OFFICE OF THE MAYOR
SAN FRANCISCO

EDWIN M. LEE
MAYOR

October 19, 2012

The Honorable Katherine Feinstein
Presiding Judge
Superior Court of California, County of San Francisco
400 McAllister Street
San Francisco, CA 94102

Dear Judge Feinstein:

The following is in response to the 2011-2012 Civil Grand Jury report, "Investment Policies and Practices of the San Francisco Employees' Retirement System."

The Mayor's Office response to the Civil Grand Jury's findings is as follows:

Finding F1: The San Francisco Employees' Retirement System Pension Fund is currently underfunded by more than $2 billion.

Response: Agree. As of the most recent San Francisco Employees' Retirement System (SFERS) actuarial valuation (July 1, 2011), the SFERS unfunded actuarial liability was $2,285.6 million.

Finding F2: The San Francisco Employees' Retirement System Board did not complete a "failure analysis" subsequent to the funding loss suffered in 2008-2009.

Response: Disagree. The Board and SFERS actuaries conducted extensive discussions and analysis subsequent to Fiscal Year (FY) 2008-09 and changes to actuarial assumptions were debated and acted upon. The Board considers the impacts of various return scenarios on an annual basis, and transmits these to the City for use in the City's budget planning.

Finding F3: The City must pay increasing contributions to the fund due to underfunding.

Response: Agree. At its February 2012 Board meeting, SFERS actuaries presented projections of contribution rates based on various investment return scenarios. These projections show that the City's contribution rate will continue to rise through FY 2014-15 as the remaining losses from FY 2008-09 are smoothed in under the Plan's five-year smoothing policy. As of that meeting, the City's contributions are expected to then begin decreasing in FY 2015-16, however, future contribution rates will be determined based on future Plan returns. These projections are revisited annually and used in the annual budget process.

Finding F4: The increases in pension contributions by the City are growing at a faster rate than expenditures on most other City services since 1999.

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Response: Agree.

Finding F5: The Fund can artificially reduce the City's estimated liabilities by increasing its investment return assumptions for future years.

Response: Disagree. Decisions around the Plan's investment return assumptions are made by the SFERS Board after recommendations and analysis from professional actuaries and after a public hearing process. The Board has a fiduciary responsibility to the Plan's beneficiaries therefore a responsibility to maintain the long-term health of the plan. It is incorrect to characterize their decisions as 'artificial'.

Finding F6: The unrealistically high, assumed investment return rate of 7.66% is driven by concern for the mandated member and City contributions, with little regard for prudent management.

Response: Disagree. Decisions around the Plan's investment return assumptions are made by the SFERS Board after recommendations and analysis from professional actuaries and after a public hearing process. The Board has a fiduciary responsibility to the Plan's beneficiaries therefore a responsibility to maintain the long-term health of the plan.

Finding F7: Studies show that public funds with low-risk investment policies perform as well as or better than those with high-risk policies.

Response: I can neither confirm nor deny the validity of this finding.

The Mayor's Office response to the Civil Grand Jury's <u>recommendations</u> is as follows:

Recommendation R1: San Francisco Employees Retirement System Board address the $2 billion dollar underfunding of the San Francisco Employees' Retirement System Pension Fund by forming a high-level task force with City officials, a panel of experts, community groups, and the public to develop a course of action.

Response: Will not be Implemented. The challenges of the Plan's liabilities are well known and have been under discussion for many years. In 2011 many stakeholders came together to address some of the concerns around the Plan, the collaboration resulted in Prop C which made significant changes and will save the City significantly in the future. In addition, each year the Plan's returns and assumptions are discussed extensively through a public process at which all are welcome to participate.

Recommendation R2: Adopt a realistic and consistent formula for estimating the assumed expected investment return rate.

Response: Recommendation Implemented. This recommendation has been implemented and is a part of the Board's existing processes. In December 2011 the Board did vote to reduce the long-term investment return assumption based on recommendations from their consultants and actuaries. The Board will continue to review this assumption and adjust it as necessary as part of their regular and existing procedures.

Recommendation R3: The San Francisco Employees' Retirement System Board undertake an in-depth investigation and "failure analysis" study of its investment policy and report its findings to its members and to the public.

Response: Recommendation Implemented. While the term "failure analysis" is not used by SFERS, the intent behind this recommendation of reviewing investment policies and reporting to the public is being implemented within the framework of the existing SFERS Board processes. The SFERS Board will continue to consider changes to their investment policies on a regular basis under its existing procedures.

Recommendation R4: Investigate, quantify and address all the major risks in the portfolio and make this information public.

Response: Recommendation Implemented. The SFERS Board Strategic Plan, adopted at the Board's October 12, 2011 meeting, discusses an investment risk management initiative, which has been implemented by SFERS with regular monthly public reports since February 2011 that include a discussion of investment risk exposures in the SFERS portfolio.

Recommendation R5: Investigate less volatile and risky investment policies that would attain sufficient returns for the San Francisco Employees' Retirement System Pension Fund.

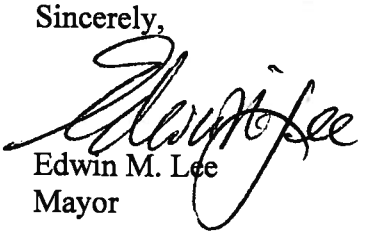
Response: Recommendation Implemented. The SFERS Board regularly analyzes and discusses a wide range of investment strategies and policies.

Recommendation R6: Replicate the Stanford, Upjohn, and *The New York Times* evidence-based comparison studies using San Francisco data, to apply their findings to the San Francisco Employee's Retirement System Pension Fund.

Response: Will Not Be Implemented. SFERS actuarial consultants and staff regularly review findings of similar type studies and industry benchmarks as part of their analyses provided to the Board. It is not warranted to require replication of these specific studies.

Thank you again for the opportunity to comment on this report.

Sincerely,



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