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7 Attorneys for California Public Employees'
 Retirement System

8 UNITED STATES BANKRUPTCY COURT
 9 EASTERN DISTRICT OF CALIFORNIA
 10 SACRAMENTO DIVISION

11 In re
 12 CITY OF STOCKTON, CALIFORNIA,
 13 Debtor.
 14

Case No. 2012-32118
 DC No. OHS-1
 Chapter 9

15 **DECLARATION OF MICHAEL B. LUBIC**
 16 **IN SUPPORT OF CALPERS' BRIEF IN**
 17 **SUPPORT OF THE CITY OF**
 18 **STOCKTON'S PETITION**

19 Date: February 26, 2013
 20 Time: 1:30 p.m.
 Place: Robert T. Matsui U.S. Courthouse,
 501 I Street
 Department C, Fl. 6, Courtroom 35
 Sacramento, CA 95814

21
 22 I, Michael B. Lubic, declare as follows:

- 23 1. I am over 18 years of age. Except where otherwise stated, I have personal knowledge
 24 of the facts set forth below and, if called to testify, I could and would testify competently thereto.
 25 2. I am duly licensed to practice law in the state of California, in the United States
 26 District Courts and Bankruptcy Courts for the Northern, Eastern, Central, and Southern Districts of
 27 California, and before the Ninth Circuit.
 28

1 3. I am a partner of the law firm of K&L Gates LLP, counsel to the California Public
2 Employees' Retirement System ("CalPERS") in this matter.

3 4. I make this declaration in support of "CalPERS' Brief in Support of the City of
4 Stockton's Petition," which has been filed contemporaneously herewith.

5 5. A true and correct copy of the relevant portions of the Transcript of City of Stockton,
6 California, Case No. 2012-32118, January 30, 2013 Hearing is attached hereto as Exhibit "1"

7 6. A true and correct copy of the relevant portions of the complaint in the case known as
8 "People of the State of California v. The McGraw-Hill Companies, Inc., Standard & Poor's Financial
9 Services LLC, and Does 1-100 filed on or about February 5, 2013 in the Superior Court of the State
10 of California, County of San Francisco is attached hereto as Exhibit "2".

11 7. A true and correct copy of the California Public Employees' Retirement System,
12 Office of Public Affairs, Facts at a Glance: General (June 2012) is attached hereto as Exhibit "3".

13 8. A true and correct copy of the relevant portions of the California Ballot Pamphlet
14 (Nov. 3, 1992) is attached hereto as Exhibit "4".

15 9. A true and correct copy of the relevant portions of the Report of the Commission on
16 Pension of State Employees (December 31, 1928) is attached hereto as Exhibit "5".

17 10. A true and correct copy of the relevant portions from the transcript of the deposition of
18 David Lamoureux taken on November 16, 2012 is attached hereto as Exhibit "6".

19 11. A true and correct copy of the relevant portions of the Legislative History to Cal. Gov.
20 Code § 20574 as Exhibit "7".

21 12. A true and correct copy of the email dated January 2, 2013, from Alan Milligan, the
22 Chief Actuary of CalPERS, to Teresia Haase, the Director of Human Resources for the City of
23 Stockton titled "RE: City of Stockton- Request for Hardship Funding Extension" is attached hereto as
24 Exhibit "8".

25 13. A true and correct copy of the relevant portions of the Internal Revenue Bulletin 2008-
26 35, Rev. Proc. 2008-50 (September 2, 2008) is attached hereto as Exhibit "9".

EXHIBIT 1

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UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF CALIFORNIA
SACRAMENTO DIVISION

---oOo---

In re:) Case No. 12-32118-C-9
)
CITY OF STOCKTON, CALIFORNIA,) Chapter 9
)
Debtor.) DCN: OHS-5, OHS-6
_____)

---oOo---

BEFORE THE HONORABLE CHRISTOPHER M. KLEIN, JUDGE
OF THE UNITED STATES BANKRUPTCY COURT, EASTERN DISTRICT OF
CALIFORNIA, AND ON JANUARY 30, 2013.

REPORTER'S TRANSCRIPT OF PROCEEDINGS

CONTINUED MOTION FOR ORDER (1) RULING THAT APPROVAL OF
SETTLEMENT AGREEMENT IS NOT REQUIRED UNDER RULE 9019 OF THE
FEDERAL RULES OF BANKRUPTCY PROCEDURE; OR ALTERNATIVELY (2)
APPROVE SETTLEMENT AGREEMENT WITH CHRISTOPHER HALLON and
MOTION TO ASSUME LEASE OR EXECUTORY CONTRACT

---oOo---

APPEARANCES:

(See pg. 2)

Reported by: VICKI L. BRITT, RPR, CSR No. 13170

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---oOo---

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---oOo---

1 WEDNESDAY, JANUARY 30, 2013 AT THE HOUR OF 10:00 A.M.

2 BEFORE THE HONORABLE CHRISTOPHER M. KLEIN

3 ---oOo---

4 THE COURT: This is the time set for hearing on
5 two motions in the City of Stockton Chapter 9 case; a motion
6 for a ruling regarding a proposed settlement and a larger
7 question relating to settlements generally, and then,
8 second, a motion to assume a lease or executory contract.

9 Let's start with entries of appearance, beginning
10 with counsel in the courtroom.

11 MR. LEVINSON: Good morning, Your Honor. On
12 behalf of the City of Stockton, Marc Levinson, Patrick
13 Bocash and John Killeen of Orrick, Herrington & Sutcliffe.
14 Also in the courtroom is John Luebberke, the City Attorney
15 for the City of Stockton.

16 MR. JOHNSTON: Good morning, Your Honor. Jim
17 Johnston of Jones Day on behalf of the Franklin High Yield
18 Tax-Free Income Fund and Franklin California High Yield
19 Municipal Fund.

20 MR. BJORK: Good morning, Your Honor. Jeff Bjork
21 from Sidley Austin on behalf of Assured Guaranty.

22 MR. WALSH: Good morning, Your Honor. Matthew
23 Walsh with Winston & Strawn on behalf of National Public
24 Finance Guarantee Corporation.

25 MR. GEARIN: Good morning, Your Honor. Michael

1 And the logical -- what I struggle with, Your
2 Honor, is really the logical implication of the City's
3 position and CalPERS' position that the chapter 9 debtor,
4 once it gets in the door, can write its own rules. It only
5 needs to seek Your Honor's approval when it wants to. The
6 rest of the time, it's free to do whatever it wants.

7 THE COURT: But isn't the answer to that is, that
8 the day of reckoning is going to be the time for the
9 consideration of the confirmation of a plan of adjustment?

10 MR. JOHNSTON: But why should that be the case, or
11 at least the only case, once the horse left the barn and
12 it's a mile down the road?

13 THE COURT: Why shouldn't it be that?

14 MR. JOHNSTON: Well, because --

15 THE COURT: What happens if the -- let's say I
16 dismiss this chapter 9 case, then what? The City pays what
17 bills it can pay, stiffs you on the bonds because it has to
18 use the money to pay other creditors, then what happens?

19 MR. JOHNSTON: That's in no one's interest.
20 Everyone gets hurt then. The City gets hurt. Creditors get
21 hurt. That's in no one's interest.

22 THE COURT: So you're making an argument for
23 chapter 9?

24 MR. JOHNSTON: I am. I believe in chapter 9. I
25 just don't believe in the one-sided City calls all the shots

1 vision of chapter 9, because I don't think that that's the
2 way that it worked --

3 THE COURT: Well, and you've also made the point
4 that paying various other categories of creditors, treating
5 them more generously than it's proposed to treat your
6 clients, will give your clients a basis for challenging
7 confirmation.

8 MR. JOHNSTON: Correct.

9 THE COURT: And on a variety of theories: Unfair
10 discrimination, section 1129(b)(1), best interest of
11 creditors, section 943(b)(7); general good faith,
12 1129(a)(3); more general good faith, section 1129(a)(2).
13 And then the consequence of not confirming a plan of
14 adjustment in the end to -- it's not like a one time thing.
15 I deny one confirmation and dismiss. The more likely thing
16 is you give a debtor, just like in Chapters 11 and 12 and
17 13, multiple opportunities to propose confirmable plans.

18 MR. JOHNSTON: It's an iterative process. And the
19 problem is, if there are no rules of the road along the way,
20 the debtor very well can find itself in a position where it
21 will be unable to take advantage of that iterative process.
22 It will not be able to confirm a plan and then what? Then
23 we're left in the hypothetical that you mentioned earlier,
24 where you're back to your state law remedies. You have a
25 whole swath of creditors who got off scot-free by being paid

1 At the plan confirmation, there may be no money left.
2 There's no money left. That's not a good result. It cannot
3 be what Congress intended. So you dismiss the case?

4 THE COURT: Well, you know, that's an argument
5 that I think has real good force in a chapter 11 case with a
6 business that may have, in fact, collapse and be more
7 abundant where there's nothing left but the scraps to be
8 handed out in a liquidation. You know, I'm thinking that
9 it's not likely that the City of Stockton is going to dry up
10 and blow away over time. You know, there's life after -- no
11 matter what happens to this case, it's dismissed or
12 whatever, there's still going to be life in the City of
13 Stockton. There's going to be people living there. There
14 will be people paying taxes. There's going to be
15 governmental authority. Isn't that more of a cash flow
16 issue?

17 MR. WALSH: Your Honor, it's an issue of treating
18 this certain category of unfavored creditors. They get
19 wrapped up in the bankruptcy and plan confirmation process
20 for months, years longer than the favored creditors. If
21 it's a dismissal, great. The City may have to file again,
22 go through the whole process all over again. That cannot be
23 what Congress intended.

24 THE COURT: But there seems to me that there is
25 potentially a difference. If I think about a business in a

1 chapter 11, ultimately, even though we're trying to protect
2 the business and hope that it reorganizes itself, continues
3 as a player in the economic market, still, there's an aspect
4 of it that's potentially a zero sum game. And if everything
5 goes bad, then they're liquidated out for scrap, and nobody
6 whose left is getting paid very much.

7 But if the chapter 9 case falls apart in the case
8 of Stockton, they're still going to be there. There's still
9 going to be the residents by a drop to \$200,000, to say
10 300,000. There will be people paying taxes. There are
11 going to be businesses. There's a port there, a convenient
12 location for a port. There's going to be economic activity
13 going on in the future, and the debts are all going to
14 survive. So doesn't that actually provide a potential
15 distinction from that zero sum analysis that you're the
16 trying to emphasize?

17 MR. WALSH: From a policing mechanism perspective,
18 it depends how much the City pays out to the favored
19 creditors in this hypothetical. But it cannot be the case
20 that the unfavored creditors are stuck forever in the plan
21 confirmation process, or Lord help us, a dismissal, a
22 refile, or do it all over again.

23 THE COURT: Well, just a dismissal. They never
24 file again, but just don't have the money to pay bonds
25 current, so they're in default.

1 compromise, which motion operates de facto as section 904
2 consent. I think there may be plenty of good reasons for
3 them to do that in the case of particular compromises.

4 And with respect to the request that I go forward
5 to consider the Hallon compromise, the condition precedent
6 that I've said 9019 does apply, is not present, so I will
7 dismiss that part.

8 It's a very interesting, tricky question. And you
9 all needed an answer, so you get it from the bench. And I
10 do anticipate putting it in writing.

11 MR. LEVINSON: Thank you, Your Honor.

12 MR. JOHNSTON: Thank you.

13 (Court concluded at 12:59 p.m.)
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EXHIBIT 2

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11 *Attorneys for the People of the State of California*

12 SUPERIOR COURT OF THE STATE OF CALIFORNIA

13 COUNTY OF SAN FRANCISCO

14
15
16 **PEOPLE OF THE STATE OF CALIFORNIA,**

17 Plaintiff,

18 v.

19
20 **THE MCGRAW-HILL COMPANIES, INC., STANDARD & POOR'S FINANCIAL SERVICES LLC, AND DOES 1-100,**

21 Defendants.
22
23

Case No.

COMPLAINT FOR TREBLE DAMAGES, CIVIL PENALTIES AND PERMANENT INJUNCTION FOR VIOLATION OF THE CALIFORNIA FALSE CLAIMS ACT, UNFAIR COMPETITION LAW, AND FALSE ADVERTISING LAW

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1 The People of the State of California, by and through Kamala D. Harris, Attorney General
2 of the State of California, based on information and belief, bring this action against The McGraw-
3 Hill Companies, Inc. and Standard & Poor's Financial Services LLC (collectively "S&P").

4 INTRODUCTION

5 1. In the years leading up to the 2007-08 financial crisis, S&P intentionally inflated
6 its ratings of structured finance securities, costing California's public pension funds and other
7 investors hundreds of billions of dollars when those overrated securities later collapsed. S&P
8 purported to be a neutral gatekeeper of the financial markets, dispensing impartial ratings on tens
9 of thousands of complex, opaque securities. Investors, including California's public pension
10 funds, relied on S&P's integrity and its ratings. That reliance turned out to be misplaced. In
11 reality, S&P corrupted its ratings process to curry favor with large banks, which paid S&P
12 billions of dollars in return. In other words, S&P claimed to be a gatekeeper, but it acted like a
13 toll collector.

14 I. S&P'S CLAIMS ABOUT ITSELF AND ITS RATINGS

15 2. S&P made many specific claims to investors and the general public about how it
16 ran its business. For example, S&P promised that the fees it collected from banks and other
17 security issuers would never affect the ratings it gave those securities. It represented that it had
18 impenetrable ethical walls protecting the S&P analysts who rated structured finance securities
19 from pressure due to "an existing or a potential business relationship between [S&P] . . . and the
20 issuer." Issuer fees, S&P promised, could "not be a factor in the decision to rate an issuer or in
21 the analysis and the rating opinion."

22 3. S&P also advertised the purported reliability and high quality of its ratings. It
23 claimed, for instance, that an AAA rating meant that a security had an "[e]xtremely strong
24 capacity to meet financial commitments." An AAA-rated security was, according to S&P, safer
25 than all but a small handful of the very highest quality corporate bonds – as secure as U.S.
26 Treasury bonds.

OTHER RELEVANT ENTITIES

1
2 35. PERS is the largest public pension fund in the United States. It provides
3 retirement and health benefits to more than 1.6 million California public employees, retirees and
4 their families. PERS's members include California firefighters, peace officers and other public
5 employees.

6 36. STRS provides retirement, disability and survivor benefits for over 850,000 of
7 California's prekindergarten through community college educators and their families. STRS,
8 whose mission is to secure the financial future of California's educators, is the largest teachers'
9 retirement fund in the United States.

10 37. PERS and STRS are arms of the State of California, operating under the California
11 Constitution and the California Government Code. Pursuant to the California Constitution, the
12 boards of PERS and STRS are bound by a "fiduciary responsibility for investment of moneys and
13 administration of the [public pension] system."

JURISDICTION

14
15 38. This Court has jurisdiction to hear the claims alleged in this Complaint and is a
16 court of competent jurisdiction to grant the relief requested.

VENUE

17
18 39. At all relevant times alleged in this Complaint, Defendants maintained an office
19 and did business in the City and County of San Francisco.

20 40. Violations of law alleged in this Complaint occurred in the city and county of San
21 Francisco.

**PERS, STRS, AND OTHER INVESTORS PURCHASED STRUCTURED FINANCE
22 SECURITIES IN RELIANCE ON S&P'S INTEGRITY AND RATINGS**

23 41. PERS and STRS were among the largest institutional investors in structured
24 finance securities during the Relevant Time Period. In reliance on S&P's ratings and integrity,
25 PERS and STRS purchased large portfolios of structured finance securities, including but not
26 limited to those listed on Appendix A.

I. STRUCTURED FINANCE SECURITIES PURCHASED BY PERS AND STRS

1 6. Pursuant to Business and Professions Code sections 17203 and 17535, that
2 Defendants, and each of them, be enjoined from engaging in violations of the California Unfair
3 Competition Law and the California False Advertising Law, including without limitation the
4 unfair, unlawful, and deceptive practices alleged herein.

5 7. That the Court make such orders or judgments as may be necessary to restore to
6 any person in interest any money or property, real or personal, which may have been acquired by
7 means of unfair competition, under the authority of Business and Professions Code section 17203.

8 8. That the Court make such orders or judgments as may be necessary to restore to
9 any person in interest any money or property, real or personal, which may have been acquired by
10 means of any practice declared to be unlawful by Business and Professions Code section 17500 et
11 seq., under the authority of Business and Professions Code section 17535.

12 9. That the People recover their costs of suit, including costs of investigation.

13 10. Such further or additional relief as the Court deems proper.

14 Dated: February 5, 2013

Respectfully Submitted,

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MARTIN GOYETTE
Senior Assistant Attorney General



FREDERICK W. ACKER
Deputy Attorney General
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EXHIBIT 3



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400 Q Street, Sacramento, CA 95811
(916) 795-3991 phone • (916) 795-3507 fax
www.calpers.ca.gov

FACTS AT A GLANCE: GENERAL

JUNE 2012

Facts at a Glance is a monthly compilation of information of interest to Board Members, staff, and the general public. Information is current as of May 31, 2012, unless otherwise noted. Every effort has been made to verify the accuracy of the information, which is intended for general use only. Please direct any questions and comments to the Public Affairs Office at (916) 795-3991.

VISION STATEMENT

Pride in our service; providing confidence for your future.

MISSION

Our mission is to advance the financial and health security for all who participate in the System. We will fulfill this mission by creating and maintaining an environment that produces responsiveness to all those we serve.

CORE VALUES

Quality, Integrity, Openness, Accountability, Respect, Balance

BACKGROUND

The California Public Employees' Retirement System manages retirement benefits for more than 1.6 million California public employees, retirees, and their families. As of June 30, 2011, we provided pension benefits to 1,103,426 active and inactive members and 536,234 retirees, beneficiaries, and survivors. CalPERS membership is divided approximately in thirds among current and retired employees of the state, schools, and participating public agencies.

CalPERS is a defined benefit retirement plan. It provides benefits based on a member's years of service, age, and highest average compensation. In addition, benefits are provided for disability and death, with payments in some cases going to survivors or beneficiaries of eligible members. Approximately half of our members pay into Social Security.

CalPERS manages health benefits for more than 1.3 million members and their families. It offers members and contracting employers three health maintenance organization (HMO) plans, three preferred provider organization (PPO) plans, and three special plans for members who belong to specific employee associations.

