File No. 120844 Committee Item No. 6
Board Item No. ____

COMMITTEE/BOARD OF SUPERVISORS

AGENDA PACKET CONTENTS LIST

Committee: Government Audit and Oversight **Date** November 19, 2012

Board of Supervisors Meeting **Date** ____

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Completed by: Alisa Miller **Date** November 15, 2012
Completed by: ____ **Date** ____

An asterisked item represents the cover sheet to a document that exceeds 25 pages.
The complete document can be found in the file.

FILE NO. 120844 RESOLUTION NO.

[Board Response - Civil Grand Jury Report - Investment Policies and Practices of the San Francisco Employees' Retirement System]

Resolution responding to the Presiding Judge of the Superior Court on the findings and recommendations contained in the 2011-2012 Civil Grand Jury report entitled "Investment Policies and Practices of the San Francisco Employees' Retirement System" and urging the Mayor to cause the implementation of accepted findings and recommendations through his/her department heads and through the development of the annual budget.

WHEREAS, Under California Penal Code Section 933 et seq., the Board of Supervisors must respond, within 90 days of receipt, to the Presiding Judge of the Superior Court on the findings and recommendations contained in Civil Grand Jury Reports; and

WHEREAS, In accordance with Penal Code Section 933.05(c), if a finding or recommendation of the Civil Grand Jury addresses budgetary or personnel matters of a county agency or a department headed by an elected officer, the agency or department head and the Board of Supervisors shall respond if requested by the Civil Grand Jury, but the response of the Board of Supervisors shall address only budgetary or personnel matters over which it has some decision making authority; and

WHEREAS, The 2011-2012 Civil Grand Jury Report entitled "Investment Policies and Practices of the San Francisco Employees' Retirement System" is on file with the Clerk of the Board of Supervisors in File No. 120844 which is hereby declared to be a part of this resolution as if set forth fully herein; and

WHEREAS, The Civil Grand Jury has requested that the Board of Supervisors respond to Finding Nos. 1, 2, 3, 4, 5, 6, and 7 as well as Recommendations 1, 2, 3, 4, 5, and 6 contained in the subject Civil Grand Jury report; and

WHEREAS, Finding No. 1 states: "The San Francisco Employees' Retirement System Pension Fund is currently underfunded by more than $2 billion;" and

WHEREAS, Finding No. 2 states: "The San Francisco Employees' Retirement System Board did not complete a "failure analysis" subsequent to the funding loss suffered in 2008-2009;" and

WHEREAS, Finding No. 3 states: "The City must pay increasing contributions to the Fund due to underfunding;" and

WHEREAS, Finding No. 4 states: "The increases in pension contributions by the City are growing at a faster rate than expenditures on most other City services since 1999;" and

WHEREAS, Finding No. 5 states: "The Fund can artificially reduce the City's estimated liabilities by increasing its investment return assumptions for future years;" and

WHEREAS, Finding No. 6 states: "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;" and

WHEREAS, Finding No. 7 states: "Studies show that public funds with low-risk investment policies perform as well as or better than those with high-risk policies;" and

WHEREAS, the Recommendation No. 1 states: "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 courses of action;" and

WHEREAS, the Recommendation No. 2 states: "Adopt a realistic and consistent formula for estimating the assumed expected investment return rate;" and

WHEREAS, the Recommendation No. 3 states: "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;" and

WHEREAS, the Recommendation No. 4 states: "Investigate, quantify and address all the major risks in the portfolio and make this information public;" and

WHEREAS, the Recommendation No. 5 states: "Investigate less volatile and risky investment policies that would attain sufficient returns for the San Francisco Employees' Retirement System Pension Fund;" and

WHEREAS, the Recommendation No. 6 states: "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 Employees' Retirement System Pension Fund;" and

WHEREAS, in accordance with Penal Code Section 933.05(c), the Board of Supervisors must respond, within 90 days of receipt, to the Presiding Judge of the Superior Court on Finding Nos. 1, 2, 3, 4, 5, 6, and 7 as well as Recommendations 1, 2, 3, 4, 5, and 6 contained in the subject Civil Grand Jury report; now, therefore, be it

RESOLVED, That the Board of Supervisors reports to the Presiding Judge of the Superior Court that it {agrees/disagrees} 1, 2, 3, 4, 5, 6, and 7, for reasons as follows__________; and, be it

FURTHER RESOLVED, That the Board of Supervisors reports that it {agrees/disagrees} Recommendations 1, 2, 3, 4, 5, and 6 for reasons as follows_________; and, be it

FURTHER RESOLVED, That the Board of Supervisors urges the Mayor to cause the implementation of accepted findings and the recommendation through his/her department heads and through the development of the annual budget.

City and County of San Francisco
Civil Grand Jury 2011-2012

INVESTMENT POLICIES AND PRACTICES OF THE SAN FRANCISCO EMPLOYEES' RETIREMENT SYSTEM

June 2012

Superior Court of California, County of San Francisco
Civic Center Courthouse
400 McAllister Street, Room 008
San Francisco, CA 94102
(415) 551-3605

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THE CIVIL GRAND JURY

California state law requires that all 58 counties impanel a Grand Jury to serve during each fiscal year (Cal. Const., Art. I, § 23; Cal. Penal Code, § 905). In San Francisco, the presiding judge of the Superior Court impanels two grand juries. The Indictment Grand Jury has sole and exclusive jurisdiction to return criminal indictments. The Civil Grand Jury scrutinizes the conduct of public business of county government.

