MICHAEL J. GEARIN (*admitted pro hac vice*)
MICHAEL B. LUBIC (SBN 122591)
MICHAEL K. RYAN (*admitted pro hac vice*)
K&L GATES LLP
10100 Santa Monica Boulevard, Seventh Floor
Los Angeles, California 90067
Telephone: 310.552.5000
Facsimile: 310.552.5001
Email: michael.gearin@klgates.com
michael.lubic@klgates.com
michael.ryan@klgates.com

Attorneys for California Public Employees' Retirement System

UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF CALIFORNIA

SACRAMENTO DIVISION

In re CITY OF STOCKTON, CALIFORNIA, Debtor.	Case No. 2012-32118 (CMK) Chapter 9 **EXHIBITS 9 THROUGH 13 TO THE DIRECT TESTIMONY DECLARATION OF DAVID LAMOUREUX IN SUPPORT OF CALPERS' RESPONSE TO FRANKLIN'S OBJECTION TO CONFIRMATION OF THE CITY OF STOCKTON'S FIRST AMENDED PLAN OF ADJUSTMENT** Date: May 12, 2014 Time: 9:30 a.m. Place: Robert T. Matsui U.S. Courthouse, 501 I Street Department C, Fl. 6, Courtroom 35 Sacramento, CA 95814 Judge: Hon. Christopher M. Klein

TABLE OF CONTENTS FOR EXHIBITS TO THE

DIRECT TESTIMONY DECLARATION OF DAVID LAMOUREUX

EXHIBIT 9

Current method vs. new method

Sample miscellaneous plan

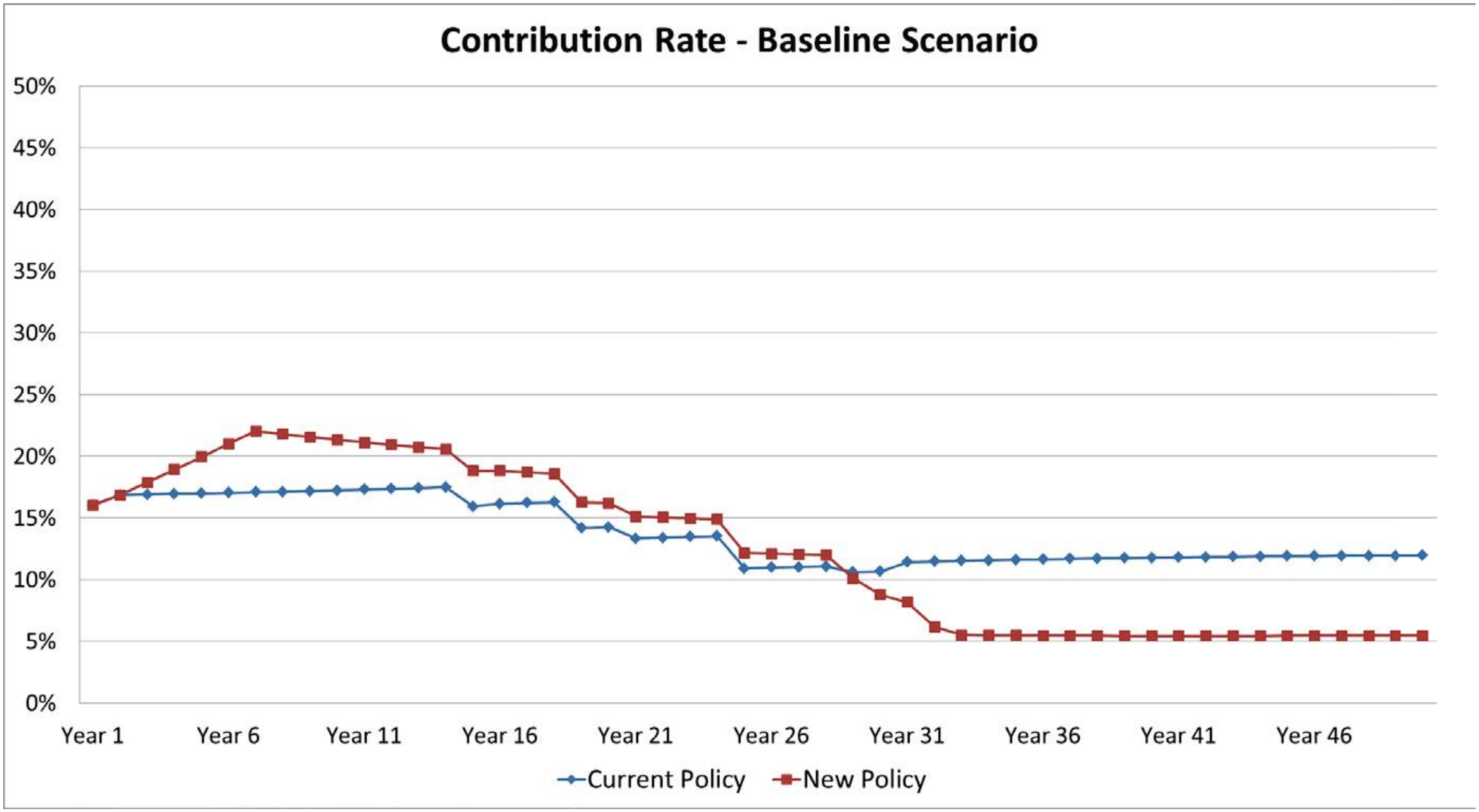

EXHIBIT 10

CalPERS

Investment Committee

California Public Employees' Retirement System

Agenda Item 5a

December 10, 2012

ITEM NAME: Adoption of the Terminated Agency Pool Investment Strategy and Related Policy

PROGRAM: Affiliate Investment Programs

ITEM TYPE: Asset Allocation, Performance & Risk – Action

RECOMMENDATION

Approve the asset allocation immunization strategy (Attachment 1) and related policy (Attachment 2) for the Terminated Agency Pool (TAP).

EXECUTIVE SUMMARY

This agenda item provides an asset allocation recommendation and related policy for the TAP. At the November 2012 Investment Committee meeting, staff was directed to examine the asset allocation strategy for the TAP by viewing the allocation in two independent segments: the immunization segment and the surplus segment.