FACTS AT A GLANCE: GENERAL
June 2012

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CalPERS was established by state law in 1932 to provide retirement benefits for state employees. In 1939, public agency and classified school employees were allowed to participate. In 1962, state law authorized CalPERS to provide health benefits to state employees. The health benefits program was expanded in 1967 to include public agency and school employees. In 1995, CalPERS began offering a supplemental deferred compensation retirement savings plan to members of public agencies that contract for it, and long-term care insurance on a not-for-profit basis.

INCOME TOTALS OVER THE PAST 20 FISCAL YEARS

YEAR	MEMBER CONTRIBUTIONS	EMPLOYER CONTRIBUTIONS	INVESTMENT AND OTHER INCOME
2010-2011	\$3,600,089,338	\$7,465,397,498	\$43,907,435,683
2009-2010	\$3,378,866,892	\$6,955,049,078	\$25,577,529,796
2008-09	\$3,882,355,341	\$6,912,376,563	-\$57,363,897,989
2007-08	\$3,512,074,936	\$7,242,802,001	-\$12,492,908,035
2006-07	\$3,262,699,076	\$6,442,383,868	\$40,757,380,692
2005-06	\$3,080,878,521	\$6,095,029,424	\$22,041,265,666
2004-05	\$3,176,780,369	\$5,774,120,281	\$21,894,201,526
2003-04	\$2,266,445,429	\$4,261,347,422	\$24,272,573,281
2002-03	\$1,887,925,497	\$1,925,043,858	\$5,482,731,568
2001-02	\$2,154,742,532	\$800,964,553	-\$9,699,792,798
2000-01	\$1,766,256,113	\$321,618,826	-\$12,248,341,399
1999-00	\$1,751,290,172	\$362,614,344	\$16,582,657,910
1998-99	\$1,522,507,527	\$1,598,316,666	\$17,622,526,922
1997-98	\$1,443,232,566	\$2,289,526,403	\$23,518,904,869
1996-97	\$1,379,743,571	\$1,986,282,287	\$20,455,866,430
1995-96	\$1,338,044,978	\$1,850,103,438	\$13,137,202,083
1994-95	\$1,290,624,208	\$1,578,933,781	\$12,504,528,262
1993-94	\$1,229,162,593	\$1,518,539,347	\$1,490,282,575
1992-93	\$1,187,174,852	\$1,810,996,606	\$9,665,319,064
1991-92	\$1,174,155,118	\$1,938,803,787	\$5,713,443,775
1990-91	\$1,131,577,838	\$1,409,848,310	\$4,420,898,516

FACTS AT A GLANCE: GENERAL
June 2012

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NUMBER OF EMPLOYEES

2,366 (budgeted positions as of July 1, 2011)

LENGTH OF SERVICE AT CalPERS

(Quarter ending September 30, 2011)

Years of CalPERS Specific Service	Number of Employees
35+	7
30 – 34	48
25 – 29	40
20 – 24	85
15 – 19	153
10 – 14	420
5 – 9	627
0 – 5	1078

TOTAL CalPERS ADMINISTRATIVE EXPENSES

2006–07 (actual)	\$395,353,207
2007–08 (actual)	\$530,550,190
2008-09 (actual)	\$566,913,372
2009-10 (actual)	\$427,149,512
2010-11 (actual)	\$306,379,733
2011-12 (budgeted)	\$334,196,000

FACTS AT A GLANCE: GENERAL
June 2012

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BOARD OF ADMINISTRATION – 13 MEMBERS

*6 Members Elected By:	All Terms Expire in January of Specified Year
Active school members	Rob Feckner, President (2015)
Active state members	George Diehr, Vice President (2015)
Active public agency members	Priya Sara Mathur (2015)
Retired members	Henry Jones (2016)
All members	Michael Bilbrey (2014)
All members	JJ Jelincic (2014)

*3 Appointed Members:	
Governor appointee	Dan Dunmoyer (2013)
Governor appointee	Vacant
Speaker & Senate Rules Committee appointee	Vacant

4 Statutory-Designated Members:	
State Treasurer	Bill Lockyer
State Controller	John Chiang
Acting Director of Dept. of Personnel Administration	Julie Chapman
Member designated by the State Personnel Board	Richard Costigan

CALIFORNIA EMPLOYERS' RETIREE BENEFIT TRUST FUND

The California Employers' Retiree Benefit Trust Fund was established by CalPERS in March 2007 to provide California public agencies with a cost-efficient, professionally managed investment vehicle for prefunding other post-employment benefits (OPEB) such as retiree health benefits. Prefunding reduces an agency's long-term OPEB liability. Participating agencies can use investment earnings to pay future OPEB liabilities, similar to the CalPERS pension fund in which three out of four dollars paid in retirement benefits come from investment earnings.

Assets under management in trust fund (as of May 31, 2012): \$1.92 billion

Participating public agencies: 332

Nine agencies joined the CERBT in May:

Alameda County Water District
Castroville Community Services District
City of Carson
Kaweah Delta Water Conservation District
Orchard Dale Water District
San Joaquin County Mosquito and Vector Control District
Shasta County Schools
Shasta Lake Fire Protection District
Town of Truckee

ACTUARIAL INFORMATION

Each year CalPERS actuaries calculate a funded ratio—the ratio of market value of assets in the fund to the liabilities for each retirement plan. The funded ratios vary from year to year.

Funded Status of Retirement Plans by Member Category

Member Category	6/30/05	6/30/06	6/30/07	6/30/08	6/30/09	6/30/10
State	85.5%	88.6%	96.6%	84.9%	58.4%	62.8%
School	96.2%	98.7%	107.8%	93.8%	65.0%	69.5%
Public Agency	90.2%	92.7%	102.0%	89.6%	60.0%	65.8%

Notes

- The funded ratios are based on the Market Value of Assets.
- There were five plans in the state category with funded ratios between 57 percent and 69 percent as of June 30, 2010. The funded ratio for the state is an aggregate of all five plans.

FACTS AT A GLANCE: GENERAL
June 2012

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- As of June 30, 2009, there were 2,039 plans with active members in the public agency category. There were 1,590 plans in one of nine risk pools and 449 public agencies in non-pooled plans. For non-pooled plans: about 98 percent of the plans were below 75 percent funded; about 2 percent of the plans was between 75 and 100 percent funded; and 0 percent of the plans were 100 percent funded or better. All risk pools were between 57 percent and 70 percent funded.

CalPERS eSUBSCRIPTIONS

CalPERS offers a number of eSubscriptions for press releases and other CalPERS news services. You can sign up for these online services at the eSubscriptions page of CalPERS On-Line at www.calpers.ca.gov.

CalPERS CHRONOLOGY

- 1932 — CalPERS established by State legislation
- 1932 — Became operational for retirement benefits for State employees
- 1939 — Public agencies and classified school employees allowed to contract for retirement benefits
- 1962 — Public Employees' Medical & Hospital Care Act allowed CalPERS to provide health insurance benefits for State employees
- 1967 — Health Program expanded to include local public employees on a contract basis
- 1984 — CalPERS initiated corporate governance reform program
- 1984 — Proposition 21 approved by voters; allowed CalPERS to invest more than 25 percent of fund portfolio in stocks
- 1985 — CalPERS becomes a founding member of the Council of Institutional Investors
- 1986 — CalPERS breaks ground on its headquarters building Lincoln Plaza
- 1990 — Long-Term Care Act allowed CalPERS to offer LTC insurance to CalPERS, STRS, and County Employees' Retirement Law of 1937 members
- 1992 — Proposition 162 approved by voters; CalPERS Board given absolute and exclusive authority over the administration and investment of pension funds
- 1995 — Long-Term Care Program created and offered to all California public employees and retirees
- 1996 — CalPERS pension fund reached \$100 billion on May 14, 1996
- 1996 — CalPERS launched International Corporate Governance Program
- 1997 — CalPERS launched CalPERS On-Line
- 1997 — CalPERS adopted corporate governance principles for United Kingdom
- 1997 — CalPERS increased public disclosure of decision making
- 1998 — CalPERS adopted U.S. corporate governance standards
- 1998 — CalPERS adopted strategy for private equity investments
- 1998 — CalPERS Board sponsored "retirement equity" legislation
- 1999 — CalPERS launched corporate governance website; draws worldwide interest

FACTS AT A GLANCE: GENERAL

June 2012

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- 2000 — CalPERS designated May “Retirement Planning Month”
- 2001 — CalPERS earmarked \$457 million to 11 California private equity firms; investments intended to target California’s under-served markets
- 2001 — CalPERS broke ground on Headquarters Expansion Project
- 2002 — CalPERS launched financial market reform initiative with principles and action plan to prevent future Enron-type accounting abuses
- 2003 — CalPERS called on “expatriate” firms to return to U.S.
- 2003 — CalPERS adopted plan to crack down on executive compensation abuses
- 2003 — CalPERS launched eNews service; also adds “Press Room” to website
- 2003 — CalPERS sued NYSE for trading specialist abuses that hurt investors
- 2004 — CalPERS launched new improved CalPERS On-Line website on March 27
- 2004 — CalPERS initiated Environmental Technology Investment Program
- 2004 — CalPERS adopted reduced hospital network, regional health plan pricing
- 2004 — CalPERS received AAA rating from Fitch Ratings
- 2005 — CalPERS reaches \$200 billion in assets, maintaining its place as the largest public pension fund in the nation
- 2005 — CalPERS headquarters expansion completed in October
- 2005 — CalPERS pension fund reached \$200 billion milestone on November 21
- 2007 — CalPERS launched retiree health benefit (OPEB) prefunding plan on March 1
- 2007 — CalPERS celebrated 75th anniversary
- 2007 — CalPERS launched my|CalPERS website for members
- 2008 — CalPERS created new inflation-linked asset class to invest in commodities, forestland, inflation-linked bonds, and infrastructure
- 2008 — CalPERS launched online member education classes
- 2009 — CalPERS adopted policy on disclosure of placement agent fees
- 2009 — CalPERS altered asset allocation given extraordinary market conditions, raised private equity, cash allocation targets
- 2009 — CalPERS adopted special employer smoothing process for public agency and school employers in light of the extraordinary market downturn during the great recession
- 2009 — CalPERS launched CalPERSResponds.com
- 2009 — CalPERS launched social media presence on Facebook, Twitter and YouTube
- 2009 — CalPERS adopted policy on greater placement agent disclosure
- 2010 — CalPERS backed federal financial market reform
- 2011 — CalPERS reorganizes to better serve members, employers and stakeholders; adds CFO position
- 2011 — CalPERS legal analysis says pension promises are a vested right
- 2012 — CalPERS releases cost analysis on creation of hybrid pension plan

EXHIBIT 4

California

BALLOT PAMPHLET

General Election

November 3, 1992

CERTIFICATE OF CORRECTNESS

I, March Fong Eu, Secretary of State of the State of California, do hereby certify that the foregoing measures will be submitted to the electors of the State of California at the GENERAL ELECTION to be held throughout the State on November 3, 1992, and that this pamphlet has been correctly prepared in accordance with law.



Witness my hand and the Great Seal of the State in Sacramento, California,
this 10th day of August 1992.

March Fong Eu

MARCH FONG EU
Secretary of State



Secretary of State

SACRAMENTO 95814

Dear Californians:

This is your California Ballot Pamphlet for the November 3, 1992, General Election. It contains the ballot title and a short summary provided by the Attorney General, the Legislative Analyst's analysis and an overview of the state bond debt, the pro and con arguments and rebuttals, and the complete texts for Propositions 155 through 167. It also contains the legislative votes cast for and against each measure proposed by the Legislature. Should any other measures be added to the ballot at a later date, materials relating to them will be sent in a supplemental ballot pamphlet. This election, at the suggestion of the California Commission on Campaign Financing, a private, non-profit organization, we are also including summary information regarding the measures. Statements from political parties about their philosophies and purposes are also included.

Many rights and responsibilities go along with citizenship. Voting is one of the most important, as it is the foundation on which our democratic system is built. Read carefully all of the measures and information about them contained in this pamphlet. Legislative propositions and citizen-sponsored initiatives are designed specifically to give you, the electorate, the opportunity to influence the laws which regulate us all.

Take advantage of this opportunity and exercise your rights by voting on November 3, 1992.

Please note that Proposition 155 is the first proposition for this election. To avoid confusion with past measures, the Legislature passed a law which requires propositions to be numbered consecutively starting with the next number after those used in the November 1982 General Election. This numbering scheme runs in twenty-year cycles.

162

**Public Employees' Retirement Systems.
Initiative Constitutional Amendment.**

Official Title and Summary Prepared by the Attorney General

**PUBLIC EMPLOYEES' RETIREMENT SYSTEMS.
INITIATIVE CONSTITUTIONAL AMENDMENT.**

- Grants the board of a public employee retirement system sole and exclusive authority over investment decisions and administration of the system.
- Requires board to administer system so as to assure prompt delivery of benefits to participants and beneficiaries.
- Provides that board's duty to participants and beneficiaries takes precedence over any other duty.
- Grants board sole and exclusive power to provide for actuarial services.
- Prohibits changing number, terms, and method of selection or removal of members of board without approval of voters of the jurisdiction in which participants of the retirement system are employed.

Summary of Legislative Analyst's

Estimate of Net State and Local Government Fiscal Impact:

- Unknown fiscal effect from giving public pension boards complete authority over assets and administration of the systems.
- Potential costs to employers as a result of public pension system giving highest priority to providing benefits to members and their beneficiaries.
- Annual savings of \$1 million to \$3 million to the state's Public Employees' Retirement System for actuarial services.

Analysis by the Legislative Analyst

Background

Public pension systems in California provide retirement benefits to a wide range of state and local government employees—such as teachers, firefighters, and police officers. The largest of these pension systems are the state's Public Employees' Retirement System (PERS) and the State Teachers' Retirement System (STRS). In addition, there are over 100 other public retirement systems that serve counties, cities, special districts, and the University of California.

Funds for payment of retirement benefits under these public retirement systems come from assets held in trust by each system's governing board. These assets include contributions from employees and employers, plus income earned on the investment of these contributions. The members of many public retirement systems elect some members of their governing boards. The State Constitution requires each board to use fund assets to: (1) provide benefits to members of the system and their beneficiaries, (2) minimize employer contributions, and (3) pay reasonable administrative costs.

The Constitution specifies the general authority and responsibilities of public pension systems. Within these limits, the Legislature can change various administrative functions and activities of public pension systems. For example, recent legislation removed the actuarial function from the PERS Board and placed this function under a State Actuary appointed by the Governor and confirmed by the Legislature. (A primary function of the actuary is to determine the employer's annual contribution rate.) In addition, recent legislation also allowed the use of certain PERS assets to offset employer contribution costs.

Proposal

This measure makes several changes to constitutional provisions related to public retirement systems:

- It gives the board of each public pension system complete authority for administration of the system's assets and for the actuarial function. (This would have the effect of returning the PERS actuarial function to the PERS Board.)
- Each board must continue to provide benefits to members of the system and their beneficiaries, minimize employer contributions, and pay reasonable administrative costs. The measure, however, specifies that each board is to give *highest* priority to providing benefits to members and their beneficiaries.
- The measure specifies that the Legislature cannot

change terms and conditions of board membership (for boards with elected employee members) unless a majority of the persons registered to vote in the jurisdiction of the retirement system approves the change. For example, a change in a county retirement system's board membership would require a countywide vote.

Fiscal Effect

The measure could have the following fiscal impacts on state and local governments.

Administration of Assets. Giving complete authority for administration of public retirement system assets to the governing boards could reduce oversight of these activities by state or local government. This would have an unknown effect on the costs of the systems.

Actuarial Responsibilities. The boards of most public retirement systems have the responsibility for the actuarial function. As noted above, the responsibility for this service for PERS was recently transferred to an actuary appointed by the Governor. By returning the function to PERS, this measure would have two fiscal effects. First, there would be annual savings in the range of \$1 million to \$3 million, as it appears that PERS can now perform the task at less cost than an outside actuary. These savings would be realized by all the public employers in the PERS system. Second, there would be an unknown effect on the cost of employer contributions resulting from potentially different assumptions by an actuary responsible to the PERS Board, rather than the Governor.

Board Responsibility to Pension Members. The requirement that pension system boards give highest priority to providing benefits to members and their beneficiaries could result in higher costs to employers. As discussed above, providing benefits is currently one of three basic, and equal, responsibilities of the pension boards. Placing benefits as the highest priority could result in higher costs to employers if board decisions increase benefits without equal consideration to the cost for those benefits. These potential costs are unknown, and are dependent on future decisions of pension system boards.

Vote on Legislative Changes. The provision requiring a vote within the jurisdiction of a pension system to approve legislative changes to the pension system board could result in increased election-related costs. The average annual costs for these elections, however, probably would not be significant.

For text of Proposition 162 see page 70

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Public Employees' Retirement Systems. Initiative Constitutional Amendment.

Argument in Favor of Proposition 162

Do you believe politicians should be able to raid the pension funds of retirees?

That's exactly what they have done—and will continue to do—unless we pass PROPOSITION 162.

A YES vote on PROPOSITION 162 will prevent politicians from raiding the pension funds of firefighters, police officers and other active and retired public employees.

It's not right to allow politicians to balance their budgets on the backs of seniors and retirees. For many retirees who have worked hard all of their lives, their only source of dignity and security is the pension they earned. They depend on those pensions to survive.

It is morally wrong and unfair to take that away from them. But politicians keep doing it.

And let's face it—if the politicians are allowed to raid public pension funds today, private pension funds will be next. The big difference is that taxpayers are ultimately responsible for public pensions. And that means taxpayers will be socked if huge future tax increases are

needed to pay back *tomorrow* the funds politicians loot from public pension funds *today*.

That's why senior citizens, taxpayer groups and active and retired people throughout California are united in support of PROPOSITION 162.

Is it any wonder that more than 1.2 MILLION of our neighbors signed petitions to place PROPOSITION 162 on the ballot?

The politicians won't do the right thing, but we can! Vote YES on PROPOSITION 162.

CHARLES CARBONARO
*Chairman, California State Legislative Committee
American Association of Retired Persons (AARP)*

PETER J. KANELOS
*Executive Director,
REsponsible VOTers for Lower Taxes (REVOLT)*

CLIFFORD F. HASKELL
Retired Firefighter

Rebuttal to Argument in Favor of Proposition 162

PROPOSITION 162 DOESN'T PROVIDE ADDITIONAL PROTECTION AGAINST PENSION RAIDS.

The California Constitution already protects public pensions. And the idea that only "politicians" raid pensions is ludicrous: State retirement boards took nearly a billion dollars out of state pension investments in the 1980s, to fund a special reserve account. Proposition 162 does nothing to stop these bureaucrats from conducting their own "raids."