The function of the Civil Grand Jury is to investigate the operations of the various officers, departments and agencies of the government of the City and County of San Francisco. Each civil grand jury determines which officers, departments and agencies it will investigate during its term of office. To accomplish this task the grand jury is divided into committees which are assigned to the respective departments or areas which are being investigated. These committees visit government facilities, meet with public officials, and develop recommendations for improving City and County operations.

The 19 members of the Civil Grand Jury serve for a period of one year from July 1 through June 30 the following year, and are selected at random from a pool of 30 prospective grand jurors. During that period of time it is estimated that a minimum of approximately 500 hours will be required for grand jury service. By state law, a person is eligible if a citizen of the United States, 18 years of age or older, of ordinary intelligence and good character, and has a working knowledge of the English language.

Applications to serve on the Civil Grand Jury are available by contacting the Civil Grand Jury office:

- by phone (415) 551-3605 (weekdays 8:00 a.m. - 4:30 p.m.).
- in person at the Grand Jury Office, 400 McAllister St., Room 008, San Francisco, CA 94102.
- by completing an online application (available at http://www.sfsuperiorcourt.org/index.aspx?page=312), and mailing it to the above address.

CITY AND COUNTY OF SAN FRANCISCO
CIVIL GRAND JURORS
2011-2012
(AS OF DATE OF PUBLICATION)

Umung Varma, Foreperson

Helen Blohm	Sharon Gadberry	Mort Raphael
Mark Busse	Ossie Gomez	Jack Saroyan
Mario Choi	Arlene Helfand	Earl Shaddix
Matthew Cohen	Lewis Hurwitz	Jack Twomey
Kay Evans	Todd Lloyd	Gregory Winters
Allegra Fortunati	Jean Ninos	Sharon Yow

WITNESSES

With regard to witnesses who provide testimony to the Civil Grand Jury to aid it in its investigation, **California Penal Code § 929** provides that:

> As to any matter not subject to privilege, with the approval of the presiding judge of the superior court or the judge appointed by the presiding judge to supervise the grand jury, a grand jury may make available to the public part or all of the evidentiary material, findings, and other information relied upon by, or presented to, a grand jury for its final report in any civil grand jury investigation provided that the name of any person, or facts that lead to the identity of any person who provided information to the grand jury, shall not be released. Prior to granting approval pursuant to this section, a judge may require the redaction or masking of any part of the evidentiary material, findings, or other information to be released to the public including, but not limited to, the identity of witnesses and any testimony or materials of a defamatory or libelous nature.

The intention of the California State Legislature in enacting **Penal Code § 929** is to encourage full candor in testimony in Civil Grand Jury investigations by protecting the privacy and confidentiality of those who participate in an investigation of the Civil Grand Jury.

REQUIRED RESPONSES

California Penal Code § 933(c) provides deadlines for responding to this report:

> No later than 90 days after the grand jury submits a final report on the operations of any public agency . . . the governing body of the public agency shall comment to the presiding judge of the superior court on the findings and recommendations pertaining to matters under the control of the governing body, and every elected county officer or agency head for which the grand jury has responsibility . . . shall comment within 60 days to the presiding judge of the superior court . . . on the findings and recommendations pertaining to matters under the control of that county officer or agency head and any agency or agencies which that officer or agency head supervises or controls. In any city and county, the mayor shall also comment on the findings and recommendations. All of these comments and reports shall forthwith be submitted to the presiding judge of the superior court who impaneled the grand jury.

California Penal Code § 933.05 provides for the manner in which responses to this report are to be made:

> (a) For purposes . . . as to each grand jury finding, the responding person or entity shall indicate one of the following:
> (1) The respondent agrees with the finding.
> (2) The respondent disagrees wholly or partially with the finding, in which case the response shall specify the portion of the finding that is disputed and shall include an explanation of the reasons therefor.
> (b) For purposes . . . as to each grand jury recommendation, the responding person or entity shall report one of the following actions:
> (1) The recommendation has been implemented, with a summary regarding the implemented action.
> (2) The recommendation has not yet been implemented, but will be implemented in the future, with a timeframe for implementation.
> (3) The recommendation requires further analysis, with an explanation and the scope and parameters of an analysis or study, and a timeframe for the matter to be prepared for discussion by the officer or head of the agency or department being investigated or reviewed, including the governing body of the public agency when applicable. This timeframe shall not exceed six months from the date of publication of the grand jury report.
> (4) The recommendation will not be implemented because it is not warranted or is not reasonable, with an explanation therefor.

EXECUTIVE SUMMARY

The San Francisco Employees' Retirement System is a public pension fund created by the San Francisco Charter and organized for the benefit of the employees and retirees of the City and County of San Francisco and all independent government agencies under it. A Board of four appointed and three elected members govern the pension fund. The Charter mandates the use of prudent investments to ensure that City employees have guaranteed retirement benefits over their lifetimes. When shortfalls occur, the City of San Francisco, as the employer, contributes funds annually to cover anticipated future liabilities. As of June 30, 2011, the Fund is more than $2 billion short.

