

**SPECIAL MEETING OF THE BOARD OF ADMINISTRATION  
RETIREMENT BOARD  
WATER AND POWER EMPLOYEES' RETIREMENT PLAN**

**MINUTES – November 3, 2004**

**Present:**

Javier Romero	President
Lilly Calvache	Vice-President
Ron Vazquez	Chief Financial Officer
Gerard McCallum II	Commissioner
Henry Martinez	Acting General Manager

**Absent:**

Michael Moore	Retiree Member
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**Others Present:**

Robert Rozanski	Acting Retirement Plan Manager
Sangeeta Bhatia	Assistant Retirement Plan Manager
Irene Colon	Recording Secretary
Michael Wilkinson	Deputy City Attorney
Sarah Bernstein	Pension Consulting Alliance
Paul Angelo	Segal Company

President Romero called the meeting to order at 9:08 a.m. after the Pledge of Allegiance.

[Pledge of Allegiance]

Mr. Rozanski indicated there was a quorum of the Board present.

**PUBLIC COMMENTS**

Ms. Cecilia Weldon (Assistant General Manager and Chief Information Officer) approached the podium.

President Romero recognized Ms. Weldon.

Ms. Weldon introduced herself and stated she wanted to provide the Retirement Board with an update on a situation that occurred over the weekend when some retirees on direct deposit did not timely receive their monthly allowances. She explained that at the end of October, the Department's Information Technology Services (ITS) should have electronically transferred a file to Bank of America and the DWP Credit Union to fund the retiree allowances. She explained how an employee in ITS creates the file, then another employee electronically transfers the file to Bank of America and the Credit

Union and sends an e-mail confirmation to the Retirement Plan Office, but the electronic transfer for Bank of America failed to occur. Ms. Weldon indicated that the ITS employee who normally transfers the file was out on disability, and that the file was created, but was not transmitted to fund the direct deposit retirees. She stated that the Retirement Office was contacted by the Credit Union notifying them that its direct deposit transfer did not occur, and ITS was informed that this transfer had not taken place. ITS then completed the Credit Union transfer, but was unaware that the Bank of America file had not been transmitted.

Ms. Weldon emphasized that this occurrence was the first time it has ever happened, and obviously there was a glitch in the system due to one of ITS's employees being out. She stated that once the new retirement system is put into place, this problem would not occur. However, in the interim, instead of depending on one employee being responsible, the process will be automated and several people will be notified when the direct deposit files need to be transferred. Ms. Weldon stated that ITS was currently working with the Retirement Office such that when the direct deposit files have been transferred to the Credit Union and Bank of America, there will be a follow up e-mail to ensure the file was successfully transferred and the funds were deposited to member accounts. Ms. Weldon left the meeting.

President Romero suggested that Mr. Rozanski provide an update under manager's comments at the next Board meeting as to how this issue has affected the retirees, the bank's position, and the need to reimburse retirees for fees incurred in connection with this matter.

**1. Presentation and Discussion of the Impact of Continuing the WPERP's Past Practice of Excluding the Balance in the General Reserve and the Reserve for Investment Gains and Losses in Actuary's Determination of the Net Actuarial Value of Retirement Plan Assets as of June 30, 2004; and the Options and Related Impacts of Changing Such Past Practice.**

Mr. Paul Angelo (Segal Company) approached the Board table.

President Romero recognized Mr. Angelo.

Mr. Angelo stated that he was present to follow-up on the discussion from the October 20<sup>th</sup> Board meeting wherein he presented the actuarial report. He explained the report contained a recommendation for a change in actuarial policy with regards to treatment of certain reserves that have been part of the Department's accounting system since it was founded back in the 1930s. Mr. Angelo stated, that at the request of both the Board and Staff, Segal prepared a discussion of this issue and passed out a copy of an e-mail that he sent to Ms. Bhatia dated October 1, 2004. He explained that the purpose of the e-mail was to give an idea of what the record is in terms of the discussions between Segal and Staff. Mr. Angelo noted the e-mail starts with a request from Ms. Bhatia to Segal to address the issue, a request to counsel, and then Segal's discussion. He then referred to a letter dated November 1, 2004 via e-mail and stated there was a summary recommendation and then a point-by-point historical background. He also

stated, as was requested by the Board President at the October 20, 2004 meeting, Segal laid out what they feel are the three alternatives that were considered and discussed between Segal and Staff, one of which is the basis on which the actuarial report was presented.