PROPOSITION 162 IS TOO RISKY.

The state pension board has already been caught making bad investments: they have invested millions in junk bonds and speculated in risky real estate ventures. Proposition 162 would give these boards even more independence. That's a risk we are simply not prepared to take.

PROPOSITION 162 ENDS TAXPAYER OVERSIGHT.

Pension boards currently have to balance the interests

of taxpayers with those of retirees. This is only fair, since nearly \$5 billion a year in tax dollars go toward public pension funds. Proposition 162 destroys this balance, and instead requires pension boards to make increased benefits their number one priority, regardless of taxpayer cost. Next, Proposition 162 takes away nearly all authority of the executive and legislative branches to oversee pension board decisions. So taxpayers would have no way to keep these boards accountable for their actions.

REJECT THE SLICK CLAIMS BEHIND PROPOSITION 162. PROTECT PENSIONS AND TAXPAYERS BY VOTING NO ON 162.

RICHARD GANN
President, Paul Gann Citizens Committee

LARRY MCCARTHY
President, California Taxpayers Association

Public Employees' Retirement Systems. Initiative Constitutional Amendment.

162

Argument Against Proposition 162

Proposition 162 doesn't protect pensions, it protects the bureaucrats who have failed to curb rampant fraud and abuse in state and local government retirement systems.

Voting NO on Proposition 162 is the only way to PROTECT PENSIONS AND TAXPAYERS.

State auditors in 1990 found pension abuse in 75% of cities studied—including one case where a former city manager was collecting a \$139,000 annual pension when his top salary was only \$89,000. The Legislature quickly authorized state pension officials to hire six new auditors—but more than a year later, NOT ONE NEW AUDITOR HAD BEEN HIRED.

STATE RETIREMENT BOARD MEMBERS INVESTED IN JUNK BONDS, ACCEPTED TRAVEL JUNKETS AND WERE WINED AND DINED BY SPECIAL INTERESTS, AND FAILED TO SPOT OUTRAGEOUS FRAUD.

Proposition 162 would give the bureaucrats at the heart of this scandal more independence and more power—and make it harder for taxpayers to ensure these retirement funds are properly managed.

PROPOSITION 162 ENDS TAXPAYER OVERSIGHT OF STATE RETIREMENT BOARDS. Last year, in the middle of a recession and a budget crisis, the PERS board voted to pay its top bureaucrat \$110,000 a year. The State Controller blocked this pay increase, but would have no authority to stop other outrageous salary hikes if Proposition 162 becomes law.

Proposition 162 would end the mandatory use of outside independent experts—called actuaries—to review the amount of money taxpayers pay into the state retirement system. Proposition 162 would take away this independent voice in determining taxpayer contributions to the nation's largest pension fund. THAT'S JUST TOO RISKY.

And Proposition 162 also dictates that retirement

boards alone would have absolute authority to determine the amount of money taxpayers must contribute to state, school and local government retirement funds each year. Retirement boards would be able to demand from taxpayers excessive contributions when the retirement system is overfunded. And in future budget crises, retirement costs could soar while vital public services are cut to the bone.

BY TAKING MORE TAX DOLLARS THAN NECESSARY, RETIREMENT BOARDS COULD FORCE MORE TAX INCREASES ON CALIFORNIA.

The interests of taxpayers and state and local government retirees are balanced carefully under current law. But Proposition 162 upsets that balance, and the taxpayers end up losing.

Proposition 162 requires retirement boards to make providing or increasing benefits their number one priority, regardless of the costs to the taxpayers. A majority of contributions to the pension fund comes from the taxpayers each year. PROPOSITION 162 WOULD REQUIRE A PENSION BOARD TO DISREGARD THE INTERESTS OF TAXPAYERS.

Bureaucrats have long employed scare tactics to get more money from the taxpayers, and Proposition 162 is based upon a colossal and phony claim that public pension funds are at risk. They are not. State and local government pensions are already protected by California's Constitution. And this initiative does not change any existing constitutional protections of retirement funds.

Vote no on Proposition 162.

LARRY MCCARTHY
President, California Taxpayers' Association
RICHARD L. GANN
President, Paul Gann's Citizens Committee

Rebuttal to Argument Against Proposition 162

Opponents of Proposition 162 are trying to mislead the voters.

The central purpose of this measure is to STOP POLITICIANS FROM USING PUBLIC PENSION FUNDS TO BAIL THEM OUT WHEN THEY FAIL TO KEEP GOVERNMENT SPENDING UNDER CONTROL. Pension funds should be used to provide promised benefits for retired workers, not as a slush fund for politicians.

Proposition 162 has nothing to do with auditors who investigate alleged pension abuse. In fact, state pension officials were unable to hire more auditors because the politicians delayed funding for the positions.

Nor does Proposition 162 have anything to do with retirement benefit levels. Only legislative bodies elected by voters and voters themselves have the power to set benefit levels.

PROPOSITION 162 does have something to do with taxes. It prevents taxpayers from being gouged in the future to pay back pension money looted by politicians.

Seniors and taxpayer groups who have carefully read Proposition 162 agree that *the real issues are protecting pension funds and taxpayer dollars.*

Pension fund security is crucial to retired workers who are struggling to pay for food, shelter and health care.

And *preventing pension raids is crucial to all taxpayers to avoid future tax increases* that would be needed to pay back the money taken by politicians.

Because politicians have repeatedly tried to loot hundreds of millions of dollars from public pension systems, Proposition 162 is needed to KEEP POLITICIANS' HANDS OUT OF THE TILL.

Vote Yes on Proposition 162.

DERRELL KELCH
President, California Seniors Coalition
PETER J. KANELOS
Executive Director,
REsponsible VOTer for Lower Taxes (REVOLT)

EXHIBIT 5

LETTER OF TRANSMITTAL

TO GOVERNOR C. C. YOUNG AND

The Members of the State Legislature:

The Commission on Pensions of State Employees under the direction of chapter 431, Statutes of 1927, respectfully transmit its report covering its investigations and study.

The Commission was appointed by Governor Young early in November, 1927, and held its first meeting on the twenty-first of this month. Subsequent meetings of the Commission were held on December 19, 1927, June 21, November 13 and December 17, 1928. Public meetings for discussion of the subject with state employees and other persons interested in the matter were held before the Commission in San Francisco, February 6, 1928; Los Angeles, February 21, 1928; and Sacramento, March 9, 1928. At these meetings the whole question of a retirement system for state employees was fully discussed and a record was kept of the views and opinions expressed by state employees, state employees' associations, and other persons and organizations who attended or were represented.

In order to be assured of the possible scope of the investigation, its duties, and the general limitations of its activities, the Commission addressed two letters of inquiry to the Attorney General, which, together with the opinions received, are attached to this report as Appendix II. A copy of the enabling act is also attached as Appendix I.

The act directed that the Commission should file a report on or before July 1, 1928, but as it was impossible to complete the actuarial study and the Commission's summation of the study by that time, a preliminary report was filed with the Governor on July 1, 1928, in accordance with the advice of the Attorney General. The investigation was then continued to completion as shown in the final report herewith submitted. The preliminary report is included with, and made a part of, this report. An actuarial report on the entire investigation submitted to the Commission by Mr. Barrett N. Coates, consulting actuary of San Francisco, and approved by Professor Albert H. Mowbray of the University of California, together with a legislative bill prepared under their supervision to put the retirement plan recommended into operation, if approved by the legislature, are also attached as appendices to the report.

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The preliminary report was filed by the chairman of the Commission after it had been approved by all the members of the Commission. The final report lacks the signature of Mrs. O. Shepard Barnum because of her absence in Europe at this time.

The Commission desires to express its appreciation to Mr. Coates and his assistant, Mr. W. C. Green, and to Professor Mowbray for the excellent actuarial study completed by them; to the Attorney General for his cooperation with the Commission in its work; to Miss Lodema Shurtleff, secretary of the State Civil Service Commission, who acted throughout the work of the Commission as its secretary without compensation; and to all others who assisted in the preparation of this final report.

Respectfully yours,

COMMISSION ON PENSIONS OF STATE EMPLOYEES.

W. A. JOHNSTONE, Chairman,
J. C. WHITMAN, Commissioner,
RALPH T. FISHER, Commissioner,
JOHN F. DALTON, Commissioner.

Sacramento, California,
December 31, 1928.

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PRELIMINARY REPORT OF THE COMMISSION ON PENSIONS
OF STATE EMPLOYEES FILED WITH GOVERNOR YOUNG
ON JULY 1, 1928

HON. C. C. YOUNG,
*Governor of California,
State Capitol,
Sacramento, California.*

June 30, 1928.

DEAR GOVERNOR YOUNG:

Under the provisions of chapter 431 of the Statutes of 1927 you appointed Mr. Ralph T. Fisher, Mrs. O. Shepard Barnum, Mr. John F. Dalton, Mr. J. C. Whitman and W. A. Johnstone as the members of "a Commission on Pensions of State Employees," all of which members duly qualified and organized the Commission on November 21, 1927, with the election of W. A. Johnstone as chairman, J. C. Whitman as vice-chairman, and Lodema Shurtleff as secretary. The principal duties of the Commission are summed up in the following sentence included in section 1 of the act: "The commission shall be appointed for the purpose of inquiring into the subject of retirement pensions, allowances and annuities for state officers and employees, especially with reference to the method of establishing and maintaining the fund from which such pensions, allowances and annuities shall be paid."

Section 6 provides that "the commission shall on or before July 1, 1928, report the result of its inquiry to the governor and legislature, including such proposed legislation as it may deem advisable."

This report must be considered in the light of a progress report for the reason that the time allowed for the intricate and technical studies required is not sufficient to complete a thorough and well-digested report upon the questions before the Commission. As pointed out further on, a supplementary and more complete report will be filed at a later date.

The first decision of the Commission was that any recommendation made by it should be based upon an actuarial study of the situation in order that any plan so recommended might be regarded as actuarially sound and reliable. After a thorough examination of the actuarial field Mr. Barrett N. Coates of San Francisco, a recognized authority on such questions, with excellent experience and splendid standing in his profession, was selected as the actuary of the Commission, and Prof. A. H. Mowbray, professor of insurance with the University of California, as advisory actuary, to undertake the investigations and studies upon which a proper and sound recommendation might be based. It was the desire of the Commission to engage Prof. Mowbray on a full time basis, but his duties with the university would not permit of this. The members of the Commission feel, however, that in the selection of these two men we have the best ability and advice obtainable. The excellent manner in which these studies have been handled up to this time has thoroughly justified this opinion of the Commission.

The Commission held open meetings in the early part of this year at San Francisco, Los Angeles and Sacramento in order that all state employees' organizations or any other associations, or groups, or individuals who might be interested should have an opportunity to appear and express opinions as to the scope and application of any plan that might be submitted by the Commission. All of these meetings were well attended and many valuable suggestions were given to the Commission expressing the views of many people on this question. In general there was a surprising harmony of views and in the question of contribution it was practically unanimously agreed that it should be upon the basis of half by the employees and half by the state. At these meetings the Commission refrained from expressing any preferences or views in order that a clear and unhampered expression of opinion might be received.

A general outline of the study was first proposed. In order to have a proper understanding of its duties and the range and application of this examination, an opinion was asked of the Attorney General, which was later received and is attached to this report, marked "A." (See Appendix II.) With this in mind, a general outline of a study based upon the following divisions was carried along:

1. General nature of proposed system
2. Eligibility of employees
3. Service retirement benefits
4. Disability retirement benefits
5. Death benefits
6. Withdrawal benefits

with a general consideration of the financing of any adopted system.

The study required a great deal of technical preparation and the collection of a large mass of information relative to the status and history of all the state employees coming within the provisions of the act, somewhere around 11,000 questionnaire cards having been sent out to assemble this information. After their return, the cards were segregated and classified into various essential groups and the actuaries proceeded with the compilation of data needful in the consideration of the general questions involved in the study. These questions involved so many angles as to service and divisions of employees, retirement benefits, ages and other matters that the actuaries have been unable to complete their study or to submit complete recommendations so that a complete and well-considered report can be submitted by July 1st.

It became apparent at this time that the work of the Commission could not be completed by July 1, 1928, the time set in the act for the filing of its report. The commissioners thereupon asked a further opinion from the Attorney General as to the life of the Commission, as referred to in the act, in order that they might know whether or not further time might be given to the study and in the completion of its report.

The Attorney General rendered an opinion, dated June 18, 1928, in which he gave it as his view that the life of the Commission did not end with the date fixed for its report, but that it should continue until its work was properly completed. A copy of this opinion is also attached hereto, marked "B." (See Appendix II.)

The chairman being advised that the actuaries were in a position to submit a progress report, a meeting of the Commission was held in San Francisco on Thursday, June 21st, attended by all members of the Commission. At this time reports were heard from the actuaries, who had compiled a considerable amount of data, and they were directed more definitely in the continuation of the survey than had been possible up to this time. It was pointed out by the actuaries that with about six weeks or two months more time they will be able to submit definite conclusions covering the main questions involved. The Commission then adjourned subject to call pending the completion of the actuarial study.

It is also essential that, when the Commission has arrived at fairly definite conclusions as to what should be recommended, the matter of the financial burden involved should be discussed with the director of finance in order to receive the approval of this department upon the financial burdens which may be imposed upon the state by the adoption of any plan submitted. There is also the further question of the submission of a bill to be submitted at the next legislature which may put into effect the recommendations of the Commission.

As chairman of the Commission, I was directed, in conjunction with the actuaries, to prepare and submit to you a progress report that would comply with the requirements of the act for the filing of a report by July 1, 1928. As this is in harmony with the opinion of the Attorney General attached hereto, I believe that you will agree with the wisdom of the Commission's continuing its study upon this important matter until it is satisfied that it has thoroughly considered all of the phases of the matter before it, and that its recommendations are sound and practicable in the interests of both the state officers and employees, and the general public.

Yours respectfully,

(Signed) W. A. JOHNSTONE,
Chairman, Commission on Pensions.

FINAL REPORT OF THE COMMISSION ON PENSIONS OF STATE EMPLOYEES TO GOVERNOR YOUNG AND THE STATE LEGISLATURE

This report supplements and completes the preliminary report filed with Governor Young on July 1, 1928.

PRELIMINARY WORK

The organization and initial work of the Commission have already been described in the earlier report. In addition to holding the public meetings mentioned in that report, the Commission has given attention to recommendations advanced by interested persons. Numerous state departments and employees, as well as other interested citizens, have availed themselves of the opportunity of expressing what they believe to be desirable features of any retirement system which might be adopted. All of these expressions have been carefully considered.

At the same time a comprehensive study has been made of the salient features of a number of present-day public retirement systems, notably those of New York state and city, Massachusetts, New Jersey, Chicago, San Francisco and Baltimore. These were of value as presenting a consensus of modern opinion on the subject, and gave a general idea of the costs that are involved. The cost of any system that might be proposed for California necessarily depends upon the number, age and length of service of eligible employees, their salary range, rates of withdrawal, etc., and the Commission found at the outset that no complete statistics were available along these lines. The procedure of securing definite information from each employee in the state service as of December 31, 1927, has already been described in the earlier report. To determine the rate of withdrawal from state service, an investigation was undertaken of all withdrawals from the service during the five-year period ending December 31, 1927, using the information on record in the office of the State Civil Service Commission.

All departments have cordially cooperated in securing the information as to present employees necessary for the work of the Commission.

REASONS FOR A RETIREMENT SYSTEM

From the standpoint of the employee, the advantages of a retirement system are obvious. If its provisions are adequate, it provides an assured income during old age or permanent disability, and gives it at minimum cost. The object of the state, as an employer, is to secure the improvement of its working personnel. An elaborate dissertation on the contribution of a retirement system toward this end is beyond the scope of this report, yet some mention should be made of some of the more important considerations.

A sound retirement system provides the state with a sure and just method of eliminating from its active force those employees who have become incapable of performing their best work because of disability or superannuation. Unless death intervenes, every worker reaches

this point at some time or other. Some may say: "Let him live on his savings, or on the charity of his children." But the discharge of a superannuated employee without adequate provision for his future needs is repugnant to every instinct of humanity, and in practice this course will not be pursued. In the absence of a retirement system, the aged or disabled employee is left in active service as long as he can "go through the motions." He is really retired on the job, but the cost to the state of paying his full salary is charged to the current salary budget, instead of to a retirement system, where it more properly belongs. To a very considerable extent, the state pays for a retirement system even though none is established.

A sound retirement system is not charity, doled out to the aged employee. It is an orderly method of providing for his retirement at the end of his normal service-life, using a capital fund which has been built up during his active service with this very eventuality in prospect. It prevents the stagnation which besets a department when the avenues of advancement are closed to the younger employees because of the continued employment of men and women far beyond their best days, but whose long service has won them the highest places within the department's command.

A sound retirement system helps to make the service of the state a "life work" for the able man or woman who is attracted toward it, yet who hesitates because it does not offer any definite prospect of financial independence in later life. The increasing complexity of state governmental and regulatory functions makes it of the utmost importance to secure and hold the best possible type of employees. The retirement system can be of marked service in stabilizing the state's employed personnel, preventing at least a portion of the losses which occur when trained, efficient employees leave the service because of superior opportunities elsewhere.

UN SOUND SYSTEM WORSE THAN NONE

An urgent responsibility rests upon the state to see that any retirement system which it may sponsor is placed upon a sound financial basis, where liabilities are provided for as they are *incurred*, rather than when they mature. The current service year must be regarded as contributing its portion to the sum total of service which will some day entitle the employee to retire, and the current year should therefore bear its share of the ultimate cost. Any system which proposes to provide funds only as they are needed to meet disbursements is inviting disaster; the unseen liabilities continue to mount, and the time will come when they will begin to mature in such volume as to cause serious embarrassment to the state, forcing it either to make staggering appropriations, or to default in its obligations to members of the system. Careful calculations have been made by the actuaries covering the annual cost of each proposed benefit, and as a further safeguard the Commission has proposed that at the end of each five-year period there be an investigation of the actual experience of the system as compared with the "expected" experience worked out by the actuaries. The determination of costs involves future salary scales, the interest rate earned on investments, mortality rate, withdrawal rate and various other elements which may change with changing conditions. By

making these quinquennial investigations, the groundwork will be laid for any minor adjustments that may become necessary in order to assure that the system will work out as planned.