Investment policies and practices are of critical importance. Public pension funds across the nation are underfunded and the City's is no exception. The San Francisco pension fund is valued at $14.9 billion and actuaries estimate the funding level needs to be over $18 billion to continue meeting benefits. Part of the reason for the underfunding is the severe investment loss suffered in 2008-2009. Over that time, the fund's assets shrank from $17.4 billion to a low of $11.1 billion. Actuaries predict the City's contributions could increase to between $557 million and $708 million per year over the next five years to make up the shortfall. The Jury recommends active dialogue and contingency planning to anticipate and prevent this range of shortfalls.

The Jury finds the City's retirement fund, like other public pension funds, has over-estimated its future returns relative to its last five and ten years' record of investment returns. Pursuing high estimated returns leads to a policy of high-risk and volatile investment policies.

Every source we interviewed believes pension funds are compelled to chase high returns in order to recover losses. Expectations are for a repeat of the successful recovery after the Dot.Com losses of 2001. Thus far, this has not been the case. Various academic comparisons and investigative reports have examined returns of pension plans over the last 20 years. Surprisingly, those few plans that invested conservatively have enjoyed returns that met or exceeded the returns of funds with riskier portfolios.

The Jury cannot of course recommend an investment policy for the pension fund. However, we do recommend that the San Francisco Employees' Retirement System Board conduct a review of its investment strategy that includes a "failure analysis" which should have been done after the 2008-2009 fund losses.

BACKGROUND

A review of the 2010 and 2011 Annual and Actuarial Reports for the San Francisco Employees' Retirement System (the "Fund," also referred to as the "System" or "SFERS") prompted our concerns. The San Francisco Civil Grand Jury (the Jury) decided to investigate the Fund's investment policies and practices to assess and determine their compliance with obligations under the City Charter. Three prior investigations of San Francisco Employees' Retirement System by past Juries in 2008, 2009, and 2010, focused on the growth of pension benefits provided to retirees but none have shined a light on investment policy and its effect on City contributions to the Fund.

The City Charter established the Fund and created the San Francisco Employees' Retirement System Board (the Board).[1] The Board consists of seven members: one from the Board of Supervisors, three appointed by the Mayor, and three elected by the active and retired members of the Fund. The Board members are the trustees overseeing and assuring the long-term viability of the Fund to pay the obligations to San Francisco's retirees.

The California Constitution grants the Board full authority and fiduciary responsibility for investment of monies and administration of the Fund.[2] Under the City Charter, the Board is the sole authority and judge of conditions under which members of the Fund receive and continue to receive benefits.[3] It retains exclusive control over the administration and selection of investments for the Fund. The Board determines how much City, County, and District contributions are sufficient to provide for the payment of all benefits to all members.

Three sources support the Fund: employee contributions, contributions from the City, and earnings from the Fund's investments. The Fund, currently valued at approximately $15 billion, is the source of retirement benefits for over 28,000 employees and more than 24,000 retirees. The Fund is twice the size of the entire annual budget of the City and County of San Francisco.

The Fund has suffered considerable losses over the last five years. It sank from a high of $17.4 billion in 2007 to a low of $11.1 billion in 2009. The Board did not do a "failure analysis" investigation after this loss. The 2010 and 2011 Actuarial Reports[4] predict annual City contributions to the Fund. The City's contributions will rise annually until at least 2015. The Fund's Annual Reports[5] describe an investment policy with the potential to expose the Fund to further disastrous losses in the future.[6]

METHODOLOGY AND APPROACH

The Jury reviewed the Fund's Annual Reports, Auditor's Reports and Actuarial Reports for the fiscal years ending June 30, 2010, and June 30, 2011. We also reviewed news media articles, academic reports, institutional investor newsletters, studies, websites, bloggers, and materials provided for Board meetings from staff and consultants. The Jury interviewed Board members, auditors, staff, City Attorneys, investment consultants, academic professionals, some of the Mayor's staff, local government employees, and union leaders.

During the course of our investigation, the Jury encountered difficulty obtaining information surrounding the Fund's investment program and its results due to a lack of transparency. In contrast, the California Public Employees' Retirement System (CalPERS) includes on their website a much greater amount of updated investment information, analysis, and news for members and the public.[7]

The Jury was surprised to find that monthly investment returns for the Fund were not publicly available on the Internet. Per the Fund's policy, information we obtained was only available by personal requests to the Fund's Executive Secretary. The materials issued to the Board prior to monthly Fund meetings were our best resource. The Jury requested, obtained, and reviewed meeting materials from January 2011 to May 2012. The names of the Fund's investment managers, investment consultants, and companies in which the Fund invests were difficult and time-consuming to acquire. The Fund's staff resisted giving the Jury contact information for their outside consulting firms. Only by approaching the firms' representatives attending Board meetings was the Jury able to request interviews. Two of the three firms asked refused requests for interviews.