Consistent with the discussion at the November Investment Committee meeting and the objectives of minimizing funding risk and immunizing projected future benefit payments, staff is recommending a strategy that (1) includes a blend of U.S. Treasury Separate Trading of Registered Interest and Principal of Securities (STRIPS), U.S. Treasury Inflation Protected Securities (TIPS) and cash or cash equivalents for the immunization segment, and (2) would invest the surplus segment along with and in the same way as the rest of the Public Employees' Retirement Fund (PERF).

The attached TAP policy reflects the recommended investment strategy.

STRATEGIC PLAN

This agenda item supports the CalPERS Strategic Plan goal to improve long-term pension and health benefit sustainability. Adopting an appropriate asset allocation investment strategy for the TAP will support efforts to ensure the Fund is actively managed and funding risk is addressed.

BACKGROUND

Currently, the TAP exists within the PERF to provide benefit payments to members who are employees of agencies whose contracts with CalPERS have been terminated. When the contract between a public agency and CalPERS is terminated, the associated assets and liabilities of that agency are transferred into the TAP.

As of June 30, 2011, the market value of assets attributable to the TAP is $184 million, and the actuarial liabilities attributable to the TAP are $71 million. This results in a funded ratio of 261%. Total expected benefit payments of the TAP is approximately $4.2 million annually.

Similar to other pension plans, there is a risk that the TAP may become underfunded in the future. Currently, the TAP is invested in accordance with the same asset allocation policy as the PERF. Although the TAP is well funded at this time, the funded status could be significantly diluted with the termination of one large employer or a number of smaller employers. Additionally, the TAP's funded status is affected by investment returns and actuarial assumptions (e.g., mortality rates, salary increases) that may differ from current projections over time. Finally, once the contract termination process outlined in the Public Employees Retirement Law is followed and a public agency is added to the TAP, CalPERS has no further recourse against the terminated agency in the event the TAP were ever to become underfunded. Since the TAP is currently well-funded, an opportunity exists to mitigate investment risks by creating a different asset allocation for the immunization segment of the TAP than the rest of the PERF.

ANALYSIS

The Investment Office and the Actuarial Office collaborated on the analysis and the investment strategy recommendation. The goal is to recommend a policy that meets the objectives of minimizing the likelihood of underfunding and immunizing the projected future benefit payments. To attain these objectives, staff recommends the asset-liability management approach set forth on Attachment 1.

The recommended strategy separates the assets of the TAP into two segments:

1) An immunization segment invested in a combination of STRIPS, TIPS and cash or cash equivalents; and
2) A surplus segment invested with and in the same way as the rest of the PERF.

Benefits of this approach include:

- Explicit immunization of forecasted benefit payments with a blend of STRIPS and TIPS which will minimize underfunding risks and balance reinvestment risk, inflation risk, implementation risk, etc.;
- A higher expected return generated by the surplus segment that will remain invested with the rest of the PERF; and
- Low monitoring requirements for staff.

BENEFITS/RISKS

The recommended investment strategy targets the TAP objectives of minimizing funding risk and immunizing projected future benefit payments. However, other risks such as actuarial risk and dilution risk as a result of a large employer entering the TAP will remain. These unpredictable risks are more difficult to mitigate. Staff requires a review of the asset allocation of the TAP at least once every three years, or as needed should the funded status of the TAP materially change.

ATTACHMENTS

Attachment 1 – Asset Allocation Investment Strategy for Terminated Agency Pool
Attachment 2 – California Public Employee' Retirement System Statement of Investment Policy for Terminated Agency Pool
Attachment 3 – Wilshire Associates Opinion Letter

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BEN MENG
Senior Portfolio Manager
Asset Allocation

____
JOSEPH A. DEAR
Chief Investment Officer

Asset Allocation Investment Strategy for Terminated Agency Pool

Ben Meng, Alan Milligan

December 10, 2012

CalPERS | Investment Office
Asset Allocation

Background

- At the November IC meeting, staff was directed to develop an asset allocation strategy for the Terminated Agency Pool (TAP) with the following two segments:
  1. Immunization:
     - Treasury securities (STRIPS and TIPS)† and cash or cash equivalents would be used for the purpose of immunization against liability.*
  2. Surplus:
     - The remaining surplus after the allocation of current assets for immunization would remain invested with the rest of the Public Employees' Retirement Fund (PERF).

CalPERS | Investment Office Asset Allocation

† STRIPS is an acronym for "Separate Trading of Registered Interest and Principal of Securities" and TIPS for "Treasury Inflation Protected Securities."

** Liability is estimated to be about $110 million with a discount rate of 1.2%, which is the nominal yield of the recommended strategy.*

Recommendation

- Staff recommends the assets of the TAP be invested as two independent segments:
  1. Immunization Segment:
     - Allocation: Approximately $110 million would be allocated for immunization. To account for estimation errors, two years worth of expected benefit payments would be reserved as a cushion which will be invested in cash or cash equivalents. The current estimate of the cushion is about $10 million.
     - Objective: To provide sufficient cash flows to pay all the expected benefit payments of the TAP provided that we are able to reinvest at current interest rate levels.
     - Structure: A mixture of STRIPS, TIPS and cash or cash equivalents.

Recommendation (continued)

- Example of a possible asset allocation strategy for the immunization segment under current market conditions:

Asset	Weight in Immunization Segment	Nominal Yield
STRIPS (1-10 year maturities)	35%	
TIPS (11-30 year maturities)	57%	1.2%
Cash or cash equivalents	8%	

Recommendation (continued)

2. Surplus Segment:
   - Allocation: Approximately $64 million would remain after the allocation of assets for immunization.
   - Objective: To seek higher expected returns than Treasury securities and to benefit from the resources allocated to the PERF.
   - Structure: The surplus would remain invested with the rest of the PERF.

Next Steps

The Investment Office would implement the Terminated Agency Pool investment strategy upon approval by the Investment Committee.

The Investment Office and Actuarial Office would continue to collaborate to monitor the funded status of the Terminated Agency Pool and rebalance the recommended portfolio annually.

The standard policy requires a review of the asset allocation of the Terminated Agency Pool at least once every three years, or as needed if there is a material change of funded status.

