liability changes. Mr. Schmidt pointed out that investing in less risky assets would lead to more stability but also higher contributions.

The concept of generational equity was discussed whereby people receiving services should pay for the benefits of employees providing those services. If there are investment gains or losses a generation may leave without paying fully for benefits. Thus the funding objectives lead to key principles of maintaining the equality of benefits and expenses (B + E) with contributions and investment earnings (C + I).

Prior standard funding mechanisms such as the Actuarial Required Contribution (ARC) and 30 year amortization are being replaced by new practices proposed by the Government Finance Officers Association (GFOA), national actuarial organizations, the California Actuarial Advisory Panel (CAAP), and the Society of Actuaries “Blue Ribbon Panel.” For example, shorter amortization periods of 15 to 25 years are recommended by all of these organizations. The components of traditional actuarial funding policies include the actuarial cost method, asset smoothing method, and amortization policies. There are no recommendations for changing the actuarial cost method, Mr. Schmidt stated. The goal of the asset smoothing method is to reduce the impact of yearly market fluctuations on annual plan cost. Traditionally, he explained, a smoothed asset value that is different from market value has been used to determine employer contributions. With the smoothed asset value recognition of asset gains and losses is deferred for a number of years, typically 5 years. A corridor limits the variance of the smoothed value of assets from the market value. Currently the smoothed value of assets is below the market value because there are deferred gains.

Regarding amortization policy the amortization of the unfunded liability is the key policy decision and has a big impact on employer contributions. This amortization period is limited to 30 years by the County Employees Retirement Law of 1937 (CERL). Considerations include the temporary negative amortization over a short time period that occurs with the level percentage of pay amortization combined with a long amortization period. Longer amortization periods mean it will take longer to fund, and shorter periods will mean higher contributions.

Mr. Schmidt reviewed current MCERA funding policies. The cost method is entry age normal, assets are smoothed over 5 years with a defined corridor, and amortization of the unfunded liability as of June 2013 is 17-year closed period with a level percentage of payroll. For the 2008 extraordinary loss the amortization period is 25 years. These methods are reasonable for the current unfunded actuarial liability (UAL), according to Mr. Schmidt; however the policy for future UAL changes should be specified in accordance with new guidance. Future sources of UAL changes from gains and losses, assumption changes, or plan changes must be put in one or more separate amortization layers, he advised. Mr. Schmidt explained how layered amortization would work.

Mr. Schmidt explained direct rate smoothing that is proposed as a replacement for asset-only smoothing. Both approaches have the goal of producing stable and predictable contribution rates. Asset smoothing operates by deferring a portion of investment gains and losses. Direct rate smoothing phases in contribution rate increases or decreases from any source. Contribution collars, corridors or modified amortization schedules are used with this approach. Direct rate smoothing is considered to be less complex and to lend transparency to the funding model, and was recently adopted by CalPERS.

Mr. Wickman stated that the actuary will present specific recommendations at the December 10 Board meeting for the determination on direct rate smoothing. Mr. Schmidt stated that to implement direct rate smoothing related parameters to be defined include the length of the amortization periods for gains and losses and for assumption changes. Mr. Schmidt recommended a 19-year amortization period that has been adopted by another plan. According to Mr. Schmidt changes to the Plan by plan sponsors will not be smoothed.

Chair Piombo invited comments on Mr. Schmidt's presentation. In response to Dan Eilerman's inquiry Mr. Schmidt explained that direct rate smoothing would have no impact on employer contribution rates all things being equal prior to July 1, 2013. Any changes in contribution rates moving forward as a result of demographic or assumption changes would be phased in over a period of time. Mr. Schmidt also responded to inquiries on potential changes in the mortality assumption and the level percentage of pay method for contribution rates. Trustee Piombo discussed the problems associated with reducing the work force with respect to using the level percentage of pay method.

Chair Piombo recessed the meeting for a break at 10:33 a.m., reconvening at 10:52 a.m.

10:30 a.m. – 12:00 p.m.
2011-2014 Experience Study - Preliminary Results
Economic Assumptions
Graham Schmidt, Actuary
Cheiron

Mr. Schmidt presented preliminary results of the 2011-2014 Experience Study and explained the process of developing economic assumptions. Inflation is the foundation for all economic assumptions, according to Mr. Schmidt. For example base wage growth is comprised of inflation plus real wage growth. Similarly the expected return is comprised of inflation plus real return. Current assumptions are 3.25% for inflation, 7.5% for the nominal expected return (net of investment expenses only), and 4.25% for real return. The investment consultant uses a shorter time frame for the inflation assumption of 2.25%. Mr. Schmidt presented 30 year rolling averages for inflation and noted that market expectations for inflation are evident in the yield curve. These sources report inflation levels nearer to 2%. From a historical perspective, according to Mr. Schmidt, the inflation assumption is reasonable. Considering current projections reducing the inflation assumption to 3% or 2.75% would be reasonable, Mr. Schmidt stated.