DISCUSSION

I. Investment Policies and Practices

A. Underfunding

The City's Charter requires a 100% funding ratio for the Fund.[8] Using the Actuarial Value of Assets, the Fund's 2011 Annual Report shows the funding level is approximately 88%, 12% short of mandated contribution levels or $2.3 billion. Actuarial value is a number the Board uses to estimate the assumed investment return rate in the future (see section B). The Market Value is the actual number for the assets in the fund. Using a market value of approximately 84%, the unfunded liability increases to 16% or $3.0 billion (see Table 1). The actuarial funding level assumes annual investment returns of 7.66% per year over the next 20 years. This rate of return is considerably higher than the Fund's annual average return for the past ten years of 6.01%. The current investment return for the 2012 fiscal year-to-date is a negative (-0.9%) rate of return.

Valuation Date	July 1, 2011	July 1, 2010
Fiscal Year End Value (millions)	**2013**	**2012**
Actuarial Liability	$ 18,598.7	$ 17,643.4
Actuarial Value of Assets	$ 16,313.1	$ 16,069.1
Unfunded Actuarial Liability (actuarial value)	$ 2,285.6	$ 1,574.3
Funding Ratio (actuarial value)	87.7%	91.1%
Market Value of Assets	$ 15,598.8	$ 13,136.8
Unfunded Liability (market value)	$ 2,999.9	$ 4,506.6
Funding Ratio (market value)	83.9%	74.5%

Table 1. Valuation Results[9]

The Board accepted, without comment, question, or statement, the Actuary's report projecting scenarios of additional needed future City contributions that could exceed 35% of the City's total payroll. When the Jury asked Board members and staff if they thought the system is underfunded, they disagreed. One board member was not worried since "we are better off than most other funds," while another stated, "It's not really a concern unless it is at least 20% short." One staff member said, "as long as the City is willing to make up the shortfall, it is not *technically* underfunded." Board members, in interviews, indicated they believe the Actuary's scenarios for future investment losses are for report purposes only, hypothetical and not of any real concern.

The Fund for the past three years has been underfunded. In order to bring the funding to the mandated 100% level, the City must increase its contributions. In 2011, the City contributed $338 million. The amount has grown, in 2012, to $433 million. Figure 1 illustrates the City's expected contributions as a percentage of salaries since 2004. For the years 2004 to 2007 the Board approved not requiring employees or the City to make contributions since the Fund was overfunded.[10] The rise from 2010 to 2013 is mainly due to the "amortization of Unfunded Actuarial Liability" (the UAL). The UAL amortization is the City's expected payment to cover the funding shortfall due to investment losses. Payments are annual and increase over time, until 2015.

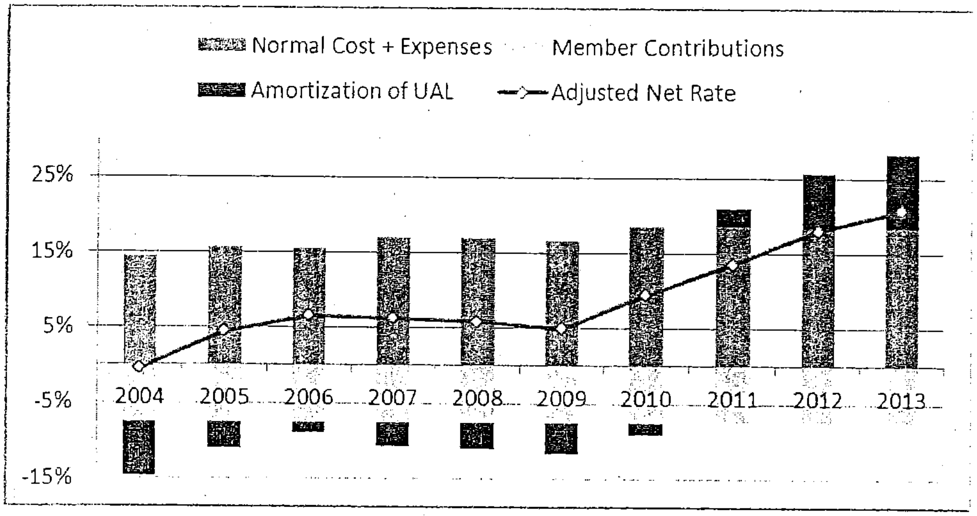

Figure 1. Historic Cost as a Percentage of Pay[11]

The Stanford Institute for Economic Policy Research issued a study titled "An Assessment of the San Francisco Unfunded Pension and Retirement Healthcare Liabilities."[12] The author found that "[o]n a market value basis, San Francisco's Fund would need to earn an average annual return of 11.5% for the next 18 years to achieve just a two-in-three probability of meeting its retirement obligations." The study recounted that:

> Between 1999 and 2011, San Francisco pension costs, which have grown at an average annual rate of 23.5%, increased faster than spending on public assistance (6.1%), public protection (5.4%), health and sanitation (2.6%), public ways and facilities (.17%), recreation and cultural services (4.1%) and miscellaneous functions (3.8%).[13]

The author also predicted that contributions by the City to the Fund along with health benefits would exceed $500 million per year until 2015. If the Fund's investments fail to meet the current expectations, annual contributions could exceed $600 million. The Board members we interviewed had not read this study and told the Jury that these types of studies are unfounded, discredited, and irrelevant.