COMPULSORY MEMBERSHIP

The Commission believes that membership in the system should be compulsory for all eligible employees. To do otherwise would be to defeat the purpose of the whole program to the extent that certain employees might elect to remain outside. An employee might take the position: "I want all my salary in cash now, and I will take my chances of being able to support myself in old age or if I am disabled." But when that employee reaches the time when he should retire, or when he becomes disabled, the fact that he is outside of the retirement system will mean in practice that he will be continued in active service as long as he is able to present himself at his place of employment. Public opinion would never sustain the position that such an employee should be summarily discharged in his old age, without financial provision for his future, on account of his failure to come under the system when it was established. The state can secure full value for the money it contributes only through compulsory membership of all employees. One employee should have no more right than another to continue at full salary far beyond the period of full working efficiency. In drafting the proposed legislation, the Commission has paid particular attention to safeguarding the rights of all employees by making the service retirement provisions elastic as to age, and by a special extension of the age of compulsory retirement for present employees.

ELIGIBILITY OF EMPLOYEES

The proposed act has been drawn on the assumption that all state employees shall participate in the system, without regard to whether or not they have civil service status. Teachers and other employees in the public school system, and in the University of California are not included. Other exclusions are part-time employees, elected officers and officers appointed for fixed terms. There are certain cases where full-time employees are paid in part by the state and in part by federal or other authority, and these employees will participate on the basis of the amount of salary drawn from the state.

As will appear later, the proposed system calls for the contribution of a certain percentage of salary by the employees, and the retirement annuity purchased by these accumulated contributions is "matched" by the state. The maximum salary considered for the purposes of the system is \$5,000 per year. The required contributions of an employee who may receive more than this amount will be calculated on the \$5,000 maximum; if he wishes to make voluntary contributions beyond this figure, he may do so, but the state will assume no corresponding responsibility.

All new employees will enter the system after their first six months of employment; during the "probationary period" of six months they will be outside of the system, and this period will not count toward their service credit.

CONTRIBUTORY BASIS RECOMMENDED

Early in its work the Commission reached the conclusion that any proposed system should embody the "contributory" principle, under which a substantial proportion of the cost of the benefits to be derived is paid directly by employees in the form of a deduction from each salary check. The remainder of the cost of the system should be paid by the state. Under this general plan the employee contributes regularly to what is for all practical purposes a savings account which will be available for him in old age or disability, and to which the state makes very substantial payments for his benefit. It secures the active interest and cooperation of the employees and keeps the additional cost to the state within reasonable bounds. The Commission further decided that the cost as regards future service should be divided, as nearly as possible, equally between the employees and the state. Both parties expect to benefit from the retirement system and it seems reasonable that the cost of the benefits to be earned should be divided in approximately equal proportions.

SCOPE OF BENEFITS CONSIDERED

The recommendations of the Commission as to the nature and extent of benefits to be granted fall naturally into the four divisions, i. e., service retirement, disability retirement, death benefits, withdrawal benefits, recommended in the first report. In considering these four aspects of the subject, the Commission was guided by the Attorney General's opinion of December 29, 1927, which appears elsewhere in this report as a part thereof.

SERVICE RETIREMENT BENEFIT

The service retirement benefit necessarily is the fundamental feature of any system. All other benefits are relatively incidental and can be fitted to the service retirement allowance once that has been determined. The employee's prime interest is to be able to look forward to an assured income in his old age so that when he has given a lifetime of service to the state, he may be able to retire in dignity and comfort. The state as the employer desires to recognize its obligations to the people who have rendered long and faithful service, and to do it directly by means of a retirement allowance rather than by the alternative method of continuing employment far past the time of physical and mental efficiency.

Age and service are the determining factors in eligibility for service retirement. No system should be established which would encourage or permit the granting of any retirement allowance to an able-bodied person in middle life who through long experience may have just reached the peak of his value to the state. Neither will the interests of the public permit the payment of substantial retirement allowances in return for short periods of service, regardless of the age at which retirement may take place. The Commission recommends a minimum retirement age of sixty and a maximum of seventy. The maximum age would be modified for persons now in the service to the extent that none should be subject to compulsory retirement until five years after the establishment of the system, except for disability, provided there should be an absolute maximum age limit of seventy-five years for

the direct waste of money paid to aged employees who have outlived their usefulness; second, through stoppage of the indirect loss entailed by the slow pace forced upon the rest of the workers by the presence of inefficient veterans; third, through the positive gain that would result from the substitution of younger men for the superannuated employees, from the increased efficiency promoted by the retirement system and possibly from the attraction of a higher grade of men into the municipal service." It is the belief of the Commission that the establishment of a sound retirement system for state employees, such as is described in this report, would prove to be a wise and timely investment for the people of California.

ADMINISTRATION OF THE SYSTEM

It is recommended by the Commission that the retirement system be administered by a board of administration to consist of three members; namely, the president of the State Civil Service Commission, the Director of Finance and one other person to be appointed by the Governor. The members of the board will serve without pay, and may appoint a secretary as the executive officer for the board and such other employees as may be necessary. This recommendation is included in the proposed legislation.

At the public hearings it was the unanimous opinion expressed by the state employees present that the interests of the employees could best be represented upon a board of administration by the president of the State Civil Service Commission. The financial obligations involved make the selection of the Director of Finance as obviously essential. The third member is left to the judgment of the Governor.

Respectfully submitted.

COMMISSION ON PENSIONS OF STATE EMPLOYEES,

W. A. JOHNSTONE, Chairman,
J. C. WHITMAN, Commissioner,
RALPH T. FISHER, Commissioner,
JOHN F. DALTON, Commissioner.

Sacramento, California,
December 31, 1928.

APPENDIX I COPY OF ENABLING ACT

(Statutes of 1927)

CHAPTER 431

An act providing for a commission on pensions of state employees; providing for the appointment of members thereof; prescribing the powers and duties of such commission, and making an appropriation therefor.

[Approved by the Governor May 10, 1927.]

The people of the State of California do enact as follows:

SECTION 1. A commission is hereby created consisting of five members as follows: One shall be the commissioner of the state department of civil service, ex officio; four members to be appointed by the governor. The commission shall be appointed for the purpose of inquiring into the subject of retirement pensions, allowances and annuities for state officers and employees, especially with reference to the method of establishing and maintaining the fund from which such pensions, allowances and annuities shall be paid. A vacancy occurring in the office of a member of such commission shall be filled by the officer who made the original appointment.

SEC. 2. A member of the commission shall not be disqualified from holding any other office, state or municipal, nor forfeit the same by reason of his appointment under this act, notwithstanding the provisions of any city charter.

SEC. 3. Such commission shall have power to subpoena and compel the attendance of witnesses, including public officers and employees, and to require the production of books, records and papers, to take and hear proofs and testimony and adopt rules for the conduct of its proceedings.

SEC. 4. The commission shall select a chairman and vice-chairman from among its own members and may employ a secretary and such other experts and employees as may be needed, in connection with the duties of the commission, and may fix their compensation, in accordance with the provisions of the civil service act. It shall be the duty of all persons subject to the authority of the state in that behalf to aid in all proper ways in carrying into effect the provisions of this act.

SEC. 5. The members of such commission shall receive no compensation for their services, but shall be paid their actual and necessary traveling, hotel and other expenses incurred in the discharge of their duties.

SEC. 6. The commission shall on or before July 1, 1928, report the result of its inquiry to the governor and Legislature, including such proposed legislation as it may deem advisable.

SEC. 7. The sum of six thousand dollars (\$6,000) or so much thereof as may be needed is hereby appropriated for the purpose of this act,

EXHIBIT 6

1 UNITED STATES BANKRUPTCY COURT
2 EASTERN DISTRICT
3 SACRAMENTO DIVISION
4 In re:
5 CITY OF STOCKTON, CALIFORNIA, No. 12-32118
6 Debtor. Chapter 9
7 /
8
9 Deposition of
10 DAVID LAMOUREUX 30(b)(6)
11 Friday, November 16, 2012

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13
14
15
16 Reported by:
17 VICKI HAINES, CSR #5995
18 Job No. 39245
19
20
21
22
23
24
25

Page 2

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Page 6			Page 8		
1	I N D E X		1	Exhibit 446 List of Employer Funded Status	165
2			2	(Attachment to Exhibit 445)	
3	Examination by:	Page	3		
4	BY MR. NEAL	9	4	Exhibit 451 Document entitled "Addressing	172
5	BY MR. WALSH	177	5	Benefit Equity: The CalPERS	
6			6	Proposal, SB 400 (Ortiz and	
7	--o0o--		7	Burton)"	
8			8		
9	EXHIBITS		9	--oOo--	
10	DEPOSITION OF DAVID LAMOUREUX 30(b)(6)		10		
11	FRIDAY, NOVEMBER 16, 2012		11		
12			12		
13	Exhibit #	Description Page	13		
14	Exhibit 450	Notice of Deposition of 11	14		
15		California Employees'	15		
16		Retirement System	16		
17			17		
18	Exhibit 449	Subpoena in a Case Under The 16	18		
19		Bankruptcy Code to CalPERS	19		
20			20		
21	Exhibit 454	Mr. Lamoureux's bio 23	21		
22			22		
23	Exhibit 232	9-1-44 Contract Between City 35	23		
24		Council of Stockton and the	24		
25		Board of Admin of CalPERS	25		
Page 7			Page 9		
1	Exhibit 233	Amendment to Contract between 35	1	BE IT REMEMBERED that on Friday, the 16th	
2		Board of Administration, State	2	day of November, 2012, commencing at the hour of	
3		Employees' Retirement System	3	9:04 a.m. in the law offices of Orrick, Herrington &	
4		and the City Council of the	4	Sutcliffe, 400 Capitol Mall, Suite 3000, Sacramento,	
5		City of Stockton, effective	5	California, before me, Vicki Haines, a Certified	
6		7-1-48	6	Shorthand Reporter in and for the State of	
7			7	California, personally appeared	
8	Exhibit 234	Amendment to Contract between 35	8	DAVID LAMOUREUX 30(b)(6),	
9		the Board of Administration,	9	called as a witness herein, who, having been duly	
10		California Public Employees'	10	sworn, was thereupon examined and interrogated as	
11		Retirement System and the City	11	hereinafter set forth.	
12		Council of the City of Stockton	12	--o0o--	
13		dated 3-16-02	13	EXAMINATION	
14			14	BY MR. NEAL:	
15	Exhibit 433	6-19-08 letter to Trena Mayer 144	15	Q. Good morning. Could you state your full	
16		from Bill Karch/CalPERS	16	name for the record?	
17			17	A. David Lamoureux.	
18	Exhibit 452	Checklist for Amendment 159	18	Q. Mr. Lamoureux, my name is Guy Neal. I'm an	
19		Valuations For City of Stockton	19	attorney for Sidley Austin LLP. I represent in this	
20			20	case Assured Guaranty Corporation and Assured	
21	Exhibit 430	Terminating Agency Procedures 162	21	Guaranty Municipal Corporation.	
22			22	It's my understanding that your counsel	
23	Exhibit 445	3-24-11 e-mail chain between 165	23	wants to make a few remarks at the start of this	
24		Bill Karch and Edward Fong and	24	deposition.	
25		Jason Poon	25	MR. RYAN: Thanks, Guy. Yeah, this is	

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1 Q. The City of Stockton contributes to two
 2 CalPERS benefit pension systems; is that correct?
 3 A. Or to two plans, yes.
 4 Q. One plan is the Miscellaneous Plan, correct?
 5 A. Yes.
 6 Q. And one is the Safety Plan, correct?
 7 A. Yes.
 8 Q. And pursuant to the City's contract with
 9 CalPERS, CalPERS manages the investments, distributes
 10 payments and determines the liability size for each
 11 plan, correct?
 12 A. Yes.
 13 Q. And with each paycheck given to an employee,
 14 the City has to set aside money as contributions to
 15 CalPERS to pay for the incurred future liability in
 16 that year based on a certain expected rate of return,
 17 correct?
 18 MR. RYAN: Object to the form, vague and
 19 ambiguous.
 20 THE WITNESS: Yes.
 21 BY MR. NEAL:
 22 Q. And in some cases, the employee contributes
 23 an amount out of his or her paycheck as part of the
 24 employee contribution, correct?
 25 A. Yes.

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1 Q. But, in some instances, the city or a city
 2 could pay for an employee's contribution, correct?
 3 A. Yes.
 4 Q. And am I correct that the amount of these
 5 contributions is based upon the employee's age,
 6 number of years worked, amount earned at the highest
 7 salary level, and other factors that may be described
 8 in a memorandum of understanding?
 9 MR. RYAN: Objection, vague and ambiguous as
 10 to any specifics, but if you can answer the question
 11 generally.
 12 THE WITNESS: Or if you could restate. Are
 13 you asking for the employer contributions or the
 14 member contributions?
 15 BY MR. NEAL:
 16 Q. Well, let's start with the member
 17 contribution.
 18 A. This amount is set by statute. The
 19 California Legislature has set that amount.
 20 Q. And again, just so that we're speaking the
 21 same language, when you say member contribution, are
 22 you talking city or are you talking individual?
 23 A. The individual. The employees of the City
 24 of Stockton, the amount they have to contribute to
 25 CalPERS is set by the legislature, it's set in

Page 40

1 statute.
 2 Q. And the amount that the employer has to pay,
 3 how is that determined?
 4 A. Set by CalPERS on an annual basis.
 5 Q. Who at CalPERS or which division of CalPERS
 6 sets that amount?
 7 A. The actuarial office.
 8 Q. The City's retirees earn a guaranteed amount
 9 of benefits regardless of CalPERS' investment
 10 success, right?
 11 MR. RYAN: Object to the form, vague and
 12 ambiguous.
 13 THE WITNESS: Yes.
 14 BY MR. NEAL:
 15 Q. And taxpayers ultimately make up the
 16 difference between CalPERS investment returns and the
 17 benefits the City guaranteed its retirement workers,
 18 correct?
 19 MR. RYAN: Object to the form, vague and
 20 ambiguous.
 21 THE WITNESS: The City of Stockton pays us.
 22 Where they get their funds, their source of income, I
 23 cannot attest to that.
 24 BY MR. NEAL:
 25 Q. And an important number in determining how

Page 41

1 much the City must contribute per employee is the
 2 discount rate, correct?
 3 A. Correct.
 4 Q. And the discount rate is equivalent to the
 5 expected rate of return on investment of fund assets,
 6 right?
 7 MR. RYAN: Object to the form.
 8 THE WITNESS: Yes.
 9 BY MR. NEAL:
 10 Q. When CalPERS assumes -- well, let me back
 11 up.
 12 How is the discount rate set?
 13 A. A recommendation is made to our board, and
 14 our board approves it. The expected return on assets
 15 is -- plays a big role in what our chief actuary
 16 recommends to the board.
 17 Q. So when you testified that a recommendation
 18 is made to our board, who makes the recommendation?
 19 A. Our chief actuary.
 20 Q. And today that is Mr. Milligan?
 21 A. Correct.
 22 Q. When CalPERS assumes a lower return on its
 23 investment or, equivalently, a lower discount rate on
 24 future obligations, the employer must pay more up
 25 front, correct?

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<p>1 MR. RYAN: Object to the form, it's vague</p> <p>2 and ambiguous.</p> <p>3 THE WITNESS: The employer has to pay more,</p> <p>4 yes.</p> <p>5 Q. BY MR. NEAL: And in recent history, CalPERS</p> <p>6 has assumed a 7.75 percent investment rate of return,</p> <p>7 correct?</p> <p>8 A. 7.5.</p> <p>9 Q. Prior to -- when was the 7.5?</p> <p>10 A. Last March.</p> <p>11 Q. And prior to that, what was the number?</p> <p>12 A. 7.75.</p> <p>13 Q. And how long had that discount rate been in</p> <p>14 place?</p> <p>15 A. Since 2004.</p> <p>16 Q. And before that, what was the discount rate?</p> <p>17 A. 8.25.</p> <p>18 Q. How long had that been in place?</p> <p>19 A. Now you're asking -- it is before my arrival</p> <p>20 at CalPERS.</p> <p>21 Q. When you joined CalPERS in 1999 --</p> <p>22 A. It was 8.25.</p> <p>23 Q. Is the discount rate set by statute?</p> <p>24 A. No.</p> <p>25 Q. And as part of the annual valuation report</p>	<p>1 determine the normal cost, correct?</p> <p>2 A. Yes.</p> <p>3 Q. And what is the normal cost?</p> <p>4 A. The normal cost is the cost of providing one</p> <p>5 year of benefits to the current employees.</p> <p>6 Q. Now, an employer's actual contribution is</p> <p>7 often more than just the normal cost, right?</p> <p>8 MR. RYAN: Object to the form.</p> <p>9 THE WITNESS: It could be more or less.</p> <p>10 BY MR. NEAL:</p> <p>11 Q. When is it more, under what circumstances?</p> <p>12 MR. RYAN: Object to the form, vague and</p> <p>13 ambiguous, lacks foundation.</p> <p>14 THE WITNESS: I can give you more of a</p> <p>15 little actuarial 101.</p> <p>16 BY MR. NEAL:</p> <p>17 Q. Please do.</p> <p>18 A. When we -- each year when we do a valuation,</p> <p>19 when we look at all of the member information, we</p> <p>20 calculate an actuarial liability for each of the</p> <p>21 members.</p> <p>22 We then look at -- we sum up all of these</p> <p>23 individual liabilities to obtain a total liability</p> <p>24 for the plan. We compare it to the assets on hand on</p> <p>25 that same date.</p>
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<p>1 process, each year CalPERS analyzes the employer's</p> <p>2 payroll to determine the additional cost of future</p> <p>3 pension benefits based on city employment during that</p> <p>4 year; is that correct?</p> <p>5 MR. RYAN: Object to the form, vague and</p> <p>6 ambiguous, and as it refers to specific -- is this a</p> <p>7 general question or related to a specific city?</p> <p>8 MR. NEAL: Related specific to Stockton.</p> <p>9 THE WITNESS: So are you saying specific to</p> <p>10 Stockton or unspecific?</p> <p>11 BY MR. NEAL:</p> <p>12 Q. Well, I think it's the same for all, but we</p> <p>13 can explore that.</p> <p>14 A. Yes. We look to more -- we basically look</p> <p>15 each June 30th at the entire membership of the plan</p> <p>16 that includes current employees. Employees that no</p> <p>17 longer work for Stockton, but have a right to a</p> <p>18 benefit at some point in the future, and also those</p> <p>19 currently in receipt of a benefit, the retirees and</p> <p>20 their beneficiaries. We look at all of these members</p> <p>21 and assess a liability and a cost for each of them,</p> <p>22 and this plays a role later on in how much the City</p> <p>23 of Stockton or any employer has to contribute to</p> <p>24 CalPERS to properly fund these benefits.</p> <p>25 Q. And through this process, you set or</p>	<p>1 In cases where the assets are below what the</p> <p>2 liabilities are, the employer is asked -- there is</p> <p>3 what we call an unfunded liability on a funding</p> <p>4 basis, that we ask the employer to contribute more</p> <p>5 than normal cost to reduce the unfunded liability.</p> <p>6 In times when the assets are greater than</p> <p>7 the liabilities, there is what we call a surplus, and</p> <p>8 the opposite occurs where we ask the employer to</p> <p>9 contribute less than the normal cost.</p> <p>10 Q. And that unfunded actuarial liability is</p> <p>11 also referred to as the unfunded accrued actuarial</p> <p>12 liability?</p> <p>13 A. Yes.</p> <p>14 Q. And that's UAAL, correct?</p> <p>15 A. Yes.</p> <p>16 Q. And the UAAL is the difference between the</p> <p>17 retirement system's actuarial value of assets and its</p> <p>18 actuarial accrued liability; do I have that right?</p> <p>19 A. We report two values of the -- for</p> <p>20 rate-setting purposes, for purposes of setting the</p> <p>21 contribution requirements that the City of Stockton</p> <p>22 or any employer at CalPERS has to pay in any given</p> <p>23 year, the unfunded liability we use for that purpose</p> <p>24 is the actuarial value of assets compared to the</p> <p>25 accrued liability, so you are correct. The unfunded</p>