Mr. Schmidt discussed factors affecting the wage growth assumption. There are reasons to project no real wage growth, he stated, given the budgetary and political environment and the fact that there has not been meaningful growth in the median wage growth. Given the relaxing of some pressures such as an improved budgetary environment, he indicated, introducing moderate real wage growth may be reasonable. Wage growth varies across employment sectors and is evident for safety members, according to Mr. Schmidt. Using an average then 0.25% or 0.50% would be a reasonable wage growth assumption, he stated. Changing the wage growth assumption does not have a major impact on contribution rates, he explained, because contributions rise with the implied rise in wages.

The annual Cost of Living Adjustment (COLA) was explained by Mr. Schmidt that is derived from the Bay Area CPI rounded to the nearest 0.5%. The COLA is subject to caps of 2, 3, or 4% for different tiers. Based on Cheiron's simulations including extensive stochastic testing, the actuary recommended minor adjustments upward for the projected COLA growth for the Plan.

The derivation of the expected rate of return was reviewed by Mr. Schmidt. The current assumed nominal return is 7.5% comprised of 3.25% inflation and 4.25% real return assumptions. Assumptions from the investment consultant for returns, risks and correlation of asset classes are assessed. Then using this information a target portfolio was simulated over 10 years using adjusted inputs resulting in an average nominal return of 7.06% (4.81% real return). For comparison simulations of capital market assumptions for two other investment advisors active in ’37 Act pension systems were conducted resulting in nominal returns ranging from 6.99% to 7.41%. Mr. Schmidt stated that projected returns for the target portfolio have an annual standard deviation of 14.88% and ten-year standard deviation of 4.64% according to Callan Associates. Based on these results Mr. Schmidt believes the current real return assumption of 4.25% is reasonable. If the inflation assumption is reduced then the nominal return assumption would be reduced accordingly from 7.5% to 7.25%.

Administrative expenses are now explicitly incorporated in contribution rate calculations in order to parallel new GASB Statement 67/68 financial reporting. Projections for the administrative expenses are on target at $4.5 million. Mr. Schmidt presented and discussed the results of a preliminary sensitivity analysis based on the June 30, 2013 valuation showing the projected effect on contribution rates of various economic assumptions. Mr. Schmidt summarized the range of economic assumptions he considers reasonable. In response to trustee inquiries Mr. Schmidt explained how varying assumptions would affect contribution rates. Upon completion of the final Experience Study the Board will review and consider economic and demographic assumptions for the June 30, 2014 valuation.

Chair Piombo recessed the meeting for lunch at 11:50 a.m., reconvening at 12:50 p.m.

12:00 p.m. – 1:30 p.m.
Lunch (on site)

1:30 – 2:30 p.m.
Disability Process Improvements
Jeff Wickman
Retirement Administrator

Ashley K. Dunning, Partner
Manatt Phelps & Phillips

Mr. Wickman stated that the Board has requested a review of the disability application and review process to consider whether efficiencies may be achieved. In particular, the Governance Committee asked staff to analyze disability proceedings that are referred to the Administrative Law Judge. Mr. Wickman introduced Board Counsel Ashley Dunning who provided an overview of the legal requirements of disability retirement adjudications.

Ms. Dunning stated that applicants for disability retirement (“applicants”) have fundamental rights with respect to the manner in which the Board acts and processes their applications. Ms. Dunning explained that fundamental rights with respect to administrative bodies such as the Retirement Board depend on circumstance. In making legal and factual determinations the Board plays the role of a judge and must therefore be impartial in order to provide due process.

In this role the Board acts in a quasi-judicial capacity in accordance with applicable law. Ms. Dunning distinguished quasi-judicial capacity from quasi-legislative determinations on pension compensation in the interpretation of legislation.

Ms. Dunning reviewed MCERA processes for disability retirement applications are set forth in the Guidelines for Discussion of Disability and Survivor Benefit Applications at Board Meetings. In response to Trustee Bolger's inquiry, Ms. Dunning explained provisions for when an administrative due process hearing is required. Ms. Dunning discussed how the Board might administer a hearing in response to Trustee Piombo's inquiry. Trustee Gladstern observed that MCERA Bylaws include provisions for disability proceedings.

In order to grant a disability application, the applicant must meet their burden of proof that the applicant should be "more likely than not" granted by the Board. Initial recommendations are provided to the Board by the MCERA disability review group, composed of the Disability Coordinator, Assistant Retirement Administrator and Retirement Administrator, who collectively review disability applications, medical records and reports from medical advisors. Recommendations are based on whether medical or other relevant evidence is disputed and the legal and medical merit of the evidence. The Board's potential courses of action with respect to disability retirement applications are:

1. Grant application for service-connected disability retirement benefit
2. Deny application for service-connected disability retirement, grant application for non-service-connected disability retirement benefit, and provide applicant with opportunity to request an administrative hearing on service connection
3. Deny application in its entirety and provide applicant with opportunity for administrative hearing
4. Remand to staff for further review
5. Refer matter to administrative hearing

In March 2013, the Board considered but did not adopt two additional recommendations with respect to its disability retirement review process:

- Summary of Recommendation No. 1: If staff and the medical advisor agree that an applicant has sustained his or her burden of proof and the application should be granted, place those applications on the Board's consent agenda, with background documentation and staff's recommendation included. The Board would approve the application on consent or pull the item from consent for consideration in closed session.
- Summary of Recommendation No. 2: If staff and the medical advisor agree that the applicant has not sustained his or her burden of proof and the application should be denied, the applicant would be advised of that initial determination and provided with 60 days to request an administrative hearing.