B. Investment Return Assumption

The funding level for the Fund depends on a number of unknowable future events, such as: life span of beneficiaries, employment rates, future contributions, salary levels, changes in benefits, and estimates of the Fund's future investment returns. Assumed investment returns are a significant aspect of this calculation. An increase in returns will result in a corresponding decrease in the need for City contributions.

The Board relies on an investment-consulting firm to recommend the "investment return rate assumption" (the Assumed Rate) and professes not to know how the number is calculated. The consulting firm told the Jury its formula is proprietary, and will not divulge it to the Board or the Jury. The Board approves the Assumed Rate for the Actuary to use in estimating funding levels. Estimated funding levels determine the amount, if any, the City, as the employer, will have to pay into the Fund. Currently, the approved Assumed Rate is 7.66% through 2013, decreasing to 7.5% over the remaining 17 years. Decreasing the assumed rate results in the City increasing its contribution and vice versa. The Board receives recommendations from the consultant in February each year to set the Assumed Rate for use in the next fiscal year.

Also in February, the Board sets the City's contribution rate for the next fiscal year. That number is based on the final earnings results from the preceding fiscal year, which ends on June 30. During the Fund's February 2012 Board meeting, the Actuary cautioned the Commissioners that the high annual return the Fund achieved and reported for Fiscal Year 2010-2011 was "the luck of the calendar." In that Fiscal Year, the Fund's returns fluctuated wildly. From July 2010 to June 2011, the Fund "earned" 22%, or about $2 billion. In the next three months, $1 billion of Fund value was lost. By December, at the half-way point in Fiscal Year 2011-2012, the Fund showed a loss of nearly 5%. Setting a contribution rate based upon eight-month-old data appears to be an unsound practice in view of the market volatility experienced over the last five years.

San Francisco is not alone in using an unrealistically optimistic Assumed Rate. *The New York Times* reported in the article "Public Pensions Faulted for Bets on Rosy Returns," that "[w]hile Americans are typically earning less than 1% interest on their savings accounts, and watching their 401(k) balances yo-yo along with the stock market, most public pension funds are still betting they will earn annual returns of 7% to 8% over the long haul."[14] The article quotes Michael Bloomberg, Mayor of New York City, commenting on similar rate adjustments in his city, "This is going from an absolutely hysterical, laughable 8%, to indefensible 7% or 7.5%." He went on to say, "if I can give you one piece of financial advice: If somebody offers you a guaranteed 7% on your money for the rest of your life, you take it and just make sure the guy's name is not Madoff."

The British Government's Financial Services Authority (FSA)[15] recommends a much lower Assumed Rate for all funds:

> The projected returns are central to estimates over a 10 to 15 year period. It is crucial that projection rates are set at a realistic level so that investors are not misled. Today's independent research indicates that our maximum projection rates should be reduced.[16]

Elected Board members dissented when the Fund's Board approved the slightly decreased Assumed Rate in early 2012. The Jury asked the elected members why they did not support lowering the Assumed Rate, and each had a different response. One Board member said "It is just hope for the future" and "It is based on return averages for the last 25 years," this despite the fact that in the last ten years returns were lower as stated in the SFERS Annual Reports for 2010 and 2011. Another stated, "You can't predict the future from the past." Finally, one of the Board members exclaimed, "It's just a number!"

Year	5-years	10-years
2010	2.73%	2.80%
2011	4.20%	6.22%

Table 2. Investment Portfolio Performance Annualized Returns for the periods ending 6/30/2010 and 6/30/2011

C. Investment Risk

The Fund currently utilizes the "Yale Model" of investing, which it followed in the mid-1980s after public funds were allowed to invest in high-risk investments.[17] Yale University was one of the first institutional investors to participate in high-risk investing, and their method for "beating the market" with high returns became a model for many other funds. Until Proposition 21 passed in 1984,[18] California law limited public pension funds to investing in either bonds or "blue chip" stocks.[19] Prior to 1984, public pension funds grew steadily with minimum volatility, thus assuring a secure and predictable source of funds for retirees. The main mechanism for assuring growth returns in a low-risk, low-return environment was to take advantage of compound interest.

Soon after Proposition 21 passed, and until 2001, pension funds saw a greater return on their investments. In turn, pension funds provided more benefits, based on the assumption that the market would continue to grow. Despite the Dot.Com market crash of 2001, pension funds continued investing in the high-risk "Yale Model."[20] In fact, optimism was so high that between 2004 and 2007, neither employees nor the City paid contributions into the system because the system was "overfunded." After the market crash of 2008-2009, the market value of the Fund's investments fell from $17.4 billion in 2007 to $11.1 billion in 2009, a loss of almost 36% (see figure 2). Prior to and after the crash, the Fund's investments included not just public equities but such alternative investments as foreign equities, foreign bonds, real estate limited partnerships, commodities, venture capital, private equities, and distressed debt. Also included were derivatives such as collateralized mortgage-backed securities, credit swaps, and securities loans.