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1 then we have the ability to move down the path of
 2 actually terminating. In some cases, we have to go
 3 in front of our board for them to make the final
 4 decision, but we have -- we have the ability to go
 5 ahead and terminate.
 6 BY MR. NEAL:
 7 Q. You talked about a path leading to
 8 termination --
 9 A. Yes.
 10 Q. -- can you take me down the steps of the
 11 path?
 12 MR. RYAN: Object to the form, outside the
 13 scope.
 14 THE WITNESS: Yeah. Since in many cases it
 15 doesn't come from our area, I won't be able to answer
 16 you exactly.
 17 We have a collections unit in our fiscal
 18 services branch at CalPERS. They are usually the one
 19 attempting to collect the information from the
 20 employer. Now, what the process is, I cannot answer
 21 to that. I know that our legal office is involved
 22 usually as well. So that's the extent of what I
 23 think I can provide you on this.
 24 And us, the actuarial office, are not part
 25 of that process. We are generally not part of that

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1 process. We accept what the contribution requirement
 2 is. Other areas of CalPERS are there to make sure
 3 that that money is given to CalPERS.
 4 BY MR. NEAL:
 5 Q. Since you've been employed at CalPERS, has
 6 CalPERS ever terminated a contracting agency for
 7 nonpayment?
 8 A. Yes.
 9 MR. RYAN: Belated objection, outside the
 10 scope.
 11 BY MR. NEAL:
 12 Q. How often has that occurred?
 13 MR. RYAN: Same objection.
 14 THE WITNESS: I cannot recall exactly. It's
 15 not a lot, but I cannot -- you know, is it five, is
 16 it ten, is it 15?
 17 BY MR. NEAL:
 18 Q. You don't know?
 19 A. I don't know. It's a small amount. I do
 20 not know the exact number.
 21 Q. Do you know if, with respect to any of those
 22 terminations, there was an unfunded liability?
 23 MR. RYAN: Same objections.
 24 THE WITNESS: There was always an unfunded
 25 liability at termination. Whether it's a positive

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1 one that we call -- that they owe money to CalPERS or
 2 it's a surplus, there was always -- it never, never
 3 works out that the assets exactly equal the
 4 liabilities. It's -- in cases of a shortfall, we ask
 5 the employer to make up the difference. In cases of
 6 a surplus, we write them a check and give them the
 7 difference.
 8 BY MR. NEAL:
 9 Q. In how many terminations has there been a
 10 shortfall --
 11 MR. RYAN: Same objection.
 12 BY MR. NEAL:
 13 Q. -- out of the pool of terminated cities,
 14 during the term of your employment?
 15 MR. RYAN: Same objection.
 16 THE WITNESS: I cannot recall.
 17 BY MR. NEAL:
 18 Q. How many had a surplus?
 19 MR. RYAN: Same objection.
 20 THE WITNESS: All I can tell you is we had
 21 one last year that I recall that we had a surplus.
 22 BY MR. NEAL:
 23 Q. And the one last year concerned which
 24 agency?
 25 A. I cannot recall the name of the agency.

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1 Q. Did any of these terminations involve a
 2 city?
 3 A. No.
 4 Q. A county?
 5 A. No.
 6 Q. Would they have concerned -- what types of
 7 entities did they concern?
 8 MR. RYAN: Same objection to the line of
 9 questioning. I think the whole -- any terminations
 10 that don't relate directly to Stockton are outside
 11 the scope, but I have a running objection on that,
 12 okay?
 13 MR. NEAL: Yes, running objection is okay.
 14 MR. RYAN: To the extent that you know,
 15 please --
 16 THE WITNESS: They were special district. I
 17 can't recall exactly if it was a fire district, a
 18 mosquito abatement district, cemetery district. We
 19 have 500 employers at CalPERS that have less than ten
 20 members, and we have many that have only one
 21 employee, very small districts. Most of the
 22 terminations we have done have involved very small
 23 employers.
 24 BY MR. NEAL:
 25 Q. And your definition of very small would be

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<p>1 ten or under?</p> <p>2 A. Yes.</p> <p>3 Q. What's the largest terminated agency that</p> <p>4 you can recall?</p> <p>5 A. I cannot recall. I'm usually -- in most</p> <p>6 cases, I'm not privy to the calculation because it's</p> <p>7 done by the actuary who is assigned to the plan, in</p> <p>8 most cases. Sometimes I'll see a list of here is who</p> <p>9 terminated, but I generally don't see the --</p> <p>10 Q. Does CalPERS keep a list of agencies that</p> <p>11 have terminated?</p> <p>12 A. Yes, we have a list and, if you want to get</p> <p>13 that list -- because once they terminate, they go</p> <p>14 into what we call the Terminated Agency Pool, so we</p> <p>15 have a list, and we do a valuation for that pool once</p> <p>16 a year, and we have the list. I believe it's</p> <p>17 somewhere between 100 to 200 agencies in that</p> <p>18 Terminated Agency Pool.</p> <p>19 Q. Yep, I will take you up on the offer for</p> <p>20 that list, thank you.</p> <p>21 A. Okay.</p> <p>22 Q. So today there is a Terminated Agency Pool,</p> <p>23 correct?</p> <p>24 A. Yes.</p> <p>25 Q. And what is a Terminated Agency Pool?</p>	<p>1 back to employers after termination to ask for more</p> <p>2 money.</p> <p>3 So that's why at termination we ask that</p> <p>4 they be 100 percent funded on a termination liability</p> <p>5 basis because we now become the guarantor of the</p> <p>6 benefits.</p> <p>7 Q. You mentioned two situations, and for</p> <p>8 clarity of the record, I want to make sure we have</p> <p>9 both of them, and you may have given them. I want to</p> <p>10 break it down.</p> <p>11 You provided one situation, I believe, that</p> <p>12 concerned an employer asking to terminate so they</p> <p>13 could move to a city or county retirement plan. Do</p> <p>14 you recall your testimony?</p> <p>15 A. Yes, that's correct.</p> <p>16 Q. And one example you gave was Los Angeles?</p> <p>17 A. Yes.</p> <p>18 Q. And the other was the --</p> <p>19 A. City and County of San Francisco Retirement</p> <p>20 System.</p> <p>21 Q. And the City and County of San Francisco,</p> <p>22 that was in the past couple of years?</p> <p>23 A. Yes.</p> <p>24 Q. What about the City of Los Angeles?</p> <p>25 A. It happened since I was at CalPERS. I think</p>
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<p>1 A. When an employer terminates their contract</p> <p>2 with CalPERS, we have seen two situations occur in</p> <p>3 the past. One that's not as common is an employer</p> <p>4 will contact us and ask to terminate their contract</p> <p>5 with us because they want to now participate in a</p> <p>6 different retirement system, like the Los Angeles</p> <p>7 County Employee Retirement System.</p> <p>8 In this case, we simply give them the money</p> <p>9 they have with CalPERS, and we let them go because</p> <p>10 now it's the responsibility of the new retirement</p> <p>11 system to make sure these liabilities are properly</p> <p>12 funded. And by law, we have an agreement with a few</p> <p>13 retirement systems to allow these transfers.</p> <p>14 We did one just a two or three years ago</p> <p>15 with the City and County of San Francisco Retirement</p> <p>16 System. We had the Airport Police still contracting</p> <p>17 with CalPERS, the San Francisco Airport Police, so</p> <p>18 they wanted to move to the City and County Retirement</p> <p>19 System and we gave them a check for their money, and</p> <p>20 they went over there.</p> <p>21 Usually what happens is an employer</p> <p>22 terminates their contract, either because they go out</p> <p>23 of existence or for whatever reason, and CalPERS now</p> <p>24 becomes the guarantor of the benefits. We are</p> <p>25 responsible to pay the benefits. We have no recourse</p>	<p>1 it was in the early 2000s.</p> <p>2 Q. That's one situation. Is there another</p> <p>3 situation?</p> <p>4 A. No, because -- the law is very specific as</p> <p>5 to -- the law actually allows for transfers between</p> <p>6 CalPERS and the LACERA system. That's the Los</p> <p>7 Angeles County Employee Retirement. And the law had</p> <p>8 to be changed for that transfer to occur between San</p> <p>9 Francisco and CalPERS because the law had not allowed</p> <p>10 for that transfer. So the law was changed, and once</p> <p>11 the law was changed, we terminated their contract</p> <p>12 with us and provided -- gave the money to City and</p> <p>13 County of San Francisco Retirement System, and that</p> <p>14 was the end of our involvement.</p> <p>15 We did not require them to fully fund</p> <p>16 because we knew that the county would then be</p> <p>17 administrating everything, and their actuaries would</p> <p>18 make sure -- you know, the City and County of San</p> <p>19 Francisco have their own actuaries, and they do their</p> <p>20 own valuations, so we kind of pass all the</p> <p>21 responsibilities to pay benefits, invest the money to</p> <p>22 the other retirement system.</p> <p>23 So that's the one way we terminate the</p> <p>24 contract that involves -- you know, that. So,</p> <p>25 basically, we give the obligation -- we give the</p>

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<p>1 administration of the benefits and paying those</p> <p>2 benefits out to a different retirement system.</p> <p>3 Q. And that different retirement system assumes</p> <p>4 all benefits and also assumes all liabilities?</p> <p>5 A. The retirement system in this case, they</p> <p>6 don't assume the liabilities. It's just the employer</p> <p>7 now gives the contribution to the new retirement</p> <p>8 system to properly fund the plan rather than giving</p> <p>9 them to CalPERS.</p> <p>10 Q. Such that the City and County of San</p> <p>11 Francisco are not placed in the Terminated Agency</p> <p>12 Pool?</p> <p>13 A. Correct, yes. Because remember, the only</p> <p>14 time they go into the Terminated Agency Pool was</p> <p>15 especially because of vested rights. You know,</p> <p>16 currently, an employer cannot just come in and simply</p> <p>17 terminate their plan just for the purpose of stopping</p> <p>18 to provide benefits. The law does not -- no.</p> <p>19 So, generally, it's either they want to move</p> <p>20 to a different retirement system which involves a</p> <p>21 termination of their contract with CalPERS. Or let's</p> <p>22 say they go out of existence, they don't have any</p> <p>23 active employees anymore, and they terminate their</p> <p>24 contract with CalPERS, and then CalPERS takes over</p> <p>25 the responsibility of guaranteeing the benefits and</p>	<p>1 have to worry about that. That allows CalPERS, in</p> <p>2 the event of a termination where the employer, after</p> <p>3 we have exhausted all efforts to collect funds, it</p> <p>4 provides the ability to CalPERS to not collect that</p> <p>5 shortfall if the chief actuary has determined that it</p> <p>6 will not hurt the actuarial soundness of the</p> <p>7 Terminated Agency Pool.</p> <p>8 And if you read the 20577.5, I believe these</p> <p>9 are the exact words that are used: That it will not</p> <p>10 impact the actuarial soundness of the Terminated</p> <p>11 Agency Pool. And we have invoked that provision the</p> <p>12 last, I think, for two or three of those earlier this</p> <p>13 year. And, again, they were very small, in some</p> <p>14 cases owing CalPERS like \$10,000.</p> <p>15 Q. Has there been a circumstance to your</p> <p>16 knowledge where CalPERS has not invoked that</p> <p>17 provision?</p> <p>18 A. Yes, where we have actually reduced</p> <p>19 benefits, yes. And for those we have to go in front</p> <p>20 of our board. Our chief actuary cannot make that</p> <p>21 determination.</p> <p>22 Q. What exact determination are you referring</p> <p>23 to?</p> <p>24 A. So, we can only -- if -- we have a board</p> <p>25 policy that says that in the event of a termination</p>
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<p>1 paying everything. So if -- yeah.</p> <p>2 Q. I understand, thank you.</p> <p>3 Has CalPERS ever terminated an agency for</p> <p>4 nonpayment?</p> <p>5 A. Yes.</p> <p>6 Q. How many times?</p> <p>7 A. How many times?</p> <p>8 MR. RYAN: Same objection.</p> <p>9 BY MR. NEAL:</p> <p>10 Q. Yeah.</p> <p>11 A. I can't recall, but I believe we had either</p> <p>12 three, four or five earlier this year.</p> <p>13 Q. And in each of those instances, there were a</p> <p>14 very few number of members; is that correct?</p> <p>15 A. Correct.</p> <p>16 Q. Was there a surplus in each of those</p> <p>17 instances?</p> <p>18 A. I think, as I mentioned before, only one had</p> <p>19 a surplus.</p> <p>20 Q. All others had a shortfall?</p> <p>21 A. Correct.</p> <p>22 Q. And did the contracting agency pay the</p> <p>23 shortfall in full?</p> <p>24 A. Not on all cases. There is a section of the</p> <p>25 law, 577.5 -- sorry. 20577.5, to be precise, so we</p>	<p>1 because of nonpayment, if we are able to invoke the</p> <p>2 requirement of -- what is stated in 20577.5, that we</p> <p>3 cannot reduce the benefit and it will not hurt the</p> <p>4 actuarial soundness of the Terminated Agency Pool,</p> <p>5 then our chief actuary has the authority to proceed.</p> <p>6 If our actuary determines it will hurt the</p> <p>7 actuarial soundness of the pool to not reduce the</p> <p>8 benefits, then it goes to our board for them to</p> <p>9 approve the reduction in benefits.</p> <p>10 Q. And there have been circumstances where the</p> <p>11 CalPERS board has approved a reduction in benefits?</p> <p>12 A. Yes, once since I have been at CalPERS, and</p> <p>13 it was done in an open session.</p> <p>14 Q. Do you recall what year?</p> <p>15 A. Probably four or five years ago.</p> <p>16 Q. Do you recall the agency?</p> <p>17 A. Instead of giving you the wrong name, you</p> <p>18 know -- I believe I remember, but instead of giving</p> <p>19 you a wrong name, if you're really interested, I can</p> <p>20 provide it afterward.</p> <p>21 Q. Okay, thank you. I'll make that request.</p> <p>22 And what was the magnitude of the reduction</p> <p>23 of benefit?</p> <p>24 A. In this case, unfortunately, we have to go</p> <p>25 back and tell the members: Your employer never gave</p>

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1 us any money, you're not going to get any benefits at
 2 all.
 3 It was an employer that contracted with
 4 CalPERS that was just -- we tried to collect
 5 information from them, contributions. They were
 6 not -- so we just terminated their contract and sent
 7 a letter to their members: You may have been told by
 8 your employer that you will get a CalPERS benefit,
 9 but they never complied with our rules, never gave us
 10 any money. We apologize, but you're not going to get
 11 a benefit from us.
 12 Q. So the date of contract and the date of
 13 termination was pretty close together?
 14 A. No. It takes time to try to collect
 15 everything. It's not going to be two months.
 16 Q. But within two years, I would imagine,
 17 right?
 18 A. I cannot recall. I was not --
 19 Q. In that circumstance, do those employees get
 20 the benefit of monies that are in the Terminated
 21 Agency Pool?
 22 A. In what?
 23 Q. In the circumstance that you just testified
 24 to, the agency you couldn't recall in which the
 25 contracting agency made no payments, and you sent the

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1 letter out to the members stating you're not going to
 2 get any benefits.
 3 A. Yes.
 4 Q. They in fact received no benefits, right,
 5 they did not get put into the pool?
 6 A. There was nothing to put in the pool because
 7 by having no benefits, they have no liabilities and
 8 no assets. You can say we added them to the pool,
 9 but it added zero to both sides. I think in this
 10 case, I think it was more voiding -- the contract, I
 11 guess, never existed, but I don't know.
 12 Q. Are the assets and liabilities of each
 13 terminated agency kept segregated or are they pooled
 14 together?
 15 A. They are pooled together into one big
 16 account. We have no way to know how much belongs
 17 to -- you know, the liabilities we can, but not the
 18 assets.
 19 Q. And what is the current state of the assets
 20 and liabilities of the Terminated Agency Pool?
 21 MR. RYAN: Object to the form, outside the
 22 scope.
 23 If you know.
 24 THE WITNESS: We will present the results to
 25 our board in December of June 30th, 2011. If I

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1 recall, the liabilities are in the neighborhood of
 2 \$90 million and the assets in the neighborhood of
 3 180. So it's about 200 percent funded. So it has
 4 about \$90 million surplus.
 5 And again, I think the actual results will
 6 be made public to our board in December.
 7 BY MR. NEAL:
 8 Q. Are prior years' results made public as
 9 well?
 10 A. We have never in the past -- we have done
 11 the calculation internally, but we have never
 12 presented it to our board in the past. But we -- our
 13 chief actuary has asked us to start presenting the
 14 results to the board for the Terminated Agency Pool.
 15 But we have done the valuation internally every
 16 single year. We have done the calculations. We have
 17 not published an official report, but we have done a
 18 calculation of the assets and liabilities every year
 19 because it's our duty to make sure that the pool is
 20 properly funded.
 21 Q. If Stockton were terminated, its assets
 22 would be put into the Terminated Agency Pool?
 23 A. And liabilities.
 24 Q. And its liabilities?
 25 A. Correct. Unless they were to ask to move to