Mr. Angelo began summarizing the letter, stating the key factor is that there is a reserve, which includes both the general reserve and the reserve for investment gains and losses. President Romero inquired, for clarification, what exactly is investment gains and losses. Mr. Angelo responded that he was not exactly clear on it and did not know how it is calculated. He stated it was his understanding that the reserve is generally affected by "realized" gains and losses, but he was not sure of the actual details and mechanics of how it is calculated, and the numbers were provided to Segal by the Retirement Office Staff.

President Romero inquired of Staff on how the gains and losses are calculated, because in last year's evaluation there was \$137 million and this year there is \$1.3 billion. He further inquired if the difference is being taken from the actual purchase value of the stock to the actual sale value, or how did the Plan accumulate \$1.3 billion. Mr. Rozanski responded that for investment gains and losses, the reserve is based on "realized" gains and losses on the sale of securities, and not the difference between the purchase price and the market value if such securities have not been sold, which could be either a gain or a loss. He explained, in this case, since a many securities are being sold in order to transition to the new allocation structure, there are many realized gains and/or losses (primarily gains). He added that all of the differences between the cost of the security and the sale price would be added to the reserve for investment gains and losses.

President Romero inquired how a loss would come into play with this account. Mr. Rozanski responded there is the accounting side of the equation, and also what Mr. Angelo does for actuarial evaluation purposes. He stated the accounting side has not been changed and it has been consistently applied through the years, which is to recognize the gains by increasing the reserve and reducing the reserve buy any losses on actual sales of securities. Mr. Rozanski explained the this issue revolves around whether the accounting reserves should be deducted in determining the actuarial value of the Plan assets. He stated that at the end of the day, the only thing that is going to pay retirees are the proceeds from securities, notwithstanding the accounting adjustments for investment gains and losses. He further stated that there were many sections within the Retirement Plan provisions that speak specifically to the issue on how one accounts for the gains and losses as it relates to the Retirement Plan as well as the Disability Plan for accounting purposes. However, it does not address the issue of the actuarial valuation of assets and how that is to be determined. Mr. Rozanski expressed that he hopes that he provided a clear explanation because this issue is somewhat confusing and at first he thought there was an issue with respect to the accounting, when in fact it was an actuarial issue.

Mr. Angelo pointed out there were two sets of financial tracking, one of which is the actuarial side, which is used to drive the cost calculations. He stated the other is the reserving mechanism, which was probably made since the time it was established, but

is based on insurance company practices that Segal feels is not relevant to the modern contemporary operations of the Plan.

Mr. Angelo began reviewing the summary and recommendations outlined in the November 1, 2004 letter submitted by Segal. He stated that the investment activity during 2003-2004 produced an increase in the investment reserves from \$137 million to \$1.3 billion, and continued treatment of the investment reserves as non-valuation reserves would produce an unanticipated increase in Department contributions of approximately 24% of compensation. Mr. Angelo stated that based on discussions with counsel and Staff, Segal recommends that for the 2004 valuation, a portion of the investment reserves equal to 1% of Plan assets be excluded from valuation of assets. He also stated that in subsequent valuations Segal requires direction from the Board. He stated the Board could either continue to exclude the 1% or conclude that none of the reserves be excluded. Mr. Angelo expressed that Segal sees no justification for excluding any portion of the reserves from the valuation reserves. He then reviewed the background of the actuarial practice, which he had previously presented orally at the October 20<sup>th</sup> Board meeting.

President Romero commented that at the last Board meeting Mr. Angelo mentioned that LACERS was addressing the same issue but had not reached a decision. Mr. Angelo clarified that he was not aware that LACERS was dealing with this valuation reserve/non-valuation reserve issue. Ms. Bernstein noted as she recalls, Mr. Angelo stated this was the first time LACERS has had an unfunded liability and they were dealing with different problems. President Romero inquired if LACERS' Death and Disability Benefits deal with the same type of reserve account as WPERP. Ms. Bhatia responded she called LACER'S chief accountant and they do not exclude reserves on the valuation of their assets. Mr. Rozanski commented that he had requested staff to follow up with LACERS after the last Board meeting after a conversation with President Romero, in order to find out specifically what their retirement system does and whether or not they exclude or include the reserves. He stated Ms. Bhatia reported back to him that LACERS does not exclude the reserves, which is consistent with what Mr. Angelo is recommending. Mr. Martinez inquired if LACERS includes the 1% reserves. Mr. Angelo responded that LACERS has no exclusions.