ATTACHMENT 2

PROPOSED REGULATORY ACTION BY CALPERS

Adoption of Title 2, Chapter 2, Subchapter1, Article 8.1
ARTICLE 8.1 TERMINATED AGENCY POOL ASSET ALLOCATION STRATEGY

§ 590 Terminated Agency Pool – Investment Earnings Allocation

Assets pooled in the Terminated Agency Pool shall be invested in accordance with the strategic investment policy and/or asset allocation strategy determined by the board for such pooled assets and the Terminated Agency Pool will be credited with income and interest earned on those assets in accordance with such policy and/or strategy.

ATTACHMENT 3

METHODOLOGY FOR SETTING THE DISCOUNT RATE FOR LOCAL AGENCIES TERMINATING THEIR CONTRACT FOR RETIREMENT BENEFITS AND FOR THE TERMINATED AGENCY POOL

The Chief Actuary will set the discount rate assumption to be used for actuarial valuations for employers terminating their contract with CalPERS and leaving their assets and liabilities in the terminated agency pool and for the annual actuarial valuation of the Terminated Agency Pool. The discount rate will be set by taking into account the yields available in the US Treasury market on the date of the termination of contract and on June 30 each year for the annual valuation of the Terminated Agency Pool according to the methodology described below.

The Chief Actuary will first determine the duration of the pension liabilities of the terminating agency at the date of termination or in the case of the Terminated Agency Pool on June 30th of each year. Next, the Chief Actuary will determine the weight that should be applied to the 10 and 30 year US Treasury durations, determined at current spot rates, to equal the duration of the termination liabilities. The discount rate assumption will be calculated by using the weighted percentages from the duration calculation and applied to the 10 and 30 year US Treasury yields to determine the discount rate assumption.

For example, the duration of the liabilities for the Terminated Agency Pool is 12. On June 30, 2011, the duration of the 10 year and 30 US Treasury securities were 8.3 and 15.6 respectively. A 50% weighting of 10 year and 30 year Treasury security durations are calculated to be 12 which equals the liabilities duration. Therefore, the discount rate assumption used for valuing the liabilities will be 50% of the 10 year US Treasury yield and 50% of the 30 year US Treasury yield. The 10 year US Treasury yield was 3.18% on June 30, 2011 while the 30 year US Treasury yield was 4.38% on June 30, 2011. A 50%/50% weighted average of both rates would result in a discount rate assumption of 3.8% for the valuation of the terminated agency pool as of June 30, 2011.

EXHIBIT 11

CalPERS

California Public Employees' Retirement System
P.O. Box 942709
Sacramento, CA 94229-2709
(888) CalPERS (or 888-225-7377)
TTY: (877) 249-7442
www.calpers.ca.gov

Reference No.:
Circular Letter No.: 200-058-11
Distribution: I, VI
Special:

Circular Letter

August 19, 2011

TO: **ALL PUBLIC AGENCIES**

SUBJECT: **CHANGES TO THE TERMINATED AGENCY POOL**

ATTENTION: **FINANCE DIRECTORS, HUMAN RESOURCE DIRECTORS, PUBLIC AGENCY DECISION MAKERS**

CalPERS is sending this Circular Letter as a result of the CalPERS Board of Administration's decision at its August meeting to take steps to protect member benefits and to mitigate funding risk to the Terminated Agency Pool (Pool).

Background

When a contracting agency terminates its CalPERS contract, the assets and liabilities of the agency are merged into the Pool. Similarly, when a contracting agency terminates a portion of its CalPERS contract, the assets and liabilities associated with the terminated portion of the contract are merged into the Pool. The Pool is part of the Public Employees' Retirement Fund (PERF) and pools those PERF assets used to pay benefits to members who are credited with service rendered as employees of terminated agencies.

As of June 30, 2009, the market value of assets attributable to the Pool was $144 million, and the funding value of actuarial liabilities attributable to the Pool was $60 million. At that time the Pool was 240% funded. Benefit payments attributable to the Pool exceed $5.4 million annually.

Due to the current economic environment and budget issues faced by public agencies, there is increasing pressure on public agencies to amend or terminate pension plan contracts. Although currently the Pool is well funded, the termination of a large employer (or several small employers) would cause the funded status of the Pool to be significantly diluted. For example, if a plan (or collection of plans) with $535 million in assets and $500 million in liabilities is merged into the Pool, the funded status of the Pool would likely drop from 240% to 121%.

Should the Pool become underfunded, CalPERS has limited funding sources available to increase the funded status of the Pool. This is because terminated agencies generally do not make ongoing contributions (other than a fixed schedule of payments established at the time of contract termination). Therefore, the Pool could be at risk should it become underfunded. Since the Pool is currently well funded, an opportunity exists to mitigate this risk before it is realized.

How Can CalPERS Minimize This Risk?

In light of the risk discussed above, the Board has adopted, in concept, an investment policy and asset allocation strategy that reflects the characteristics of future expected benefit payments that will be paid out of the Pool. By implementing a specific investment policy and asset allocation strategy, CalPERS is taking steps to increase benefit security and mitigate the Pool's funding status risk.

Change to Investment Policy, Income Allocation and Other Actuarial Assumptions

The assets of the Pool will be invested in a way that reflects the characteristics of future expected benefit payments. The Pool will continue to be part of the PERF and will be allocated income in accordance with this investment policy and asset allocation strategy. Over the next few months, CalPERS will establish the investment policy and asset allocation strategy to better match the liabilities and assets of the Pool.

To ensure that the most appropriate actuarial assumptions are used at the time a public agency terminates its contract with CalPERS, the Board has adopted an interim method to determine the discount rate, inflation assumption and other related economic assumptions to be used when calculating the liabilities of terminating agencies and to be used in the annual actuarial valuation of the Pool entitled "Method to Determine the Discount Rate, Inflation Assumption and Wage Growth Assumption for Termination Calculations," a copy of which is attached.

The interim method will be used to set the discount rate, inflation assumption and other related economic assumptions for contract terminations (and partial contract terminations) with a termination date on or after August 18, 2011. In addition, this method will be used to set the discount rate and other actuarial assumptions for the June 30, 2010, actuarial valuation of the Pool that will be performed later this fall. It is expected that there will be changes to the interim method when an investment policy and asset allocation strategy are adopted, and thereafter from time to time to reflect changes to the investment policy and asset allocation strategy.