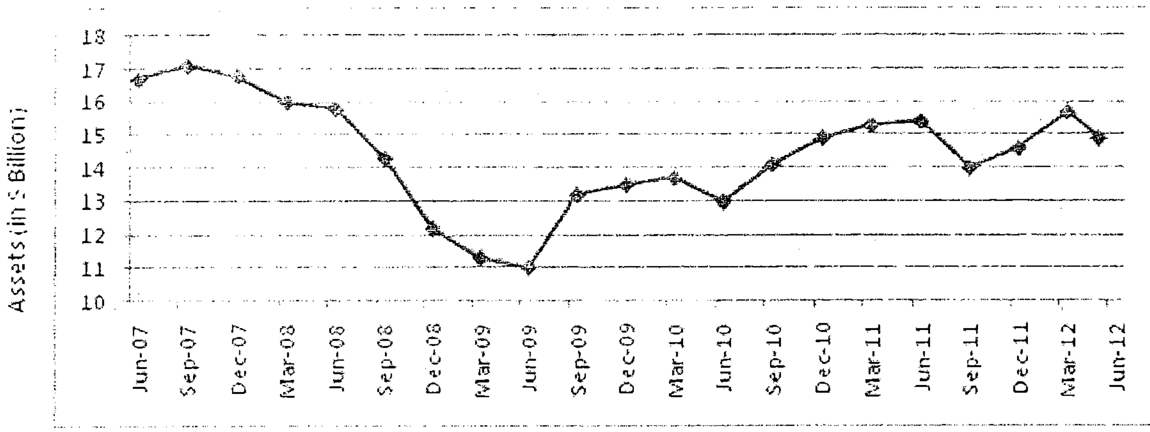

Figure 2. Monthly Assets June 2007 – May 2012[21]

Even after losing over one-third of the Fund's value, the Board did not conduct a "failure analysis" or investigate the reasons for this enormous loss. The Board did not openly question the policies and practices that led up to the crash and the severe financial impact it had on the Fund. Board members serving at the time of the crash told the Jury that the Fund's policies did not have anything to do with the losses. They offered no explanation as to how they reached this conclusion or why it would not happen again. The Jury inquired about any studies they knew of that would support their continuing use of this investment policy. No Board member cited any studies, reports, research, or other authority for this position.

Opinions vary regarding the appropriate level of risk for public funds. The Jury did an extensive search for factual evidence of the success of various investment policies. We found recent studies from Stanford University, the Upjohn Institute, *The New York Times,* and Ibbotson Associates. The reports researched whether a low-risk investment policy could equal or exceed a high-risk investment policy. While San Francisco's Fund was not the subject of any of the reports, the conclusions of these studies are directly applicable to the Fund's investment policies and practices as they examined large public and private pension funds.

Stanford Institute for Economic Policy Research reviewed CalPERS' investment returns from 1984 until 2009. During this period, CalPERS followed the Yale Model of aggressive high-risk investing. The study compared CalPERS' returns to a hypothetical low-risk portfolio pursued over the identical 25 year period. The authors found only a negligible (0.1%) increase in overall returns gained from investing in high-risk assets[22] (see figure 3). Both the report and CalPERS responses are on the CalPERS' website.[23] CalPERS read and reviewed this report and made it available to the public. San Francisco ignored the study of their Fund from the same Institute, had no response to it, and did not make it public.

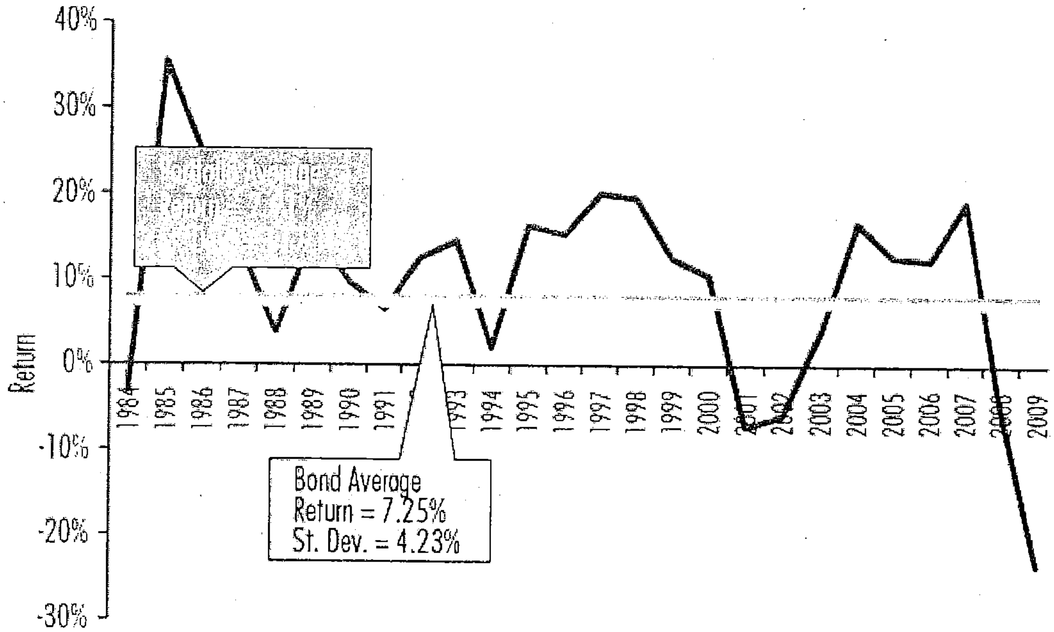

Figure 3. CalPERS Returns vs. Bond Average[24]