President Romero inquired as to when Mr. Angelo notified Staff upon receiving and reviewing the numbers from Staff, and noting that there was a considerable balance in the reserves, and the Department's contributions would be significantly higher than they had been. Mr. Angelo responded in the affirmative. He then stated the first thing Segal does is verification, and when they initially reviewed the reserve they saw that last year it was \$137 million and this year it is \$1.3 billion, and wondered if it was a typo. He stated that the increase was due to the asset rebalancing. President Romero inquired if Mr. Angelo felt this was a significant issue that the Board should have been aware of. Mr. Angelo commented it is a question of whether this is something that should be discussed with the Board in advance or is it the type of thing that should be incorporated in the actuarial report. He stated last year Segal wanted to address the asset smoothing method, which is something the Board clearly has to make judgment calls on. Mr. Angelo pointed out that Segal did have conversations with the Board in advance regarding this matter, in addition to a meeting prior to the actual Board meeting

because the firm knew that this was going to be an issue requiring active Board attention. He expressed, that the idea of continuing the current practice in Segal's view is simply not an option. Mr. Angelo stated that he would have difficulty signing an actuarial report where for no obvious justification, other than historical practice, a billion dollars is left off the table. He added that the whole idea of present value of contributions equal present value of benefits would fail. Mr. Angelo expressed the need to take action was so commanded by the facts that it would be reasonable for Segal to come up with a workable recommendation and then incorporate it into the discussion they present to the Board with a report. He explained the reason Segal did not pull it out as an advance issue is because in their judgment this was not the sort of thing wherein it was a matter of whether the Board was going to take action, but rather what the specifics of the actions were going to be, which is where whether to exclude the 1% comes into play. Mr. Angelo stated it was sometimes hard to tell during valuations, which issues require advance discussions and which do not, because there are a host of issues that come up. President Romero expressed that he felt it was a terrible judgment call on behalf of Segal, and if it was important enough to discuss looking into it, then the act should have been more important to discuss before the Board. He stated that the Plan is not in the same status of overfunding and there would now be higher contributions, which is all the more reason to bring this issue before the Board.

President Romero stated that he was concerned that everyone knew about the issue except for the elected members of the Board and this makes him cautious in signing off on the actuarial report too quickly. He also expressed it was bad policy to exclude the elected members of the Plan. Mr. Angelo clarified that Segal did not discuss this issue with any of the Board members and reminded President Romero that there was a presentation made by Segal to the staff and the Board when presenting the previous year's annual actuary report. Ms. Calvache commented that apparently it was just she and President Romero who were not aware of the situation. She then inquired when Mr. Angelo first notified staff, who he talked to, when did he talk to them, and who instructed him to move forward with the report. Mr. Angelo reiterated that he had not discussed this issue with any of the Board members and if President Romero and Ms. Calvache are under the impression they were the only Board members who did not know, this is simply untrue. Mr. Vazquez noted that the Board members receive their Retirement Board materials in advance of the Board meeting, and speaking for himself, he reviews the agenda and the items and familiarized himself with this particular issue, became comfortable with it, and understood it. He further stated that he had not been notified by Staff, the actuary or any other Board member about this item. Mr. Vazquez reiterated that he became familiar with the issue on his own in his advance review of the materials. Commissioner McCallum stated he agreed with Mr. Vazquez, he had no prior knowledge of the issue, and the only question he had was the history of why. Ms. Calvache stated that this was a very important issue that staff should have discussed with the Board. President Romero inquired if Mr. Moore had brought the issue up with Ms. Bhatia. Ms. Bhatia responded Mr. Moore had not discussed this with her. Mr. Rozanski explained that at a prior Board meeting he was approached by Mr. Moore who informed him there was an issue regarding the investment gains and reserves, but at the time, he did not quite understand the issue because he had not yet read the details of how it all works, and the nexus between that and the actuarial report. Mr. Rozanski stated he informed Mr. Moore he would look into it and afterwards he had a