Impact on Liabilities in the Pool and Agencies Contemplating Termination of a Contract with CalPERS

In light of the current benefits attributable to the Pool, and using the US Treasury rates in effect as of June 30, 2011, and the new termination calculation method described above, the discount rate for valuation of the Pool as of June 30, 2011, would be 3.8%. Using this rate, actuarial liabilities attributable to the Pool increases from $60 million to close to $92 million, resulting in a decrease in surplus assets of the Pool from $84 million to $52 million.

Going forward, if an agency terminates its contract, or a portion of its contract, a similar increase in the value of actuarial liabilities at the time of termination (compared to the value of actuarial liabilities as an active agency with ongoing contributions) can be expected assuming rates remain at 3.8%. Note that as rates fluctuate in the market, the value of actuarial liabilities at the time of termination will also fluctuate. Employers should be aware that under the current interest rate environment this new termination calculation method will increase the amount of assets that employers will need to leave behind when they terminate; if there is insufficient assets in the employer's account at CalPERS, the employer will be required to make up the shortfall.

In order to ensure transparency and provide relevant information, the CalPERS Actuarial Office expects to be able to provide employers with hypothetical information regarding their termination liabilities as part of the regular annual actuarial valuation report. At this time we expect this information to be available, at the earliest, in the June 30, 2011, actuarial valuation report that will be mailed in October of 2012.

If you wish to discuss these issues further, please contact your CalPERS actuary at **888 CalPERS** or (**888**-225-7377).

ALAN MILLIGAN, Chief Actuary
Actuarial Office

Enclosure
Method to Determine the Discount Rate

Circular Letter No. 200-058-11 Enclosure

METHOD TO DETERMINE THE DISCOUNT RATE, INFLATION ASSUMPTION AND WAGE GROWTH ASSUMPTION FOR TERMINATION CALCULATIONS

The discount rate assumption to be used for actuarial valuations for employers terminating a contract (or portion of a contract) with CalPERS, and for the annual actuarial valuation of the Terminated Agency Pool, will be a weighted average of the 10 and 30 year US Treasury yields in effect on the valuation date. The weighted average percentages will be the weights that when applied to the duration of the 10 and 30 year US Treasury, determined at current spot rates, equal the duration of the expected benefit payment cash flows of the contract (or portion of a contract in the case of a partial termination) being terminated or the terminated Agency Pool.

In addition, the inflation assumption used to project the expected benefit payment cash flows of the contract (or portion of a contract in the case of a partial termination) being terminated or the terminated Agency Pool will be the inflation imbedded in the US Treasury Inflation Protected Securities (TIPS) on the valuation date. The wage growth assumption used for the same calculation will be 0.25% higher than the inflation assumption. This wage growth assumption will be used in combination with the merit, seniority and promotion component of individual salary increases previously adopted by the Board to project individual salaries into the future.

EXHIBIT 12

CalPERS
California Public Employees' Retirement System
Actuarial Office
P.O. Box 942701
Sacramento, CA 94229-2701
TTY: (877) 249-7442
(888) 225-7377 phone • (916) 795-2744 fax
www.calpers.ca.gov

Agenda Item 4b

August 16, 2011

TO: MEMBERS OF THE BENEFITS AND PROGRAM ADMINISTRATION COMMITTEE

I. SUBJECT: Asset Allocation Change for the Terminated Agency Pool

II. PROGRAM: Actuarial Office

III. RECOMMENDATION:

Staff recommends that the Committee take the following actions regarding the Terminated Agency Pool (Pool), and upon taking such actions, the Committee recommend adoption by the full Board:

- Adopt in concept an investment policy and asset allocation strategy for assets of the Pool which more closely reflects the characteristics of future expected benefit payments of the Pool.
- Approve staff initiating the Rulemaking Process to adopt the proposed addition to Title 2 of the California Code of Regulations for crediting income to the Pool.
- Adopt Board Resolutions ACT-11-04 (Attachment 1) regarding delegation of authority to set the actuarial assumptions used when calculating the actuarial liabilities of a public agency at the time it terminates (or partially terminates) its contract with CalPERS and to be used in the annual actuarial valuation of the Pool.

IV. ANALYSIS:

Because of the Pool's limited funding sources, by adopting an investment policy and asset allocation strategy which more closely reflect expected benefit payments, CalPERS can increase benefit security for members while limiting its funding risk.

Background

Currently, the Pool exists within the Public Employees' Retirement Fund (PERF) to provide for the payment of benefits to members who are credited with service rendered as employees of terminated agencies. When a contracting agency terminates its CalPERS contract, the assets and liabilities of the agency are merged into the Pool. Similarly, when a contracting agency terminates a portion of its CalPERS contract, the assets and liabilities associated with the terminated portion of the contract are merged into the Pool. However not all agencies are required to move assets and liabilities to the Pool. There are some instances where terminating agencies can move their assets and liabilities to other retirement systems.

As of June 30, 2009 (most recent actuarial valuation), the market value of assets attributable to the Pool was $144 million, and the actuarial liabilities attributable to the Pool were $60 million. The funded status was 240% funded on June 30, 2009. Benefit payments attributable to the Pool exceed $5.4 million annually.

As with all pension plans there is a risk that the Pool could become underfunded at some point in the future. Although currently the Pool is very well funded, the termination of one employer (or a number of smaller employers) could significantly dilute the funded status of the Pool and substantially increase this risk.

It is important to note that, should the Pool become underfunded, CalPERS has limited recourse against terminated agencies. Unlike active agencies, terminated agencies are generally not required to make additional contributions, except to the extent that the agency's assets at the time of termination are less than the agency's liabilities at the time of termination. The following sources are available for funding the Pool:

i. Assets merged into the Pool at the time of contract termination;

ii. Fixed schedule of payments from the terminated agency established at the time of contract termination if the existing assets were insufficient at that time; and

iii. Investment income.

Therefore, if the Pool became underfunded, CalPERS would have few funding options available to increase the funded status of the Pool. However, since the Pool is currently very well-funded, an opportunity exists to address this risk before it is realized.

Change to Investment Policy

To mitigate the funding risk associated with the current Pool, staff is recommending that the assets of the Pool be invested in a way that reflects the characteristics of future expected benefit payments. The Pool will remain in the

PERF and will be allocated income in accordance with this investment policy and asset allocation strategy.