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1 a different retirement system which, again, I'm not
 2 sure that the law would allow right now, but if it
 3 were to come to that, then they would not go into the
 4 Terminated Agency Pool.
 5 Q. Does the law that you referred to in your
 6 prior testimony, is it specific to Los Angeles and
 7 San Francisco or --
 8 A. If I recall, I believe that the law that
 9 existed before allowed a transfer to the Los Angeles
 10 County Retirement System and one more that I can't
 11 recall right now, and then it had to be changed to
 12 allow to do it with City and County of San Francisco.
 13 Q. It's specific as to the contracting agency?
 14 A. No, it's specific to the retirement system
 15 that said that transfers can occur between CalPERS
 16 and the Los Angeles County Retirement System.
 17 Q. Describe to me how Stockton's hypothetical
 18 termination liability would be calculated?
 19 A. What do you mean by "would be" because it's
 20 already been calculated here.
 21 Q. Thank you.
 22 A. No, no, I was just wondering --
 23 Q. No, that's very helpful. I appreciate the
 24 precision, I do.
 25 A. Correct, I'm an actuary, I want precision

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1 before I answer.
 2 So, in this case, for 6-30-11 -- remember,
 3 we are presenting the information based on the
 4 membership and information we had in place on
 5 June 30th, 2011.
 6 So the purpose of this is if Stockton had
 7 terminated their contract on June 30th, 2011, and we
 8 had invested the assets, in accordance with the
 9 direction our board has given us to immunize the
 10 liabilities, we -- and I -- the question didn't come
 11 up, but in August, 2011 when our board adopted --
 12 when our board gave staff the direction to change the
 13 way the assets are invested for the Terminated Agency
 14 Pool, they also adopted a board policy on the
 15 discount rate for the Terminated Agency Pool. And
 16 it's -- the policy does not have a discount rate
 17 stated in it. It has a method to derive what the
 18 discount rate should be that involves looking at
 19 duration of liabilities and durations of 30-year
 20 treasury bonds and 10-year treasury bonds. We do a
 21 calculation based on that policy, and the answer we
 22 got, on June 30th, 2011, based on the rates that
 23 were -- the treasury rates that were in effect on
 24 June 30, 2011, the answer was 4.82 percent.
 25 So, if you look at the number here, had they

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1 terminated on June 30, 2011, and had we been able to
 2 invest the assets at the rates that were in effect
 3 back then, the liabilities would have been about --
 4 for this plan, \$1.186 billion. Since their assets,
 5 the market value is only 598 million, that leaves a
 6 shortfall of \$588 million. The unfunded liability,
 7 the shortfall on termination, had they terminated
 8 back in 2011 would have been 588 million.
 9 In this report -- and when we have
 10 conversations with employers, we make sure they are
 11 aware of the way our board has moved toward investing
 12 the Terminated Agency Pool. Now, as a result, the
 13 liabilities at termination are very sensitive to
 14 interest rates, especially treasury rates in the
 15 market. This is why we inserted that sentence that
 16 you have highlighted in your report, the last
 17 sentence just above the table that says that we want
 18 to give them a heads-up that please note that as of
 19 June 30, 2012, the 30-year U.S. Treasury strip coupon
 20 rate was now 2.87 percent.
 21 This is just to give them a heads-up that a
 22 year from now when we do the 2012 valuation telling
 23 them what their termination liability would have been
 24 had they terminated back in 2012, it's going to be
 25 even higher than what we show here.

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1 Q. Such that their unfunded termination
 2 liability was --
 3 A. Would be even higher. And if they were to
 4 come today to say we want to terminate our contract
 5 with CalPERS, the rates today, if you keep -- you
 6 know, if you're looking to refinance to buy a home,
 7 you're probably very happy right now. I don't know
 8 exactly what it is, but I think it's now below
 9 two percent, what the 30-year treasury rate is. I
 10 may be mistaken, but it's much lower than the
 11 2.87 percent you see there.
 12 So our intent going forward is that table
 13 will be a historical table. We will keep at least
 14 five years of information similar to the two tables
 15 above to help an employer understand that the point
 16 in time to terminate now will have a big influence.
 17 Like the interest rate in the market at the time of
 18 termination will have a big influence on what the
 19 amount owed at termination will be.
 20 Q. On the date of termination?
 21 A. On the date of termination.
 22 And we have processes set in place at
 23 CalPERS with respect -- you know, they call us today
 24 and say, "I want to terminate tomorrow," the
 25 effective date is not going to be tomorrow. There

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1 are different processes in place by law, depending on
 2 who asks for the termination.
 3 Q. But the discount rate reflected here on page
 4 15 of 4.82 percent, that's not provided by law,
 5 that's provided by board policy?
 6 A. Board policy, yeah, and it's the rate
 7 that -- if you want, that links to the valuation
 8 date. This is what we would have been able to obtain
 9 on our investments had we terminated them on June 30,
 10 2011.
 11 Q. And that is because the assets are invested
 12 differently after termination, correct?
 13 A. Correct, in a much more conservative
 14 fashion, mostly because we have no recourse back to
 15 employers. So we don't want to leave the money all
 16 in the stock market because, if it tanks, then we
 17 don't have enough money to pay the benefits. It's
 18 never gotten to that, but that's the reason we do
 19 that. We don't want to ever get to that point where
 20 we don't have enough money to pay benefits because we
 21 cannot go back to employers and tell them and ask for
 22 additional contribution from them. And also, most of
 23 the employers that have already terminated their
 24 contract with CalPERS are no longer in existence.
 25 Q. Has there ever been a termination of an

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<p>1 or not those folks ultimately did or did not get 2 their pension benefits? 3 MR. RYAN: Speculation. 4 THE WITNESS: I cannot answer that question. 5 BY MR. WALSH: 6 Q. CalPERS would have no financial stake in 7 whether or not the members of those pools that might 8 have transferred got their pension benefits going 9 forward? 10 MR. RYAN: Same objection. 11 THE WITNESS: Yeah, there would be no direct 12 financial impact to CalPERS, yeah. 13 BY MR. WALSH: 14 Q. You mentioned the difference between the 15 discount rate for the ongoing agencies and the 16 discount rate for terminated agencies. Do you recall 17 that testimony? 18 A. Yes. 19 Q. And the discount rate for terminated 20 agencies is lower, that I recall, correct? 21 A. Yes. 22 Q. And you discussed immunization; do you 23 recall that? 24 A. Yes. 25 Q. You also discussed an August 2011 change to</p>	<p>1 Q. What was the policy before the immunization 2 policy with respect to this sort of issue? 3 MR. RYAN: Outside the scope. 4 THE WITNESS: The Terminated Agency Pool 5 assets prior to the adoption of that policy were 6 invested in the same fashion as other assets of the 7 PERF, as listed on page 20 of Exhibit 423. 8 BY MR. WALSH: 9 Q. And the PERF is the Public Employees' 10 Retirement Fund? 11 A. Correct. 12 Q. And that is the -- currently, the single 13 fund where all CalPERS members have their assets 14 invested? 15 A. Most CalPERS members have their assets 16 invested, yes. 17 Q. Was the Terminated Agency Pool just part of 18 the PERF before the August 2011 changes or was it 19 still separate from the PERF? 20 MR. RYAN: Outside the scope. 21 If you know. 22 THE WITNESS: It's part of the PERF. It was 23 part of the PERF, yes. 24 BY MR. WALSH: 25 Q. And when did the August 2011 policy changes</p>
Page 187	Page 189
<p>1 the policy. Do you recall that? 2 A. Yes. 3 Q. I'm trying to tie it altogether. I have 4 three different ideas. I'd like to ask your help in 5 helping me tie this together. 6 The immunization policy, is that an effect 7 or ramification of the August 2011 change of policy? 8 A. Yes. 9 Q. And in effect, does that suggest that going 10 forward CalPERS wants to have zero risk with respect 11 to terminated pools? 12 MR. RYAN: Calls for speculation. 13 BY MR. WALSH: 14 Q. I'm going to restate the question, actually. 15 The immunization policy is designed so that 16 CalPERS would have zero investment risk with respect 17 to a terminated pool? 18 MR. RYAN: Calls for speculation, outside 19 the scope. 20 MR. WALSH: You can answer. 21 THE WITNESS: It was done in an attempt to 22 reduce the risk. I don't think -- whether it's zero 23 or not, basically it's a change in investment policy 24 into a more conservative asset mix. 25 BY MR. WALSH:</p>	<p>1 become effective? 2 MR. RYAN: Same. 3 THE WITNESS: As I mentioned this morning, 4 our board is expected to adopt the official policy 5 exactly how much bonds in December. A discussion 6 took place earlier this week, and in December they 7 are expected to finalize the actual asset allocation 8 for that fund. 9 BY MR. WALSH: 10 Q. And as of today, the Terminated Agency Pool 11 is a separate pool from the PERF? 12 MR. RYAN: Outside the scope. 13 THE WITNESS: Yeah. To me, it is part of 14 the PERF, but the PERF is comprised of multiple 15 little pools, so it is one of the pool within the 16 PERF. 17 As you remember, we keep track of the assets 18 by the employers. They're all in the PERF. It's 19 like you and me investing in the same mutual fund. 20 We're part of the same mutual fund, but your assets 21 are not mine. 22 BY MR. WALSH: 23 Q. Now, the different discount rate utilized 24 with respect to the Terminated Agency Pool, can you 25 tell me the components that go into determining what</p>

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<p>1 that rate is?</p> <p>2 MR. RYAN: Objection, outside the scope.</p> <p>3 THE WITNESS: I apologize, my mind was</p> <p>4 drifting for a second. Would you mind restating the</p> <p>5 question?</p> <p>6 BY MR. WALSH:</p> <p>7 Q. Certainly.</p> <p>8 The different discount rates that apply to</p> <p>9 the Terminated Agency Pool, could you tell me what</p> <p>10 components go into determining that discount rate?</p> <p>11 MR. RYAN: Same objection.</p> <p>12 THE WITNESS: I know you said the different</p> <p>13 discount rate, but we only have one discount rate for</p> <p>14 the Terminated Agency Pool.</p> <p>15 Every discount rate we use at CalPERS is a</p> <p>16 reflection of the asset policy or how the assets are</p> <p>17 invested. So on the PERF, we have more aggressive</p> <p>18 asset mix. We use public equities, private equities.</p> <p>19 We have a discount rate of seven-and-a-half, which is</p> <p>20 a reflection of how it's invested.</p> <p>21 The discount rates for the Terminated Agency</p> <p>22 Pool is a reflection of how now these assets will be</p> <p>23 invested, which will be using mostly treasury bonds.</p> <p>24 So we have -- our board has adopted a policy</p> <p>25 right now that we use in setting the discount rate</p>	<p>1 understanding of the law that permits CalPERS in</p> <p>2 certain instances to transfer members to other</p> <p>3 retirement systems.</p> <p>4 Do you recall that testimony?</p> <p>5 A. Yes.</p> <p>6 Q. And you mentioned the Los Angeles Retirement</p> <p>7 System?</p> <p>8 A. Yes.</p> <p>9 Q. And you mentioned the San Francisco</p> <p>10 Retirement System?</p> <p>11 A. Yes.</p> <p>12 Q. Is it correct that there might be one more,</p> <p>13 but you couldn't recall what that was?</p> <p>14 MR. RYAN: It's outside the scope.</p> <p>15 THE WITNESS: Correct. I believe there is</p> <p>16 one more, but I may be wrong, but that's my</p> <p>17 understanding from past recollection.</p> <p>18 BY MR. WALSH:</p> <p>19 Q. So if Stockton could persuade, say, the San</p> <p>20 Francisco Retirement System to accept the current</p> <p>21 members of the Stockton retirement plan, there would</p> <p>22 be no termination payment required to CalPERS?</p> <p>23 MR. RYAN: Calls for speculation, outside</p> <p>24 the scope, assumes facts not in evidence.</p> <p>25 THE WITNESS: To the extent it's done in</p>
Page 191	Page 193
<p>1 for the Terminated Agency Pool, which is a reflection</p> <p>2 of how the assets will be invested. As I mentioned</p> <p>3 earlier this morning, it's a mix. The policy states</p> <p>4 that we have to look at the duration of our</p> <p>5 liabilities, compare it to the duration of ten-year</p> <p>6 treasury bonds and 30-year treasury bonds. We apply</p> <p>7 a formula. And for the June 30th, 2011, the answer</p> <p>8 we got was 4.82 percent.</p> <p>9 On June 30, 2012, as we stated in our</p> <p>10 report, on page 15 of Exhibit 423, it will be</p> <p>11 2.87 percent. And again, it's a reflection of the</p> <p>12 rates because we are going to invest -- we are</p> <p>13 investing in bonds, in treasury bonds. It's related</p> <p>14 directly to the rates in effect at that time. So</p> <p>15 today, that rate is even lower.</p> <p>16 BY MR. WALSH:</p> <p>17 Q. If the City of Stockton were to terminate</p> <p>18 its pension plans, over what period would CalPERS</p> <p>19 expect the termination of liability to be funded?</p> <p>20 MR. RYAN: Calls for speculation.</p> <p>21 THE WITNESS: When an employer terminates</p> <p>22 and we calculate how much is owed at termination, we</p> <p>23 seek these funds immediately.</p> <p>24 BY MR. WALSH:</p> <p>25 Q. You testified this morning about your</p>	<p>1 similar fashion to how we did it in the past when</p> <p>2 CalPERS agreed to this, then I would assume we would</p> <p>3 agree to it, but I'm not a position to tell you what</p> <p>4 would be CalPERS' position, what our board would say,</p> <p>5 but we have done it in the past so I don't see -- you</p> <p>6 know, assuming everything else is the same.</p> <p>7 BY MR. WALSH:</p> <p>8 Q. But when it was done in the past, was there</p> <p>9 any requirement that the new retirement system</p> <p>10 provide the same level of benefits as were previously</p> <p>11 provided by CalPERS, or was that matter that was not</p> <p>12 of interest to CalPERS?</p> <p>13 MR. RYAN: Outside the scope.</p> <p>14 THE WITNESS: In all instances that I'm</p> <p>15 aware, the same level of benefits were provided with</p> <p>16 the other retirement system.</p> <p>17 BY MR. WALSH:</p> <p>18 Q. And once the members were enrolled in the</p> <p>19 other retirement system, are you aware of whether</p> <p>20 CalPERS -- and once the members were enrolled in the</p> <p>21 other retirement system, are you aware whether</p> <p>22 CalPERS had any residual financial obligation or</p> <p>23 stake with respect to those members?</p> <p>24 MR. RYAN: Outside the scope, foundation.</p> <p>25 THE WITNESS: I don't believe we had</p>

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1 anything -- we had no financial stakes anymore after.
 2 We provided them the assets, and the liabilities went
 3 to the other retirement system.
 4 MR. WALSH: I think that's all I have at the
 5 moment, sir. Thank you very much.
 6 MR. NEAL: Mike? Mike Gardener, are you on
 7 the line and do you have any questions?
 8 MR. WALSH: He probably forgot to unmute.
 9 MR. RYAN: Going once --
 10 (Whereupon, an off-the-record discussion was held.)
 11 MR. NEAL: Does the City have any questions?
 12 MR. LUTTERMAN: No.
 13 MR. KILLEEN: No.
 14 MR. NEAL: Thank you very much. This
 15 concludes today.
 16 (Brief off-the-record discussion.)
 17 MR. NEAL: Why don't we go on the record for
 18 one more minute.
 19 MR. RYAN: This is Mike Ryan on behalf of
 20 CalPERS. We are reserving signature on this
 21 transcript.
 22 MR. NEAL: Off the record.
 23 (Deposition concluded at 3:27 p.m.)
 24 --o0o--
 25

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1 CERTIFICATE OF DEPONENT
 2
 3 I hereby certify that I have read and examined the
 4 foregoing transcript, and the same is a true and
 5 accurate record of the testimony given by me.
 6 Any additions or corrections that I feel are
 7 necessary, I will attach on a separate sheet of
 8 paper to the original transcript.
 9
 10 _____
 11 Signature of Deponent
 12
 13 I hereby certify that the individual representing
 14 himself/herself to be the above-named individual,
 15 appeared before me this _____ day of _____,
 16 2012, and executed the above certificate in my
 17 presence.
 18
 19 _____
 20 NOTARY PUBLIC IN AND FOR
 21
 22 _____
 23 County Name
 24
 25 MY COMMISSION EXPIRES:

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1 CERTIFICATE OF REPORTER
 2 I, VICKI HAINES, a Certified Shorthand
 3 Reporter, hereby certify that the witness in the
 4 foregoing deposition was by me duly sworn to tell the
 5 truth, the whole truth and nothing but the truth in
 6 the within-entitled cause;
 7 That said deposition was taken down in
 8 shorthand by me, a disinterested person, at the time
 9 and place therein stated, and that the testimony of
 10 the said witness was thereafter reduced to
 11 typewriting, by computer, under my direction and
 12 supervision;
 13 That before completion of the deposition,
 14 review of the transcript was requested. If
 15 requested, any changes made by the deponent (and
 16 provided to the reporter) during the period allowed
 17 are appended hereto.
 18 I further certify that I am not of counsel or
 19 attorney for either or any of the parties to the said
 20 deposition, nor in any way interested in the event of
 21 this cause, and that I am not related to any of the
 22 parties thereto.
 23 DATED: NOVEMBER 23, 2012
 24
 25 _____
 VICKI HAINES, CSR #5995

EXHIBIT 7



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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

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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

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Documents Generated During Assembly Deliberations

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BILL ANALYSIS

AB 1648 (CHACON)

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California Legislature

Assembly Committee

on

Public Employees and Retirement

CURTIS R. TUCKER

CHAIRMAN

DAVE COX
SENIOR CONSULTANT
ROBBIN LEWIS-COAXUM
ASSOCIATE CONSULTANT
DEBORAH REED
COMMITTEE SECRETARY
STATE CAPITOL BUILDING
SACRAMENTO, CALIFORNIA
95814
(916) 322-4320

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

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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 securities, 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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BILL ANALYSIS
AB 1648 (Chacon)
Original

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Furthermore, this bill replaces the reference to an acceptable list of securities with a provision authorizing the Board to adopt detailed guidelines concerning the acceptability of real property or securities 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 occurring as late as the morning of the 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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BILL ANALYSIS
AB 1648 (Chacon)
Original

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The pursuit of subrogation rights has been an expensive, complex, time-consuming process. Evolving case law 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
 other _____

Hearing Date: July 2, 1981

Urgency: Yes No

State Mandated Local Program:
 Yes No

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.

ml: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.