A recent investigative report from *The New York Times* titled "Pensions Find Riskier Investments Fail to Payoff" found that pension funds investing in more alternative investments have the highest risk level of all investment portfolios.[25] Contrary to expectations, these funds had poorer returns than those that remained in traditional investments. The average annual return for funds with the riskiest investment portfolio was 4.1% over the last five years, and the average return for funds with the lowest risk was 5.3%. The study concluded that high risk equaled less gain. San Francisco's Fund was not part of this study. However, the five-year average return rate for the San Francisco Fund, containing alternative investments, was 4.2% placing it in the lower return bracket. Surprisingly, quite a few funds that had done well with low-risk investing nevertheless intend to switch to the high-risk model.

The Upjohn Institute also found this phenomenon in another study.[26] In over 100 pension funds reviewed, they noted, "even if a fund made a higher return with a low-risk portfolio, there was still pressure to change from the conservative policy to assume more risk." Economists refer to this trend as the "herd mentality."

There are, however, contrary reports. The Ibbotson *SBBI Classic Yearbook* concludes that a high-risk investment policy is superior, over the long term, over low risk policy.[27] Based on historical returns for stocks and bonds, the *Yearbook's* charts show Treasury Bills and long-term bonds went up at a lower rate than large and small company stocks over a 70-year period ending in the year 2010. This reference is widely quoted as support for the high-risk investment policy.

It is important to note that Ibbotson's information is an historical tracking of stock and bond returns not a comparison of actual returns of pension funds.

These studies provide a different perspective on the San Francisco Fund. Replicating those studies would require updating the Fund's investment information and using San Francisco actuarial data for analysis. Such studies would determine the degree the above findings apply to the San Francisco Fund and need to be undertaken.

II. Findings

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

Responses requested from the Mayor, Board of Supervisors, Controller, San Francisco Employees' Retirement System Board, and San Francisco Employees' Retirement System Executive Director.

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

Responses requested from the Mayor, Board of Supervisors, Controller, San Francisco Employees' Retirement System Board, and San Francisco Employees' Retirement System Executive Director.

F3. The City must pay increasing contributions to the Fund due to underfunding.

Responses requested from the Mayor, Board of Supervisors, Controller, San Francisco Employees' Retirement System Board, and San Francisco Employees' Retirement System Executive Director.

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

Responses requested from the Mayor, Board of Supervisors, Controller, San Francisco Employees' Retirement System Board, and San Francisco Employees' Retirement System Executive Director.

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

Responses requested from the Mayor, Board of Supervisors, Controller, San Francisco Employees' Retirement System Board, and San Francisco Employees' Retirement System Executive Director.

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.

Responses requested from the Mayor, Board of Supervisors, Controller, San Francisco Employees' Retirement System Board, and San Francisco Employees' Retirement System Executive Director

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

Responses requested from the Mayor, Board of Supervisors, Controller, San Francisco Employees' Retirement System Board, and San Francisco Employees' Retirement System Executive Director.

III. Recommendations

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 courses of action.

Responses requested from the Mayor, Board of Supervisors, Controller, San Francisco Employees' Retirement System Board, and San Francisco Employees' Retirement System Executive Director.

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

Responses requested from the Mayor, Board of Supervisors, Controller, San Francisco Employees' Retirement System Board, and San Francisco Employees' Retirement System Executive Director.

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.

Responses requested from the Mayor, Board of Supervisors, Controller, San Francisco Employees' Retirement System Board, and San Francisco Employees' Retirement System Executive Director.

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

Responses requested from the Mayor, Board of Supervisors, Controller, San Francisco Employees' Retirement System Board, and San Francisco Employees' Retirement System Executive Director.

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

Responses requested from Mayor, Board of Supervisors, Controller, San Francisco Employees' Retirement System Board, and the San Francisco Employees' Retirement System Executive Director.

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 Employees' Retirement System Pension Fund.

Responses requested from the Mayor, Board of Supervisors, Controller, San Francisco Employees' Retirement System Board, and San Francisco Employees' Retirement System Executive Director.

CONCLUSION

The Jury finds that the San Francisco Employees' Retirement System Fund is pursuing a high-risk investment model adopted over 28 years ago. The Fund continues to rely on the "Yale Model" even after the 2008-2009 losses left the Fund short. To make up for the losses, City contributions to the Fund have ballooned to $433 million in 2012. Those contributions will continue to rise until at least 2015. This expense will divert money from other essential City services. Continuing high-risk investments create the possibility of further losses which will require even higher City contributions.

The Jury recommends the Fund investigate and formulate long- and short-term contingency plans to reduce exposure to future losses. The assumed investment return rate employed by the Fund is unrealistically high. Efforts to meet this high rate lead to high-risk investment policies and practices. The Jury recommends the Fund adopt a reality-based assumed investment return rate that accurately predicts the funding needed for guaranteed benefits of present and future retirees.