Over the next few months, CalPERS investment staff will work closely with staff from the Actuarial Office to establish the best approach to better match the liabilities and assets of the Pool. Investment staff will be coming back to the investment committee over the next few months for adoption of a formal policy.

Change to Income Allocation

With this proposed change to the investment policy, regulatory action will be needed to carry out this change to the investment income allocation. Therefore, staff is requesting approval to initiate the Rulemaking Process to adopt the proposed addition to Title 2 of the California Code. The proposed regulation provides that assets pooled in the Pool shall be invested in accordance with the strategic investment policy and/or asset allocation strategy determined by the Board for such pooled assets and that the Pool be credited with income and interest earned on those assets in accordance with such policy and/or strategy. The proposed regulation language can be found in Attachment 2.

Change to Actuarial Assumptions

Setting actuarial assumptions, including the discount rate, for actuarial valuations currently requires Board approval. Staff recommends that the Board adopt Board Resolution ACT-11-04 to delegate to the Chief Actuary the authority to act finally to set the actuarial assumptions to be used when calculating the actuarial liabilities of a public agency at the time it terminates (or partially terminates) its contract with CalPERS, and to act finally to set the actuarial assumptions to be used in the annual actuarial valuation of the Terminated Agency Pool. See Attachment 1 for a copy of the proposed delegation.

Staff is recommending this delegation in order to ensure that the most appropriate actuarial assumptions are used at the time a public agency terminates (or partially terminates) its contract with CalPERS.

Based on detailed discussions between CalPERS actuarial and investment staff as well as outside investment consultants, staff has developed a methodology for determining an appropriate discount rate. One of the main goals in developing this method was to promote transparency and ensure that anyone outside of CalPERS would be able to determine, based on the date of termination, the discount rate that would be used to calculate the amount of any required contributions or refunds. See Attachment 3 for details on the method.

If the Board approves the delegation of authority to the Chief Actuary to set the actuarial assumptions, staff will start using the method described in Attachment 3 to set the discount rate for terminations of contracts by contracting agencies with a termination date on or after August 18, 2011. In addition, this method will be used to set the discount rate and other actuarial assumptions for the June 30, 2010 actuarial valuation of the terminated agency pool that will be performed later this fall. It is expected that there will be changes to the methodology from time to time to reflect changes to the investment policy. Corresponding changes will be needed in the inflation and salary increases assumptions to ensure consistency with the discount rate assumption.

Impact on Liabilities

For the existing Pool, under rates in effect as of June 30, 2011 and based on the method described in Attachment 3, the discount rate for valuation of the Terminated Agency Pool as at June 30, 2011 would be 3.8%. Had these rates been in effect on June 30, 2009, this discount rate would have been used in the June 30, 2009 valuation resulting in an increase in the actuarial liabilities from $60 million to close to $92 million leaving a surplus of about $52 million. For active agencies that wish to terminate in the future, a similar percentage increase in liabilities can be expected if rates remain unchanged. Note that the cost will fluctuate over time as rates fluctuate in the market. If rates were to rise then the terminating liabilities would be proportionately less. For example, if the rates were to rise to a flat 7.75 percent then the termination liability would be close to the ongoing funding liability.

Stakeholder Communication

New terminating agencies will most likely see a higher termination liability compared to their current liabilities. The main reason for this is the lower discount rate that will be used to calculate the termination liability. In order to ensure transparency and provide relevant information, the CalPERS Actuarial Office expects to provide employers with hypothetical termination liabilities in their annual actuarial valuation report.

CalPERS will need to proactively communicate with all stakeholders, including employers, members, and the general public about this change and why it was necessary to protect our members. This communication effort will need to be a joint effort between the Office of Public Affairs, Customer Account Services Division, Customer Service and Outreach Division, Constituent Relations Office and CalPERS Actuarial Office. For employers, this communication can be accomplished using the Employer Newsletters, Circular Letters, Employer E-bulletin, or through outreach efforts. For members, information can be distributed through the PERSpective newsletters, a news release targeted at employee associations, and during retirement fairs.

V. STRATEGIC PLAN:

This item supports Goals I CalPERS Strategic Goals, to exercise global leadership to ensure the sustainability of CalPERS' pension and health benefit systems.

VI. RESULTS/COSTS:

Staff anticipates that due to the design of the new MyCalPERS system there will be only modest system costs related to the change in allocating investment income. A full analysis will be performed later this fall to determine the needed changes to the new MyCalPERS environment. There will be additional investment related expenses but these cannot be quantified until the detailed investment policy is determined.

BILL KARCH
Supervising Pension Actuary
Actuarial Office

ALAN MILLIGAN
Chief Actuary

Attachments

ATTACHMENT 3

METHODOLOGY FOR SETTING THE DISCOUNT RATE FOR LOCAL AGENCIES TERMINATING THEIR CONTRACT FOR RETIREMENT BENEFITS AND FOR THE TERMINATED AGENCY POOL

The Chief Actuary will set the discount rate assumption to be used for actuarial valuations for employers terminating their contract with CalPERS and leaving their assets and liabilities in the terminated agency pool and for the annual actuarial valuation of the Terminated Agency Pool. The discount rate will be set by taking into account the yields available in the US Treasury market on the date of the termination of contract and on June 30 each year for the annual valuation of the Terminated Agency Pool according to the methodology described below.

The Chief Actuary will first determine the duration of the pension liabilities of the terminating agency at the date of termination or in the case of the Terminated Agency Pool on June 30th of each year. Next, the Chief Actuary will determine the weight that should be applied to the 10 and 30 year US Treasury durations, determined at current spot rates, to equal the duration of the termination liabilities. The discount rate assumption will be calculated by using the weighted percentages from the duration calculation and applied to the 10 and 30 year US Treasury yields to determine the discount rate assumption.

For example, the duration of the liabilities for the Terminated Agency Pool is 12. On June 30, 2011, the duration of the 10 year and 30 US Treasury securities were 8.3 and 15.6 respectively. A 50% weighting of 10 year and 30 year Treasury security durations are calculated to be 12 which equals the liabilities duration. Therefore, the discount rate assumption used for valuing the liabilities will be 50% of the 10 year US Treasury yield and 50% of the 30 year US Treasury yield. The 10 year US Treasury yield was 3.18% on June 30, 2011 while the 30 year US Treasury yield was 4.38% on June 30, 2011. A 50%/50% weighted average of both rates would result in a discount rate assumption of 3.8% for the valuation of the terminated agency pool as of June 30, 2011.