Ms. Dunning explained that the Board has considerable authority that includes, for example, requesting additional materials before the administrative hearing. Applicants and counsel also may request the inclusion of additional documents for hearings. With respect to staff recommendations, Ms. Dunning noted that the applicant or counsel may provide a response to staff's recommendation. In any event the Board will be provided the same information on disability retirement applications, thereby providing for good governance through a transparent review process. Ms. Dunning reviewed the Board's options once a due process hearing is conducted and the Board receives proposed findings of fact and a recommended decision from an Administrative Law Judge. Trustee Gladstern voiced support for using a disability consent calendar in Recommendation No. 1. Discussion included Chair Piombo's inquiry on the effect of referring more disability cases to administrative hearings.

In conclusion, Ms. Dunning addressed circumstances leading to Board member recusals. Recusal means leaving the room and not influencing the decision in any way. Ms. Dunning explained that there are other types of recusals. For example, she explained, it is best practice to restrict participation that could lead to contracts that involve a Board member's department. The Board's interpretation of the "same service" provision in section 31520.1 of the Government Code is that the safety or alternate safety Board member in the same service as the applicant does not vote on the matter unless the other safety member is not present at the meeting, notwithstanding same-department provisions.

With respect to department-based recusal, Trustee Gladstern indicated in large departments it is likely there is no connection between an applicant and a Board member in the same department. Ms. Dunning indicated that there would be a judgment call on a case-by-case basis based on an assessment of potential risk. Chair Piombo added that the experience of a same-service member is of value in assessing disability retirement applications. In response Ms. Dunning and Mr. Wickman explained that the Board could allow for department participation knowing there is a risk in that the Board may be prohibited from resolving the matter by contract with the member.

Based on discussions Chair Piombo and Trustee Bolger directed staff to implement Recommendations 1 and 2 above, incorporate the recommendations into the Guidelines for Discussion of Disability Retirement Applications at Board Meetings, and develop a Disability Application Review Policy based on the related Guidelines.

Chair Piombo recessed the meeting for a break at 2:34 p.m., reconvening at 2:55 p.m.

Trustee Cooper was excused from the meeting at 2:40 p.m.

2:30 p.m. – 4:00 p.m.
Investment Committee Structure and Process
Jeff Wickman
Retirement Administrator

Mr. Wickman stated that the Investment Committee Structure and Process presentation is a follow-up on the October 2012 Governance Committee discussion regarding the size and composition of the current Investment Committee. Mr. Wickman stated that he believed a structure similar to the Finance and Risk Management Committee, whose charter provides for the delegation of Board functions and providing recommendations to the full Board for action, is something the Board should consider. Mr. Wickman indicated that based on his own observation there is a need for the Investment Committee to be able to consider subject matters at a detailed and deliberative level. With a smaller composition the Committee may more readily handle the considerable work and information involved in managing the investment portfolio.

In response to Chair Piombo's inquiry Mr. Wickman indicated that as a smaller committee the Investment Committee could take a deeper dive into issues and spend more time that could result in a better decision-making which would in turn be recommended to the full Board for approval.

There was a discussion among the Board about the concept of moving to a smaller committee. Although there was some support for a more focused committee there were also concerns raised about maintaining a committee structure that included a balance of elected and appointed members. There was general acknowledgement that the work of the Investment Committee puts a premium on Board education and commitment to understanding the various issues and approaches to managing the Fund's portfolio. The general consensus was to retain the current structure for the Investment Committee and re-emphasize the importance of continued education and commitment to the issues that are required for managing the MCERA portfolio.

Chair Piombo requested a summary of recommendations.

4:00 p.m. – 4:30 p.m.
Closing and Follow-up Items from Today's Agenda

Mr. Wickman summarized follow-up on today's discussions as follows:

1. Direction to Callan Associates to pursue Option 1 on page 14 of the Real Assets Overview and create a new allocation for all proceeds from the private real estate portfolio. Present options for the real asset mix and managers.
2. Governance Committee to consider next steps as a result of the Cortex presentation on governance practices.
3. Cheiron to provide a presentation on layered amortization and direct rate smoothing to the Board for consideration in addition to the final Experience Study
4. Governance Committee will review the proposed disability policy that will include recommended changes from the workshop.

Chair Piombo thanked presenters for the productive presentations. There being no further business, Chair Piombo adjourned the meeting at 4:30 p.m.

Alan Piombo, Chair	Attest: Jeff Wickman Retirement Administrator