conversation with Ms. Bhatia, who informed him that the reserves were fully invested. Mr. Rozanski stated that at that time he determined that there was no issue and Ms. Bhatia agreed there was no issue because the reserves were fully invested. He stated this was the last time he discussed it until a few days before he was ready to go on vacation. As Mr. Angelo had mentioned, there were numerous conversations and information that passed between various members of the Retirement Staff to the actuary in validating data, assumptions, etc. Mr. Rozanski stated, as part of that process, Ms. Bhatia suggested discussing the reserve for investment gains and losses with Mr. Angelo. He indicated he and Ms. Bhatia had a conference call with Mr. Angelo and the accountants because he initially thought it was an accounting issue, but later realized they would be deducting the reserves of \$1.3 billion from the actuarial value of Plan assets. Mr. Rozanski stated the accountants provided him with the language in the Plan that explains how to record the gains and losses. He stated in the discussion with Mr. Angelo and his associate, their primary focus was on the accounting and how to deal with the reserves and that a series of e-mails had been relayed while he was on vacation. He stated upon his return, he learned through the e-mail trail and Ms. Bhatia, that the matter had been resolved and nothing needed to be done on the accounting side, but if it had been, it would required a meet and confer process and an amendment to the Plan. He reiterated that he had not communicated with any of the Board members regarding this issue because Ms. Bhatia informed him that the reserves were fully invested and there was no issue.

President Romero inquired as to whether was an issue regarding a policy that, as a result, would increase the Department's contribution, wouldn't it be the obligation of the Retirement Office to notify the financial side of the Department. Mr. Rozanski responded in the negative. He explained that being directly involved on the planning end for the Department, generally the Department's Financial Services Organization (FSO) is forced to wait while actuarial studies are performed not only for the Retirement and Disability Death Benefit Plans, but also for Post Retirement Health Care, which is not part of the scope of the Board of Administration. Mr. Rozanski also explained that every year the FSO sits on pins and needles wondering what is going to happen and what the numbers are going to be so they can plug those into their plan. He added the timing is such that those reports are not available until after the fiscal year ends. Mr. Rozanski indicated the problem FSO always faces is that the plans are finalized, the Board approves the budget, and it goes through a review process at the City Attorney's office prior to having the reports. He stated once the reports are finalized by the Board and/or in the case of the Health Benefits are finalized by the Accounting Group in our organization, this information is immediately passed to the FSO, is evaluated, and it is determined what the implications are to the Department and the plans are updated accordingly. He clarified they do not work back and forth with the actuary and discuss what the Retirement Plan assumptions are because it is beyond the scope of their knowledge and ability, and is a decision made by the Retirement Board.

Mr. Angelo continued reviewing the November 1st letter in the "alternatives" section. He stated that Staff and counsel received and reviewed the alternatives, adding that the WPERP does not provide the Board of Administration with the authority to use the investment reserves to fund ad hoc benefits. Mr. Angelo stated that Segal's initial recommendation was to include the entire investment reserve in the actuarial valuation

of Plan assets. He indicated there were provisions in the Plan that discuss the accounting side, which Segal believes is from a policy issue separate from the actuarial funding. Mr. Angelo also indicated it was staff's suggestion in an "excess of caution" to hold 1% of the Plan's assets and continue to treat 1% of the reserve as a non-valuation asset. He emphasized Segal was very clear that this was not done for actuarial reasons and it is not their understanding the 1%, in fact, could be used to fund ad hoc benefits at the discretion of the Retirement Board. Mr. Angelo pointed out, as reflected in the e-mail, Segal requested direction from Staff on whether to include 100% or include 100% minus the 1% of Plan assets. He stated Segal did receive telephonic communication to go forward with the 1% at \$61 million and then proceeded to prepare the actuarial report.

Mr. Rozanski explained before he went on vacation there was discussion regarding the accounting side and the reference to 1% was brought up repeatedly. He indicated there was a timing issue of trying to make the next Board meeting and also allow sufficient time for Segal to prepare the actuarial report. Mr. Rozanski expressed he leaned on the side of caution and recommended putting the minimum per the Plan even though that is on the accounting side, and then the Board could revisit it at a later date. He added that he did suggest this issue needed to be looked into at the last Board meeting. Mr. Rozanski pointed out recommendations of putting aside 1% of reserves has the effect of actually making the Department's contributions higher than they would otherwise be to the extent of \$7 million for the upcoming year. He reiterated that he made this decision as an abundance of caution, there were time constraints, and he felt this was conservative.