EXHIBIT 13

Legislative Research & Intent LLC

1107 9th Street, Suite 220, Sacramento, CA 95814
(800) 530.7613 · (916) 442.7660 · fax (916) 442.1529
www.lrihistory.com · intent@lrihistory.com

Legislative History of

CALIFORNIA GOVERNMENT CODE § 20574

As Derived From

Former Government Code § 21600

As Added By

Statutes of 1982, Chapter 77, § 4
Assembly Bill 1648 – Chacon

Legislative Research & Intent LLC

1107 9th Street, Suite 220, Sacramento, CA 95814
(800) 530.7613 · (916) 442.7660 · fax (916) 442.1529
www.lrihistory.com · intent@lrihistory.com

Authentication of the Records and Table of Contents

Legislative History Research Report Regarding:
CALIFORNIA GOVERNMENT CODE § 20574
As Derived From Former Government Code § 21600
As Added By Statutes of 1982, Chapter 77, § 4, AB 1648 – Chacon

I, Lisa Hampton, declare that this report includes:

- *Historical documents relating to the above legislation.* These documents were obtained by the staff of Legislative Research & Intent LLC and are true and correct copies of the originals obtained from the designated official, public sources in California unless another source is indicated, with the following exceptions: In some cases, pages may have been reduced in size to fit an 8 ½" x 11" sized paper. Or, for readability purposes, pages may have been enlarged or cleansed of black marks or spots. Lastly, paging and relevant identification have been inserted.

  Since 1983 LRI has specialized in the historical research surrounding the adoption, amendment and/or repeal of California statutes, regulations and constitutional provisions pursuant to California Code of Civil Procedure § 1859 which states in pertinent part: "In the construction of a statute the intention of the Legislature ... is to be pursued, if possible ...." Our research and expert witness services have assisted the courts in understanding and applying the underlying purpose of enactments in countless cases, such as *Redlands Community Hospital v. New England Mutual Life Insurance Co,* 23 Cal. App.4th 899 at 906 (1994). LRI also provides similar research for other states and at the federal level. (Formerly Legislative Research Institute and Legislative Research, Incorporated.)

- *A table of contents itemizing the documents.* This table of contents cites the sources of the documents.

I declare under penalty of perjury under the laws of the United States and the State of California that the foregoing is true and correct and that I could and would so testify in a court of law if called to be a witness.

Executed August 13, 2012, in Sacramento, California.

Lisa Hampton, Research Director

Table of Contents

PRIMARY SOURCE RECORDS (UNPUBLISHED HARDCOPY): At least one official California source is cited for the primary source records provided in this report. Multiple copies may have been obtained from various sources (primarily State Archives, the state library system and/or legislative offices), but the clearest/most legible version was selected for this report.

ENACTMENT HISTORY

GENERAL

DOCUMENTS GENERATED DURING
ASSEMBLY DELIBERATIONS

DOCUMENTS GENERATED DURING
SENATE DELIBERATIONS

NOTE: The Senate *fiscal committee* reported the bill out on a "Rule 28.8" (per the final calendar), signifying an insignificant impact on the State General Fund – eliminating the need for a fiscal hearing and vote. The bill is then moved on to the next stage of legislative deliberations – the Senate floor.

ASSEMBLY "CONCURRENCE" DOCUMENTS

NOTE: If the bill was amended "in the other house" (i.e., an Assembly Bill amended in the Senate or vice versa) it must return to the house of origin for "concurrence" on the other house's amendment(s). Concurrence results in immediate passage to the enrolled bill file (to the Governor). Nonconcurrence forces the bill into a joint house "conference committee." Here there was not concurrence.

CONFERENCE COMMITTEE DOCUMENT(S)

NOTE: If the house of origin refuses to concur with amendments made in the other house, the bill is assigned to a joint house "conference committee." This committee adopts a report (proposed amendments) which must then be approved by both houses via floor action. If the report is not adopted, a new conference committee is convened. Here the first and only conference report was adopted.

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BILL ANALYSIS AB 1648 (CHACON)

California Legislature

Assembly Committee on Public Employees and Retirement

CURTIS R. TUCKER
CHAIRMAN

ASSEMBLY BILL 1648 - CHACON - AS INTRODUCED
HEARING DATE: April 29, 1981

SPONSOR:

Public Employees' Retirement Board

DESCRIPTION:

Assembly Bill 1648 would amend various sections of the Public Employees' Retirement Law. The measure is part of the PERS Board's 1981 legislative program.

ANALYSIS:

An analysis, as prepared by PERS is attached.

FISCAL COMMITTEE:

Yes.

NOTE:

Opposition has been expressed to Section 3 of the bill. Section 3 would exempt PERS from Section 7504 of the Government Code, which, among other things, requires all state and local public retirement systems to submit audited financial statements to the State Controller within six months of the close of each fiscal year (subsection c).

Such an exemption is being opposed by California Taxpayers' Association and (it is understood) the State Controller. It is also understood that PERS and the State Controller are attempting to agree on a compromise.

CONTACT: Dave Cox
PHONE: 322-4320
DATE: April 24, 1981

2446

PUBLIC EMPLOYEES' RETIREMENT SYSTEM
1981-82 REGULAR SESSION
BILL ANALYSIS

AB 1648 (Chacon)
Original

PERS POSITION: SUPPORT

BILL SUMMARY:

This bill is a part of the PERS Board of Administration's 1981 legislation program. A section by section analysis follows.

SPECIFIC FINDINGS AND DISCUSSION:

Section 1

Amends the Public Employees' Retirement Law (PERL) to provide that the mere refusal of PERS to admit liability pursuant to a provision of the retirement law shall not in itself be considered arbitrary or capricious action.

Explanation

Government Code Section 800 provides for the award of attorney's fees, not to exceed $1500, against any public entity, other than the State Board of Control, where it is shown that any award, determination, or finding was the result of arbitrary or capricious conduct. A further provision of Section 800 provides that the mere refusal of a public entity to admit liability to a contract of insurance shall not be considered arbitrary or capricious. It has been alleged by members dissatisfied with PERS determinations that mere refusal of PERS to admit liability for benefits should be considered arbitrary and capricious and entitle the member to attorney fees under Section 800. PERS feels that the System is entitled to the same protection granted other public entities in the administration of insurance programs.