<u>Fiscal Year</u>	<u>Gross Amount Collected</u>	<u>Collection Costs</u>	<u>Net Amount Collected</u>	<u>Collection Costs as Percent of Gross</u>
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.

71

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

PUBLIC EMPLOYEES' RETIREMENT SYSTEM
FLOOR STATEMENT
AB 1648

Handwritten scribbles and the number 1351 in a circle.

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 ARBITRARY 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.

EXHIBIT 8

From: Milligan, Alan
Sent: Wednesday, January 02, 2013 4:08 PM
To: 'Teresia Haase'
Cc: Ratto, Gina; Sturm, Kelly
Subject: RE: City of Stockton - Request for Hardship Funding Extension

Teresia Haase
Director of Human Resources
City of Stockton

Thank you for your letter of December 4th requesting information about the viability and effectiveness of a request for a funding extension under the current Board policy. I apologize for the delay in providing you with a response.

The current policy that lays out the requirements for qualifying for a 30 year funding extension are available at the following link:

<http://www.calpers.ca.gov/eip-docs/about/board-cal-agenda/agendas/bpac/201009/item3g-2.pdf>

As outlined in that document, there must be "Evidence that reductions in the employer rate will produce no long-term harm to the employer's plan including ... A review of the plan's funded status on a termination basis i.e. in the event that the employer terminates the plan (as current State law allows) to determine if the plan's assets will be sufficient in the future to cover all plan termination liabilities without any reduction in benefits."

The City of Stockton does not meet this criteria. The plans' assets were not sufficient to cover all plan liabilities on a termination basis as of June 30, 2011 as was shown in the hypothetical termination liability calculation included in the most recent actuarial valuation report. If the City has additional information that would suggest that the situation is significantly different today, please provide us with details of what has changed.

There is an exception to the above requirement as follows: "If the plan's assets will not be sufficient, other factors will be considered on a case by case basis based on the specific facts and circumstances of each request, including without limitation, the likelihood of the employer terminating its contract, the employer's ability to provide continuation of funding at termination, whether annual contributions continue to and are projected to continue to exceed benefits paid to retirees and beneficiaries, and/or whether the rate relief would have a material impact on the plan's funded status."

If the City feels that it can make the case that it can show that it meets this exception, it should make the case that this is so and provide documentation that supports the City's position. We would be pleased to review any such submission.

Should you require further assistance, please let us know. While the City is in litigation regarding bankruptcy, it would be best to copy our legal office on any correspondence as that will help to ensure that there are no unnecessary delays.

Yours Truly

Alan Milligan | Chief Actuary, CalPERS
(916) 795-2113 | alan_milligan@calpers.ca.gov

EXHIBIT 9

Internal Revenue bulletin

Bulletin No. 2008-35
September 2, 2008

HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

REG-142680-06, page 565.

Proposed regulations under section 7508A of the Code clarify rules relating to the postponement of certain tax-related acts by reason of a Presidentially declared disaster or terroristic or military action. The regulations clarify the scope of relief under section 7508A and specify that interest may be suspended during the postponement period. These changes are necessary to reflect changes in the law made by the Victims of Terrorism Tax Relief Act and current IRS practice.

Notice 2008-71, page 462.

This notice requests comments with respect to possible expansion of regulations section 1.475(a)-4 (safe harbor valuation regulations) so that financial institutions headquartered outside the United States can qualify to make the election described in regulations section 1.475(a)-4(b).

Rev. Proc. 2008-51, page 562.

This procedure provides that the Service will not treat the debt instrument, issued by a corporation pursuant to a binding financial commitment obtained from an unrelated lender that satisfies certain conditions, as an applicable high yield discount obligation (AHYDO) for purposes of sections 163(e)(5) and 163(i) of the Code. As a result, no portion of the corporation's interest deductions attributable to the debt instrument will be disallowed under section 163(e)(5).

EMPLOYEE PLANS

Rev. Proc. 2008-50, page 464.

This procedure updates the comprehensive system of correction programs for sponsors of retirement plans that are intended to satisfy the requirements of sections 401(a), 403(a), 403(b), 408(k), or 408(p) of the Code, but that have not met these requirements for a period of time. This system, the Employee Plans Compliance Resolution System (EPCRS), permits Plan Sponsors to correct these failures and thereby continue to provide their employees with retirement benefits on a tax-favored basis. The components of EPCRS are the Self-Correction Program (SCP), the Voluntary Correction Program (VCP), and the Audit Closing Agreement Program (Audit CAP). Rev. Proc. 2006-27 modified and superseded. Rev. Proc. 2007-49, section 3, modified and superseded.

(Continued on the next page)

Finding Lists begin on page ii.



Department of the Treasury
Internal Revenue Service

- b. What regulatory amendments, if any, should be considered if those costs are taken into account, keeping in mind the interaction of section 475 with other sections of the Code and Income Tax Regulations (e.g., section 861 and Treas. Reg. § 1.882-5)?
- 6. In what circumstances is section 475 relevant for other purposes of the Code and in what circumstances do the policies of other sections of the Code and the Regulations that rely on asset values determined under section 475 (including those determined pursuant to an election under Treas. Reg. § 1.475(a)-4(b)) require special adjustment to the amount determined under section 475?

- 7. Should the definition of “eligible method” go beyond the accounting methods that the SEC has accepted? If so, what is an appropriate (and administrable) framework for evaluating whether such a method complies with the basic criteria outlined above?

SECTION 4. INSTRUCTIONS

Comments should be submitted on or before November 1, 2008, and should include a reference to Notice 2008-71. Send submissions to CC:PA:LPD:PR (Notice 2008-71), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, D.C. 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8:00 a.m. and 4:00 p.m. to CC:PA:LPD:PR (Notice 2008-71),

Courier’s Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224, or sent electronically via the following email address: *Notice.Comments@irscounsel.treas.gov*. Please include the notice number 2008-71 in the subject line of any electronic communication. All materials submitted will be available for public inspection and copying.

DRAFTING INFORMATION

The principal author of this notice is Sheila Ramaswamy of the Office of Associate Chief Counsel (International). For further information regarding this notice, contact Sheila Ramaswamy at (202) 622-3870 (not a toll-free call).

26 CFR 601.202: Closing agreements.

Rev. Proc. 2008-50

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SECTION 1. PURPOSE AND OVERVIEW

.01 *Purpose.* This revenue procedure updates the comprehensive system of correction programs for sponsors of retirement plans that are intended to satisfy the requirements of § 401(a), 403(a), 403(b), 408(k), or 408(p) of the Internal Revenue Code (the “Code”), but that have not met these requirements for a period of time. This system, the Employee Plans Compliance Resolution System (“EPCRS”), permits Plan Sponsors to correct these failures and thereby continue to provide their employees with retirement benefits on a tax-favored basis. The components of EPCRS are the Self-Correction Program (“SCP”), the Voluntary Correction Program (“VCP”), and the Audit Closing Agreement Program (“Audit CAP”).

.02 *General principles underlying EPCRS.* EPCRS is based on the following general principles:

- Sponsors and other administrators of eligible plans should be encouraged to establish administrative practices and procedures that ensure that these plans are operated properly in accordance with the applicable requirements of the Code.
- Sponsors and other administrators of eligible plans should satisfy the applicable plan document requirements of the Code.
- Sponsors and other administrators should make voluntary and timely correction of any plan failures, whether involving discrimination in favor of highly compensated employees, plan operations, the terms of the plan document, or adoption of a plan by an ineligible employer. Timely and efficient correction protects participating employees by providing them with their expected retirement benefits, including favorable tax treatment.
- Voluntary compliance is promoted by providing for limited fees for voluntary corrections approved by the Ser-

vice, thereby reducing employers’ uncertainty regarding their potential tax liability and participants’ potential tax liability.

- Fees and sanctions should be graduated in a series of steps so that there is always an incentive to correct promptly.
- Sanctions for plan failures identified on audit should be reasonable in light of the nature, extent, and severity of the violation.
- Administration of EPCRS should be consistent and uniform.
- Sponsors should be able to rely on the availability of EPCRS in taking corrective actions to maintain the tax-favored status of their plans.

.03 *Overview.* EPCRS includes the following basic elements:

- *Self-correction (SCP).* A Plan Sponsor that has established compliance practices and procedures may, at any time without paying any fee or sanction, correct insignificant Operational Failures under a Qualified Plan, a 403(b) Plan, a SEP, or a SIMPLE IRA Plan, provided the SEP or SIMPLE IRA Plan is established and maintained on a document approved by the Service. In addition, in the case of a Qualified Plan that is the subject of a favorable determination letter from the Service or in the case of a 403(b) Plan, the Plan Sponsor generally may correct even significant Operational Failures without payment of any fee or sanction.
- *Voluntary correction with Service approval (VCP).* A Plan Sponsor, at any time before audit, may pay a limited fee and receive the Service’s approval for correction of a Qualified Plan, 403(b) Plan, SEP, or SIMPLE IRA Plan. Under VCP, there are special procedures for anonymous submissions and group submissions.
- *Correction on audit (Audit CAP).* If a failure (other than a failure corrected through SCP or VCP) is identified on

audit, the Plan Sponsor may correct the failure and pay a sanction. The sanction imposed will bear a reasonable relationship to the nature, extent, and severity of the failure, taking into account the extent to which correction occurred before audit.

SECTION 2. EFFECT OF THIS REVENUE PROCEDURE ON PROGRAMS

.01 *Effect on programs.* This revenue procedure modifies and supersedes Rev. Proc. 2006–27, 2006–1 C.B. 945 (as modified by Rev. Proc. 2007–49, 2007–30 I.R.B. 141), which was the prior consolidated statement of the correction programs under EPCRS. The modifications to Rev. Proc. 2006–27 that are reflected in this revenue procedure include:

- Expanding the definition of a plan loan failure to include violations of § 72(p)(2), regardless of whether the plan contains language relating to § 72(p). (sections 4.01 and 6.07)
- Clarifying that in particular cases the Service may decline to make available one or more correction programs under EPCRS in the interest of sound tax administration. (section 4.01(5))
- Expanding the scope of the SCP by: (i) liberalizing the requirements for determining whether there was substantial completion of correction as of the first date the plan or Plan Sponsor is considered to be Under Examination and (ii) expanding the failures for which sample correction methods are provided. (sections 4.05(2) and 9.04, Appendix A .05, and Appendix B 2.02)
- Expanding the correction method with respect to elective deferrals to include catch-up contributions under § 414(v) and plans that provide the opportunity for an employee to designate all or a portion of elective deferrals as designated Roth contributions. (Appendix A .05, and Appendix B 2.02)

butions. SCP is not otherwise available for a Plan Sponsor to correct an Operational Failure by a plan amendment.

.06 *Availability of correction of Employer Eligibility Failure.* SCP is not available for a Plan Sponsor to correct an Employer Eligibility Failure.

.07 *Availability of correction of a terminated plan.* Correction of Qualification Failures in a terminated plan may be made under VCP and Audit CAP, whether or not the plan trust is still in existence.

.08 *Availability of correction of an Orphan Plan.* An Orphan Plan that is terminating may be corrected under VCP and Audit CAP, provided that the party acting on behalf of the plan is an Eligible Party, as defined in section 5.03(2). See section 6.02(2)(e)(ii).

.09 *Availability of correction of § 457 plans.* Submissions relating to § 457(b) eligible governmental plans will be accepted by the Service on a provisional basis outside of EPCRS through standards that are similar to EPCRS.

.10 *Submission for a determination letter.* In any case in which correction of a Qualification Failure includes correction of a Plan Document Failure, Demographic Failure, or Operational Failure by plan amendment, a determination letter application may be required. See section 6.05.

.11 *Egregious failures.* SCP is not available to correct Operational Failures that are egregious. Egregious failures include: (a) a plan that has consistently and improperly covered only highly compensated employees; (b) a plan that provides more favorable benefits for an owner of the employer based on a purported collective bargaining agreement where there has in fact been no good faith bargaining between *bona fide* employee representatives and the employer (see Notice 2003–24, 2003–1 C.B. 853, with respect to welfare benefit funds); or (c) a defined contribution plan where a contribution is made on behalf of a highly compensated employee that is several times greater than the dollar limit set forth in § 415(c). VCP is available to correct egregious failures. However, egregious failures are subject to the VCP fees described in section 12.06 and, for purposes of section 12.06, an egregious failure would include any case in which the IRS concludes that the parties controlling the plan recognized that the action taken would constitute a Qualifica-

tion Failure and the failure either involves a substantial number of participants or beneficiaries or involves participants who are predominantly highly compensated employees. Audit CAP also is available to correct egregious failures.

.12 *Diversion or misuse of plan assets.* SCP, VCP, and Audit CAP are not available to correct failures relating to the diversion or misuse of plan assets.

.13 *Abusive tax avoidance transactions.* (1) *Effect on Programs.* (a) *SCP.* With respect to SCP, in the event that the plan or the Plan Sponsor has been a party to an abusive tax avoidance transaction (as defined in section 4.13(2)), SCP is not available to correct any Operational Failure that is directly or indirectly related to the abusive tax avoidance transaction.

(b) *VCP.* With respect to VCP, if the Service determines that a plan or Plan Sponsor was, or may have been, a party to an abusive tax avoidance transaction (as defined in section 4.13(2)), then the matter will be referred to the Internal Revenue Service's Employee Plans' Tax Shelter Coordinator. Upon receiving a response from the Tax Shelter Coordinator, the Service may determine that the plan or the Plan Sponsor has been a party to an abusive tax avoidance transaction, and that the failures addressed in the VCP submission are related to that transaction. In those situations, the Service will conclude the review of the submission without issuing a compliance statement and will refer the case for examination. However, if the Tax Shelter Coordinator determines that the plan failures are unrelated to the abusive tax avoidance transaction or that no abusive tax avoidance transaction occurred, then the Service will continue to address the failures identified in the VCP submission, and may issue a compliance statement with respect to those failures. In no event may a compliance statement be relied on for the purpose of concluding that the plan or Plan Sponsor was not a party to an abusive tax avoidance transaction. In addition, even if it is concluded that the failures can be addressed pursuant to a VCP submission, the Service reserves the right to make a referral of the abusive tax avoidance transaction matter for examination.

(c) *Audit CAP and SCP (for plans Under Examination).* For plans Under Examination, if the Service determines that

the plan or Plan Sponsor was, or may have been, a party to an abusive tax avoidance transaction, the matter may be referred to the Internal Revenue Service's Employee Plans' Tax Shelter Coordinator. With respect to plans Under Examination, an abusive tax avoidance transaction includes a transaction described in section 4.13(2) and any other transaction that the Service determines was designed to facilitate the impermissible avoidance of tax. Upon receiving a response from the Tax Shelter Coordinator, (i) if the Service determines that a failure is related to the abusive tax avoidance transaction, the Service reserves the right to conclude that neither Audit CAP nor SCP is available for that failure and (ii) if the Service determines that satisfactory corrective actions have not been taken with regard to the transaction, the Service reserves the right to conclude that neither Audit CAP nor SCP is available to the plan.

(2) *Abusive tax avoidance transaction defined.* For purposes of section 4.13(1) (except to the extent otherwise provided in section 4.13(1)(c)), an abusive tax avoidance transaction means any listed transaction under § 1.6011–4(b)(2) and any other transaction identified as an abusive transaction in the IRS web site entitled "EP Abusive Tax Transactions."

PART III. DEFINITIONS, CORRECTION PRINCIPLES, AND RULES OF GENERAL APPLICABILITY

SECTION 5. DEFINITIONS

The following definitions apply for purposes of this revenue procedure:

.01 *Definitions for Qualified Plans.* The definitions in this section 5.01 apply to Qualified Plans.

(1) *Qualified Plan.* The term "Qualified Plan" means a plan intended to satisfy the requirements of § 401(a) or § 403(a).

(2) *Qualification Failure.* The term "Qualification Failure" means any failure that adversely affects the qualification of a plan. There are four types of Qualification Failures: (a) Plan Document Failures; (b) Operational Failures; (c) Demographic Failures; and (d) Employer Eligibility Failures.

(a) *Plan Document Failure.* The term "Plan Document Failure" means a plan

provision (or the absence of a plan provision) that, on its face, violates the requirements of § 401(a) or § 403(a). Thus, for example, the failure of a plan to be amended to reflect a new qualification requirement within the plan's applicable remedial amendment period under § 401(b) is a Plan Document Failure. In addition, if a plan has not been timely or properly amended during an applicable remedial amendment period for adopting good faith or interim amendments with respect to disqualifying provisions, as described in § 1.401(b)-1(b)(1) of the Income Tax Regulations, the plan has a Plan Document Failure. For purposes of this revenue procedure, a Plan Document Failure includes any Qualification Failure that is a violation of the requirements of § 401(a) or § 403(a) and that is not an Operational Failure, Demographic Failure, or Employer Eligibility Failure.

(b) *Operational Failure.* The term "Operational Failure" means a Qualification Failure (other than an Employer Eligibility Failure) that arises solely from the failure to follow plan provisions. A failure to follow the terms of the plan providing for the satisfaction of the requirements of § 401(k) and § 401(m) is considered to be an Operational Failure. A plan does not have an Operational Failure to the extent the plan is permitted to be amended retroactively to reflect the plan's operations (e.g., pursuant to § 401(b)). In the situation where a Plan Sponsor timely adopted a good faith or interim amendment which is not a disqualifying provision as described in § 1.401(b)-1(b)(1), and the plan was not operated in accordance with the terms of such amendment, the plan is considered to have an Operational Failure.

(c) *Demographic Failure.* The term "Demographic Failure" means a failure to satisfy the requirements of § 401(a)(4), 401(a)(26), or 410(b) that is not an Operational Failure or an Employer Eligibility Failure. The correction of a Demographic Failure generally requires a corrective amendment to the plan adding more benefits or increasing existing benefits (cf. § 1.401(a)(4)-11(g)).

(d) *Employer Eligibility Failure.* The term "Employer Eligibility Failure" means the adoption of a plan intended to include a qualified cash or deferred arrangement

under § 401(k) by an employer that fails to meet the employer eligibility requirements to establish a § 401(k) plan. An Employer Eligibility Failure is not a Plan Document, Operational, or Demographic Failure.