Mr. Angelo continued to convey Segal's alternatives to the Board, stating they believe the 1% approach was suggested in defense to language in the Plan document that talks about making transfers. He then pointed out a summary reflecting the three possible approaches (exclude entire investment reserves, exclude 1% of Plan assets, or include entire investment reserve) that came up in the course of the discussion. Mr. Angelo noted that the chart reflects what the amount of excluded reserves would be, what the unfunded actuarial accrued liability would be, and what the Department's contribution would be in both rates and dollars. He indicated there was a separate issue raised in the actuarial report that discusses whether to restart the amortization method, adding the numbers provided in the chart were calculated on the assumption the Board is going to adopt the restart, but the difference from one alternative to another would be the same whether the Board decides to or not. Mr. Angelo stated if the Board decides to take no action and continues with the prior practice, the entire \$1.313 billion would be excluded and would increase the unfunded actual accrued liability (UAAL) to \$1.4 billion in a \$6 billion fund. He added this would also increase the Department's contribution from the 14% up to 38.8% at approximately \$225 million contribution, as opposed to the \$84 million, which would be produced by the 1% approach. Mr. Angelo explained if the entire reserve were included, the UAAL would be \$109 million and using the smoothing value of assets would produce a contribution of 13.38% at \$77 million. He stated as Mr. Rozanski mentioned, the 1% approach makes the Department's contribution of \$7 million higher than it would have been if the pure approach of not excluding any of the assets for the valuation had been taken. He pointed out that holding the 1% back has a little bit of a comfort zone feel to it and Segal recommends this for this year. However,

Segal also feels there is no actuarial justification, and if the Board decides to use that as a basis for their policy, then going forward, Segal would do next year's valuation using all of the Plan's assets with no exclusion.

Mr. Angelo expressed that the idea of excluding the full \$1.3 billion would produce an actuarial result that could not be justified under the standards of Segal's profession. He added the Plan's process in this regard was greatly in need of improvement.

President Romero inquired if this issue would be on the next Board meeting's agenda. Mr. Rozanski responded in the affirmative, stating that Staff would bring back the actuarial report that was presented at the prior Board meeting for consideration.

Mr. Vazquez inquired that since the issue is an agenda item, could the Board make a recommendation as to what the actuary should do? President Romero clarified that this was the purpose for placing it on the agenda at the next Board meeting. He explained it was listed on today's agenda for discussion because of the circumstances of how it came before the Board initially. President Romero indicated that he needed time to absorb the new information and then a decision could be made. He expressed he did not think it would impact the report with the City and according to Mr. Rozanski there is time for the Board to make a decision. Mr. Vazquez clarified that at the next Board meeting Segal would present an actuarial report to the Board. Mr. Rozanski clarified that the report that will be presented to the Board for consideration is the initial recommendation by the actuary subject to the 1% held back out of abundance of caution. Mr. Vazquez stated that from his perspective, the Board will be presented a report that is based on certain assumptions, and if the Board is in agreement or disagreement with those assumption it would be better at this time to clarify those assumptions, so as to come back with an actuarial report that the Board will be able to approve. President Romero responded that what was presented at the last Board meeting was regarding the 1%, and Segal should be coming back sometime in the middle of the month to provide those reflections and the Board could then take action.

## **2. Presentation and Discussion of the Revised Actuarial Review of the Disability Fund as of July 1, 2004, Revision Dated October 25, 2004**

Mr. Angelo noted that at the October 20<sup>th</sup> Board meeting, Segal presented a disability valuation report to the Board. He stated that the only difference in this report is that the July 1, 2004 review of the disability fund reflects the 5% actuarial assumption that was adopted by the Board two years ago for the valuation of this benefit. He explained that the reason for the 5% assumption, as opposed to an 8% assumption, for the Retirement Plan is that these monies are invested in much shorter term fixed income securities, and one cannot get the same level of returns. Mr. Angelo reported that Segal is recommending an increase from \$0.68 per \$100 to \$0.74 per \$100 for the Temporary Disability Benefit Fund, which would require specific Board action. He explained that this was due primarily to a higher rate of incurred claims, and even though there are very large reserves, the reserves are actually keeping this cost lower than the actual benefit cost. He stated that for the Total and Permanent Disability Fund, there are huge reserves and there is no recommended change from the current process of zero contribution.



Mr. Rozanski informed the Board that Mr. Angelo's presentation was for information and discussion, and that the plan is to bring both actuarial reports back to the Board at the next regularly scheduled Board meeting for consideration.

President Romero inquired if Mr. Rozanski had any manager comments. Mr. Rozanski informed the Board that staff was doing everything possible to work with the retirees affected by the direct deposit error that occurred, and to try and mitigate the costs to the maximum extent possible. He expressed from his viewpoint, to the extent there are cost incurred by the retirees, they should be reimbursed. President Romero stated he wanted to reiterate what he wrote in his e-mail to Mr. Rozanski, regarding his thanks to the Retirement Office staff, on behalf of the Board, in dealing with all these problems.

The Board meeting was adjourned at 10:06 a.m.

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JAVIER ROMERO  
President

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ROBERT ROZANSKI  
Secretary

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IRENE COLON  
Recording Secretary