Fiscal Effect

Possible savings if attorney fees would otherwise be awarded.

Section 2

Amends Section 20205 to change the number of affirmative PERS Board member votes required to authorize investment transactions from five to a simple majority of those present, deletes the reference to an acceptable list of securites, and requires monthly investment reports to the PERS Board.

Explanation

Under current law, five affirmative Board member votes are required to approve investment transactions. When this law was enacted, five members constituted a majority of the Board. This bill would instead require the affirmative vote of a majority of those present to allow for a situation in which a quorum is present but one member must abstain.

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Furthermore, this bill replaces the reference to an acceptable list of securiies with a provision authorizing the Board to adopt detailed guidelines concerning the acceptability of real property or securites as PERS investments.

Finally, this section eliminates the requirement that all purchases and sales of securities must be reported to the Board at its next regular meeting following the transaction. This requires analysis and reporting of transactions occuring as late as the morning of thee Board meeting. This bill would require monthly reporting.

Fiscal Effect

Nominal.

Section 3

Amends the Public Employees' Retirement Law to exempt PERS from the reporting requirements of Section 7504 (c) of the Government Code.

Explanation

Assembly Bill 727, Chapter 928, Statutes of 1977, requires all state and local public retirement systems to file an audited financial report with the State Controller within six months of the end of each fiscal year. Because of the size of the Public Employees' Retirement Fund and other constraints on the System's audit firm, PERS cannot meet the six month requirement for an audited report.

This bill would exempt PERS from the six months filing requirement and would instead allow the system to file an audited report as soon as practicable.

Fiscal Effect

None.

Section 4

Repeals PERS subrogation provisions.

Explanation

When PERS benefits are payable with respect to the injury or death of a member proximately caused by a third party other than the employer, the PERS Board may, on behalf of the System, receive from such party an amount equal to the lesser of either: (1) one-half of the actuarial equivalent of the benefits provided by the System, or (2) one-half of the remaining balance of the amount recovered after allowance of that amount which the employer or its insurance carrier has paid or become obligated to pay.

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The pursuit of subrogation rights has been an expensive, complex, time-consuming process. Evolving case law is is reducing the System's net recovery and making recovery more difficult.

Fiscal Effect

PERS expects to collect some $186,000 in fiscal year 1979/80 after administrative expense.

Section 5

Amends the PERL to grant to the PERS Board of Administration and governing bodies of other public entities the authority to negotiate a transfer of the rights of members, retirees, and beneficiaries and survivors, and the assets and liabilities derived therefrom, to, from, or within PERS as deemed necessary.

Explanation

A wide variety of fact situations have arisen in recent months involving the dissolution of member agencies, the transfer of functions or a portion of the workforce of member agencies, the consolidation or reformation of agencies, the transfer of state functions to local systems, the possible transfer of state functions to private industry (the U.C. weapons labs), etc. After an exhaustive review, PERS has concluded that the best alternative to the relatively inflexible current merger provisions is a broad delegation of authority to the Board to provide the most equitable solution possible in each individual case.

Fiscal Impact

Will depend on individual situations - expected to be nominal.

4/24/81

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AB 1648

WAYS AND MEANS STAFF ANALYSIS

BILL NUMBER AB 1648 AUTHOR Chacon AMENDED 5/5/81 ITEM

POLICY COMMITTEE P. E. and Ret. VOTE (6-1) CONSULTANT M. Corbett

This bill was set because it:
/_/ results in a cost or revenue loss of $25,000 or less
/_/ contains an urgency clause with a letter of approval from the Speaker
/_/ contains a deficiency appropriation for the usual current expenses of the State
/_/ contains an appropriation to pay claims against the State
/x/ other

Hearing Date: July 2, 1981

Urgency: Yes/_/No/x/

State Mandated Local Program: Yes/_/No/x/

Disclaimed: Yes/_/No/_/

COMMENTS:

1. Technical Problems: None.

2. Policy Issues: The analysis of the Legislative Analyst sufficiently addresses the policy issues and fiscal implications of this bill.

3. Opposition/Support: This bill is part of the PERS Board of Administration legislation program for 1981. There is no known opposition to the bill.

mrl:BA26:18A

Legislative Analyst
June 1, 1981

ANALYSIS OF ASSEMBLY BILL NO. 1648 (Chacon)
As Amended in Assembly May 5, 1981
1981-82 Session

AB 1648 (Am. 5/5/81)

Fiscal Effect:

Cost: Minor PERS administrative costs and cost-savings to the Public Employees' Retirement Fund (PERF).

Revenue: Undetermined, but potentially substantial annual loss to the PERF from repeal of subrogation authority.

Analysis:

This bill makes certain technical changes in the Public Employees' Retirement Law as administered by the Public Employees' Retirement System (PERS).

Specifically, the bill:

1. Provides that the mere refusal of PERS to admit liability under a provision of the retirement law shall not, in itself, be considered arbitrary or capricious action. This provision is to give PERS the same protection granted to other agencies charged with administration of benefit programs against suits by members for refusing to admit liability for benefits;

2. Changes the number of affirmative PERS Board-member votes required to authorize investment transactions from five to six of those present; deletes reference to an acceptable list of securities, provides for specified investment resolution, and requires monthly investment reports to the PERS Board;

3. Permits the PERS to file temporarily unaudited financial report with the State Controller to satisfy a current reporting requirement, until an audited report is available.

AB 1648 (continued)

4. Repeals a provision authorizing the PERS to take subrogation action. Under this provision, the system may recover the cost of PERS benefits paid for injury or death caused by a third party. The PERS proposes to repeal this provision on the basis that the cost of pursuing subrogation rights has increased significantly, thereby reducing the system's net recovery. However, the following historical data, supplied by the PERS, does not indicate a substantial increase in "collection" costs as a percent of gross amounts collected under subrogation rights.