(3) *Excess Amount; Excess Allocations; Overpayment.* (a) *Excess Amount.* The term "Excess Amount" means a Qualification Failure due to a contribution, allocation, or similar credit that is made on behalf of a participant or beneficiary to a plan in excess of the maximum amount permitted to be contributed, allocated, or credited on behalf of the participant or beneficiary under the terms of the plan or that exceeds a limitation on contributions or allocations provided in the Code or regulations. Excess Amounts include: (i) an elective deferral or after-tax employee contribution that is in excess of the maximum contribution under the plan; (ii) an elective deferral or after-tax employee contribution made in excess of the limitation under § 415; (iii) an elective deferral in excess of the limitation of § 402(g); (iv) an excess contribution or excess aggregate contribution under § 401(k) or § 401(m); (v) an elective deferral or after-tax employee contribution that is made with respect to compensation in excess of the limitation of § 401(a)(17); and (vi) any other employer contribution that exceeds a limitation under § 401(a)(17), § 401(m) (but only with respect to the forfeiture of nonvested matching contributions that are excess aggregate contributions), § 411(a)(3)(G), or § 415. However, an Excess Amount does not include a contribution, allocation, or other credit that is made pursuant to a correction method provided under this revenue procedure for a different Qualification Failure. Excess Amounts are limited to contributions, allocations, or annual additions under a defined contribution plan, after-tax employee contributions to a defined benefit plan, and contributions or allocations that are to be made to a separate account (with actual earnings) under a defined benefit plan. See generally section 6.06 for the treatment and correction of certain Excess Amounts.

(b) *Excess Allocation.* The term "Excess Allocation" means an Excess Amount for which the Code or regulations do not provide any corrective mechanism. Excess Allocations include Excess Amounts

as defined in section 5.01(3)(a) (i), (ii), (v), and (vi) (except with respect to § 401(m) or § 411(a)(3)(G) violations). Excess Allocations must be corrected in accordance with section 6.06(2).

(c) *Overpayment.* The term "Overpayment" means a Qualification Failure due to a payment being made to a participant or beneficiary that exceeds the amount payable to the participant or beneficiary under the terms of the plan or that exceeds a limitation provided in the Code or regulations. Overpayments include both payments from a defined benefit plan and payments from a defined contribution plan (either not made from the participant's or beneficiary's account under the plan or not permitted to be paid either under the terms of the plan or under the Code or regulations). However, an Overpayment does not include a payment that is made pursuant to a correction method provided under this revenue procedure for a different Qualification Failure. Overpayments must be corrected in accordance with section 6.06(3).

(4) *Favorable Letter.* The term "Favorable Letter" means, in the case of a Qualified Plan, a current favorable determination letter for an individually designed plan (including a volume submitter plan that is not identical to an approved volume submitter plan), a current favorable opinion letter for a Plan Sponsor that has adopted a master or prototype plan, (standardized or nonstandardized), or a current favorable advisory letter and certification that the Plan Sponsor has adopted a plan that is identical to an approved volume submitter plan. A plan has a current favorable determination letter, opinion letter, or advisory letter if (a), (b), (c), or (d) below is satisfied:

(a) The plan has a favorable determination letter, opinion letter, or advisory letter that considers the law changes incorporated in the Plan Sponsor's most recently expired remedial amendment cycle determined under the provisions of Rev. Proc. 2007-44.

(b) For plans with respect to whom the initial remedial amendment cycle under Rev. Proc. 2007-44 has not expired, the favorable determination letter, opin-

EXHIBIT 10

Checkpoint Contents

Federal Library

Federal Source Materials

IRS Rulings & Releases

Private Letter Rulings & TAMs, FSAs, SCAs, CCAs, GCMs, AODs & Other FOIA Documents

General Counsel Memoranda (1962 to Present)

1983

GCM 38972 -- IRC Sec(s). 503, 03/25/1983

General Counsel Memoranda

General Counsel Memorandum 38972, 03/25/1983, IRC Sec(s). 503

UIL No. 0503.02-00; 0503.05-00

Headnote:

Reference(s): Code Sec. 503;

Full Text:

CC:EE-166-81

June 30, 1982

Br3:MRosenbaum

Date Numbered: March 25, 1983

Memorandum to:

TO: S. ALLEN WINBORNE

Assistant Commissioner (Employer Plans and Exempt Organizations)

Attention: Director, Employee Plans Division

In a memorandum dated December 16, 1981, the Director, Employee Plans Division (E:EP) forwarded a proposed taxpayer letter ruling concerning the above subject for our formal consideration.

ISSUE

Whether a public retirement system's acceptance of bonds issued by an employer-municipality in satisfaction of contributions required from the employer-municipality constitutes a bona fide collection effort of delinquent contributions rather than a loan within the meaning of I.R.C. s 503(b).

CONCLUSION

We agree with the conclusion of the Employee Plans Division (E:DP) that the transaction described herein is a loan within the meaning of section 503(b)(1).

FACTS

Rulings were requested on behalf of the City of *** (City) regarding the federal income tax consequences of the proposed purchases

by the *** General Retirement System (General Fund) and the *** Policemen and Firemen Retirement System (Uniformed Services Fund) of bonds issued by the City.

It is represented that both Funds are governmental plans within the meaning of  section 414(d) of the Internal Revenue Code. The Funds provide certain retirement and other benefits for specific classes of employees of the City. The City is the major contributor to both Funds and the ultimate obligor with respect to financial benefits due the participants.

The City incurred substantial deficits for the fiscal year ending in ***. As a result, contributions for that year were not made to either of the Funds. In addition, the City faced potential deficits in future fiscal years which, if unaddressed, were estimated to aggregate *** dollars by ***.

***.

Due to its financial circumstances, the City was delinquent in its contributions to both Funds for the fiscal years ending in ***. In *** the Uniformed Services Fund *** to obtain delinquent fiscal *** contributions. Subsequently, the trustees of the General Fund *** to collect delinquent fiscal *** contributions. The City entered into *** agreements with both Funds in ***. However, when the City defaulted on the *** agreements, the ***. The City paid the delinquent contributions for the fiscal year ending in *** to both Funds and interest to the Uniformed Services Fund. However, the City remained delinquent in its contributions to both Funds for the fiscal year ending in ***. It is represented that in view of the financial resources of the City, a favorable judicial settlement, once obtained, would not result in an improvement in the position of the Funds.

The City proposed to issue general obligation bonds authorized by *** for the purpose of funding the City's current operating deficit and satisfying its *** obligations to both Funds. The issuance of the bonds was approved by the State *** as being in compliance with the *** and qualified by the State *** as being in compliance with the ***.

Interest and principal payments on the bonds are secured by a first and exclusive statutory lien under the *** and by a first lien on the proceeds of a portion of the increase in the City's income tax. A superior lien or claim will not be granted by the City against these two sources of revenue while principal and interest payments remain owing, but the City may make future equal liens against its increases in income tax. The funds which are distributed under the *** are subject to annual appropriation by the State of ***.

The City issued bonds with a face value of *** of which were purchased by a syndicate of banks at a net aggregate purchase price of ***. The cash proceeds resulting from the purchase of the bonds by the banks, exclusive of issuance expenses, was combined with other funds of the City to discharge a total of *** in delinquent contributions owing to the General and Uniformed Services Funds. The cash contributions represented *** of the City's delinquent contributions to the plans, exclusive of interest.

In the commitments of each of the Funds to accept *** percent of the bond issue, the trustees signed agreements of nonlitigation. Thus, the obligation of the City to pay the delinquent contributions will be discharged and the remedies available to the trustees for collection of the principal and interest on the bonds will be limited to the provisions of the ***.

Based on the foregoing, three rulings were requested. The original ruling request asked for ruling 3 below, only if the Service did not issue ruling 2. However, a subsequent letter requested that ruling request 2 be severed and considered separately.

1. In determining whether the acquisition of the City's bonds by the trusts satisfies the exclusive benefit rule of  section 401(a) of the Code, the economic circumstances of the City, as principal contributor to the trusts and ultimate obligor with respect to financial benefits, can be taken into account in establishing the terms for the portion of the delinquent contributions to be satisfied by the bonds accepted by the trusts.
2. The acceptance of the bonds constitutes a bona fide collection effort of delinquent contributions and, therefore, falls outside the prohibited transactions provisions of  section 503 of the Code.
3. The proposed transaction constitutes a loan to the employer within the meaning of  section 503(b)(1) of the Code and, in applying the provisions of section 503(e), the acquisition by the syndicate of banks of a portion of the bond issue will be treated as an acquisition by persons independent of the issuer.

On *** a favorable letter ruling was issued pertaining to the issues presented in 1 and 3 above. Accordingly, with respect to issue 1, for purposes of the exclusive benefit rule, economic conditions may be taken into account together with all the other facts and circumstances in establishing the terms, including the interest rate, for the portion of the delinquent contributions that will be satisfied

by the bonds.

A favorable ruling was also issued with respect to issue 3 based upon the data submitted indicating that the banks were independent of the City within the meaning of section 503(e). For the purpose of issue 3 it was assumed that the acquisitions of the bonds by the trusts were loans.

In a proposed letter ruling addressing issue 2, the Employee Plans Division (E:EP) holds that the described transaction is a loan to the City and is a prohibited transaction within the meaning of section 503(b)(1).

ANALYSIS

Section 501(a) exempts from federal income tax plans of deferred compensation described in section 501(a) as qualified pension plans.

Section 503(a)(1)(B) provides that an organization described in section 401(a) and which is referred to in section 4975(g)(2) as a governmental plan shall not be exempt from taxation under section 501(a) if it has engaged in a prohibited transaction.

Section 503(b)(1) provides that the term "prohibited transaction" means any transaction in which an organization subject to the provisions of section 503 lends any part of its income or corpus, without the receipt of adequate security and a reasonable rate of interest, to the creator of such organization (if a trust) or a person who has made a substantial contribution to the organization.

Treas. Reg. s 1.503(b)-1(a) provides that whether a transaction is a prohibited transaction depends on the facts and circumstances of a particular case. This section states that it is intended to deny tax-exempt status to organizations engaging in certain transactions that inure to the advantage of the creator of such organization (if a trust) or a substantial contributor.

Section 1.503(b)-1(b) defines the term "adequate security" as:

something in addition to and supporting a promise to pay, which is so pledged to the organization that it may be sold, foreclosed upon, or otherwise disposed of in default of repayment of the loan, the value and liquidity of which security is such that it may reasonably be anticipated that loss of principal or interest will not result from the loan.... A borrower's evidence of indebtedness, irrespective of its name, is itself not security for a loan, whether or not it was issued directly to the exempt organization.

The same section further provides that "[i]f an organization subject to section 503(b) purchases debentures issued by a person specified in section 503(b), the purchase is considered, for purposes of section 503(b)(1), as a loan made by the purchaser to the issuer on the date of such purchase "

 Section 503(e) of the Code provides that, for purposes of section 503(b)(1), defining prohibited transactions, a bond or other evidence of indebtedness shall not be treated as a loan made without the receipt of adequate security if, among other requirements, immediately following the acquisition of such obligation, not more than 25 percent of the aggregate amount of the obligations issued in such issue and outstanding at the time of acquisition is held by the trust, and at least 50 percent of the aggregate amount of the obligations issued in such issue and outstanding is held by persons independent of the issuer.

Section 1.503(e)-1(a)(2) provides that section 503(e) does not affect the requirement of section 503(b)(1) of a reasonable rate of interest. If the indebtedness does not bear a reasonable rate of interest the obligation will not fall within the exception of section 503(e) although it meets all the other requirements under that section.

Section 1.503(e)-1(b)(1) defines the term "obligation " for purposes of section 503(e) to mean a bond, debenture, note, certificate or other evidence of indebtedness.

The terms "loan" and "bond" are not defined for purposes of section 503; however, their use in that section and corresponding regulations appears to be in accordance with common usage. The purpose of section 503 is to require arm's length dealings between the creator and the trustee so that the trust property will not be subject to abnormal risks without proper compensation and security. S. Rep. No. 2375, 81st Cong., 2d Sess. 36-37 (1950), 1950-2 C.B. 483, 509-511. Section 503(b)(1) refers to a loan of income or corpus; section 503(e), for purposes of section 503(b)(1), refers to a bond as evidence of indebtedness or an obligation. In general, term loans of documents including bonds. *Encyclopedia of Banking and Finance* 543 (7th ed. 1973).

In describing the relationship between the parties with respect to the type of instrument being held, there may be a corporation-shareholder or owner-type relationship as in the case of stock, or a debtor-creditor relationship as in the case of bonds. Section 385 (b).

In *** [G.C.M. 34353, A-615756](#) (September 18, 1970) we stated that section 503(e) is operative only with respect to section 503(b)(1); and, that section 503(b)(1) is operative only with respect to loans. Therefore, notes and other items enumerated in section 503(e) must constitute loans. Furthermore, we stated that unless bonds, debentures, notes, certificates or other evidences of indebtedness of the creator acquired by the trust are considered to be loans, section 503(e) will be rendered nugatory. We were of the opinion that it would be meaningless for section 503(e) to provide that such obligations meeting the requirements of that section "shall not be treated as a loan without receipt of adequate security" if the obligations did not constitute loans in the first place. [G.C.M. 34353, supra](#), at 6. We concluded that the contribution of the employer's notes to the employees' trust and acceptance by the trust of such, constitutes a prohibited transaction within the meaning of section 503(b)(1). [G.C.M. 34353, supra](#), at 8.

We approached the issue in the instant case in *** [G.C.M. 36013, I-497-73](#) (September 27, 1974), where we considered the acceptance of an employer's unsecured promissory note by an employees' trust in lieu of a required contribution. The prohibition against such an extension of credit was based upon section 2003(a) of the Employee Retirement Income Security Act of 1974 (Pub. L. 93-406, 1974-3 C.B.) (ERISA), added to [the 1954 Code](#) as section 4975, and made it unnecessary to consider whether the transaction constituted a prohibited transaction under section 503(b)(1). The substance of the instant transaction and that described in [G.C.M. 36013](#) are the same. Each involves an attempt to satisfy a required contribution to an employee retirement benefit plan with a debt instrument issued by the employer.

Although Section 4975(c), prohibited transactions, does not apply to transactions involving a trust associated with a government plan by operation of section 4975(g)(2), the congressional intent underlying the prohibited transaction section 4975(c) and the congressional intent beneath section 503 are the same. The Conference Report to ERISA prohibits the direct or indirect lending of money or other extension of credit between an employee benefit plan and a party-in-interest. The report states that prohibited loans include the acquisition of a debt instrument which is an obligation of a party-in-interest by the retirement plan. Specifically, "it is intended that it would be a prohibited transaction (in effect a loan by the plan to the employer) if the employer funds his contributions to the plan with his own debt obligations " H.R. Conf. Rep. No. 1280, 93d Cong., 2d Ses. 308 (1974), 1974-3 C.B. 415, 469. As we stated in [G.C.M. 36013, supra](#), this position is consistent with existing Service policy, because [G.C.M. 34353, supra](#), reached the same result under section 503(b)(1). The purpose underlying section 503 is to prohibit transactions that would inure to the benefit of a party-in-interest. S. Rep. No. 2375, 81st Cong., 2d Sess. 36-37 (1950), 1950-2 C.B. 483, 509-511.

The City argues that the retirement Funds sought payment from the City through bona fide debt collection efforts, as opposed to the voluntary acceptance of the employer's debt obligation in satisfaction of a plan contribution. The City maintains that the prohibited transactions restrictions do not apply to involuntary workout arrangements. It is claimed that this conclusion has been implicitly recognized in Prohibited Transaction Exemption 76-1, 1976-1 C.B. 357, wherein an exemption from the prohibited transaction restrictions under section 4975 was given to workout arrangements resulting from bona fide debt collection efforts.

As discussed above, there is a great similarity in the legislative intent underlying the prohibited transactions under section 503 and section 4975(c). However, Prohibited Transaction Exemption 76-1, *supra*, applies only to section 4975(c) and in that framework, only with respect to certain transactions in which multiemployer and multiple employer plans are involved. The lack of a similar exemption for prohibited transactions under section 503 indicates that the prohibitions still apply to workout arrangements under that section. The fact that a specific prohibited transaction exemption was deemed necessary under section 4975(c) indicates that, in the absence of a similar exemption procedure under section 503, such an arrangement is a transaction prohibited under section 503.

In this case, the effort to collect payment is irrelevant because the net result of the compromise transaction was an extension of credit to the City by agreeing to accept the City's general obligation bonds. This transaction results ultimately in a loan to the City which could be a prohibited transaction within the meaning of section 503(b)(1) but for the structure of the transaction which enables it to come within the exception of section 503(e).

In *Fuqua National, Inc. v. United States*, 334 F. Supp. 1116 (S.D. Ga. 1971), the District Court held that where an employer issued a promissory note to its profit-sharing trust in lieu of cash, there was a loan without adequate security and a prohibited transaction under [section 503\(b\)\(1\)](#) of the Code. The court stated that a loan may be implied and that transactions must be viewed according to their real nature rather than mere form. The court also stated that "forbearance to accept immediate payment of a debt is an extension of credit " 334 F. Supp. at 1118. An extension of credit is the giving of time to pay a debt or the allowance on the part of the creditor to a debtor of further time to pay a debt.

Furthermore, in the instant case, the Funds surrendered their *** rights against the City in exchange for the bonds. These rights were assets of the Funds and should be viewed as consideration for the bonds. In addition, any potential for payment under the prior *** was exchanged for the payment provisions of the bonds and all rights of the Funds for cash payments of the fiscal *** contributions (which the discount value of the bonds represents) arose thereafter under the *** and the *** . Thus, a portion of the corpus of both Funds was lent to the City.

Inasmuch as the City was able to delay making immediate cash contributions to the Funds for which it was currently liable in amounts equivalent to the amount of debt being postponed by the bond issue, the acquisition of the bonds by the Funds is a transaction that inured to the advantage of the Funds' creator, the City.

Accordingly, it is our opinion that acceptance by the two employees' trusts of bonds issued by the employer-City as a part of a settlement of delinquent contributions is a loan to the City, rather than debt collection, and as such is a prohibited transaction within the meaning of  section 503(b)(1) of the Code.

We have suggested to a representative from your office that some changes be made to the proposed letter ruling in accordance with this G.C.M.

KENNETH W. GIDEON

Chief Counsel

By:

JONATHAN P. MARGET

Assistant Director

Employee Plans and Exempt Organizations Division

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EXHIBIT 11



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%.

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August 19, 2011

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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.

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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



California Public Employees' Retirement System
Actuarial Office
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Sacramento, CA 94229-2701
TTY: (877) 249-7442
(888) 225-7377 phone • (916) 795-2744 fax
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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

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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

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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

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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.

Members of the Benefits and Program Administration Committee

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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



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.

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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.

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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

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

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).

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%	1.2%
TIPS (11-30 year maturities)	57%	
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, Subchapter 1, 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.