Fiscal Year	Gross Amount Collected	Collection Costs	Net Amount Collected	Collection Costs as Percent of Gross
1976-77	$207,284	$33,939	$173,345	16.4
1977-78	224,662	45,768	178,894	20.4
1978-79	314,536	59,546	254,990	18.9
1979-80	248,827	62,297	186,530	25.0%

In addition, the PERS asserts that recovery under subrogation rights should be the employer's, rather than the system's, responsibility, because the net amount recovered is credited to the employer's retirement contribution account; and

5. Authorizes the PERS Board and governing bodies of other public systems to transfer specified members and fiscal information.

Fiscal Impact

1. Program cost. None.

AB 1648 (continued)

2. PERS administrative costs. Enactment of the second, third and fifth provisions of the bill (as discussed in this analysis) would increase PERS administrative costs by minor amounts. The first provision may yield PERS administrative cost-savings from avoided legal costs. Repeal of the PERS subrogation provision would result in the loss of undetermined, but probably substantial, annual revenues to the Public Employees' Retirement Fund. These revenues would be reimbursements for PERS benefits paid to a member when that member is compensated by the party causing the injury or death.

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AB 1648

ASSEMBLY THIRD READING

AB 1648 (Chacon) As Amended: July 6, 1981

ASSEMBLY ACTIONS:

COMMITTEE P. E. & RET. VOTE 6-1 COMMITTEE W. & M. VOTE 19-0

Ayes: Chacon, Elder, Lockyer, Moore, L. Stirling, Tucker

Ayes:

Nays: Lewis

Nays:

DIGEST

This bill makes certain technical changes in the Public Employees' Retirement Law as administered by the Public Employees' Retirement System (PERS).

Specifically, the bill:

1) Provides that the mere refusal of PERS to admit liability under a provision of the retirement law would not, in itself, be considered arbitrary or capricious action. This provision would give PERS the same protection granted to other agencies charged with administration of benefit programs against suits by members for refusing to admit liability for benefits.

2) Changes the number of affirmative PERS board member votes required to authorize investment transactions from five to six of those present; deletes reference to an acceptable list of securities; provides for specified investment resolution; and requires monthly investment reports to the PERS board.

3) Permits the PERS to file temporarily unaudited financial report with the Controller to satisfy a current reporting requirement, until an audited report is available.

4) Authorizes the PERS board and governing bodies of other public systems to transfer specified members and fiscal information.

FISCAL EFFECT

Minor PERS administrative costs and cost-savings to the Public Employees' Retirement Fund.

7/6/81
7/fh/AFA-11:87

ASSEMBLY OFFICE OF RESEARCH

AB 1648

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PUBLIC EMPLOYEES' RETIREMENT SYSTEM
FLOOR STATEMENT
AB 1648

AB 1648 IS SPONSORED BY THE PUBLIC EMPLOYEES' RETIREMENT SYSTEM AND ENACTS MINOR POLICY AND TECHNICAL CHANGES TO THE RETIREMENT LAW.

THERE IS NO OPPOSITION TO THE BILL THAT I AM AWARE OF, AND IT IS SUPPORTED BY A NUMBER OF ORGANIZATIONS.

THE BILL HAS ONLY MINOR ADMINISTRATIVE COSTS ~~AND~~ I ASK FOR AN AYE VOTE.

CFC:JLC
7/7/81

BACK-UP INFORMATION

ON

AB 1648

SECTION 1. PROVIDES PERS WITH THE SAME PROTECTION GRANTED INSURANCE COMPANIES WHO ISSUE ANNUITY POLICIES IN THAT MERE REFUSAL TO PAY A BENEFIT SHALL NOT IN ITSELF BE CONSIDERED ARBUTARY OR CAPRICIOUS ACTION ENTITLING THE PLAINTIFF TO UP TO $1500 IN ATTORNEY'S FEES.

SECTION 2. REQUIRES SIX PERS BOARD MEMBERS (A MAJORITY OF THE 11 MEMBER BOARD) TO APPROVE INVESTMENT DECISIONS. CURRENT LAW REQUIRES FIVE.

SECTION 3. ALLOWS PERS TO FILE AN UNAUDITED FINANCIAL STATEMENT WITH THE STATE CONTROLLER WITHIN THE 6 MONTHS REPORTING REQUIREMENT OF THE GOVERNMENT CODE AND TO FILE AN AUDITED REPORT AS SOON AS IT IS AVAILABLE.

PERS, WITH SOME 1200 LOCAL EMPLOYERS AND 1100 SCHOOL DISTRICTS IS NOT ABLE TO COLLECT, PROCESS, RECONCILE AND BALANCE ITS ACCOUNTS AND SECURE AN OUTSIDE AUDIT OF SUCH ACCOUNTS WITHIN THE SIX MONTHS TIME FRAME OF EXISTING LAW. THIS BILL WOULD GIVE THE CONTROLLER 99% OF THE REQUIRED INFORMATION WITHIN THE TIME LIMIT. THE CHANGES TO THE STAFF REPORTS BY THE AUDITORS ARE GENERALLY VERY MINOR IN NATURE.

SECTION 4. REPEALS PERS SUBROGATION PROVISIONS WHICH REQUIRE THE RETIREMENT SYSTEM TO SEEK RECOVERY OF ANY BENEFITS PAID WITH RESPECT TO INJURY OR DEATH OF A MEMBER CAUSED BY A THIRD PARTY. AFTER THE IMPOSITION OF ATTORNEY'S FEES AND COURT COSTS AND ANY LIENS BY WORKMEN'S COMPENSATION, DISABILITY CARRIERS, ETC, THE REMAINING RECOVERY IS USUALLY DIMINISHED SUBSTANTIALLY AND PERS IS THEN REQUIRED TO, IN MOST CASES, DEMAND HALF

OF WHAT IS LEFT. THIS CREATES BAD FEELINGS AMONG MANY MEMBERS AND OCCUPIES A GOOD DEAL OF PERS STAFF TIME.

SECTION 5. GRANTS PERS A LIEN AGAINST THE ASSETS OF PUBLIC AGENCIES WHO HAVE TERMINATED THEIR MEMBERSHIP IN THE SYSTEM, USUALLY AS A RESULT OF AGENCY DISSOLUTION AND BANKRUPTCY, AND WHO HAVE UNFUNDED LIABILITIES OWED TO PERS FOR VESTED EMPLOYEE BENEFITS AND HAVE NO ABILITY TO PAY SUCH LIABILITIES.

PERS IS CURRENTLY ONLY AN UNSECURED GENERAL CREDITOR.