Most importantly, the Jury recommends the Fund undertake a serious and thorough investigation of their investment policies and practices. High volatility investing is not desirable for a public fund that exists to provide predictable, secure and safe funding levels for retirees far into the future. Current studies question the widely and long-held assumption that public funds must engage in high-risk investing to meet their funding needs.

ENDNOTES

[1] City and County of San Francisco Charter, Article XII.

[2] Constitution of the State of California, Article XVI, §17.

[3] City and County of San Francisco Charter, Article XII, §12.100.

[4] William Hallmark and Kenneth Kent, "Cheiron Presentation to the Retirement Board of SFERS," January 2012.

[5] *San Francisco Employees' Retirement System Annual Report for Fiscal Year Ended June 30, 2010.*

[6] *San Francisco Employees' Retirement System Annual Report for Fiscal Year Ended June 30, 2011.*

[7] CalPERS website, www.calpers.ca.gov.

[8] City and County of San Francisco Charter, Article XII.

[9] The Actuarial figures are as of June 30, 2011. Updated figures will not be available until January 2013. William Hallmark and Kenneth Kent, "Cheiron Presentation to the Retirement Board of SFERS," January 2012. The actuarial value is lower to account for the contribution debt owed by the city amortized over time and for higher benefits in future.

[10] Per interviews with SFERS Board members.

[11] 2012 Actuary Report to the San Francisco Employees' Retirement System Board.

[12] Joe Nation, "An Assessment of San Francisco's Unfunded Pension and Retiree Health Care Liabilities," Stanford Institute of Economic Research, March 15, 2011.

[13] *Ibid.*

[14] Mary Williams Walsh and Danny Hakim, "Public Pensions Faulted for Bets on Rosy Returns," *The New York Times,* May 27, 2012.

[15] Ben Moshinsky, "Pension, Insurance Firms Must Reduce Return Estimates, FSA Says," *Bloomberg* Apr 10, 2012, http://www.bloomberg.com/news/2012-04-10/pension-insurance-firms-must-reduce-return-estimates-fsa-says.html.

[16] Peter Smith, Former Head of Investments at the Financial Services Agency of the British Government as quoted by R A McCleod & Co., "Investment project rates must be set at a realistic level, says FSA," April 2012. http://www.ramcleod.co.uk/site/news/801337367.html.

[17] Rick Ferri, "The Curse of the Yale Model," *Forbes*, April 2012 http://www.forbes.com/sites/rickferri/2012/04/16/the-curse-of-the-yale-model/.

[18] Proposition 21 amended Section 17 of Article XVI of the California Constitution.

[19] CalPensions, "Pension Crisis: Did Prop 21 Pave the Way?," 2010, http://calpensions.com/2010/07/01/pension-crisis-did-prop-21-pave-the-way/.

[20] *Ibid.*

[21] Provided by SFERS staff per requested by the Jury (June 2012); unaudited from August 2011 to May 2012.

[22] Howard Bornstein, *Going for Broke: Reforming California's Public Employee Pension*, Stanford Institute for Economic Policy Research, April 2, 2010.

[23] CalPers website.

[24] Howard Bornstein, *Going for Broke: Reforming California's Public Employee Pension*, Stanford Institute for Economic Policy Research, April 2, 2010.

[25] Julie Creswell, "Pensions Find Riskier Funds Fail to Pay Off," *The New York Times*, April 2012.

[26] N. Mohan, and T. Zhang, "An analysis of risk-taking behavior for public defined benefit plans," *Upjohn Institute Working Paper* 112-179, November 2011.

[27] *SBBI Classic Yearbook*, www.corporate.morningstar.com/ib/asp/detail.aspx?xmlfile=1409.xml. SBBI stands for Stocks, Bonds, Bills, & Inflation.

RESPONSE MATRIX

Pursuant to **Penal Code** § **933.05**, the Civil Grand Jury requests responses as follows:

	Findings						
Respondent	F1	F2	F3	F4	F5	F6	F7
Mayor	X	X	X	X	X	X	X
Board of Supervisors	X	X	X	X	X	X	X
Controller	X	X	X	X	X	X	X
San Francisco Employees' Retirement System Board	X	X	X	X	X	X	X
San Francisco Employees' Retirement System Executive Director	X	X	X	X	X	X	X

	Recommendations					
Respondent	R1	R2	R3	R4	R5	R6
Mayor	X	X	X	X	X	X
Board of Supervisors	X	X	X	X	X	X
Controller	X	X	X	X	X	X
San Francisco Employees' Retirement System Board	X	X	X	X	X	X
San Francisco Employees' Retirement System Executive Director	X	X	X	X	X	X

APPENDIX

Glossary of Terms

Actuarial Report: An analysis of funding needed for payment of benefits, based on a number of assumptions such as salaries, number of employees, ages and life spans of employees and retirees, length of service of employees, inflation rate, benefit guarantees, and expected return on investments.

Alternative Investments: An Investment Allocation category that is mostly Private Equity investments in Venture Capital and Buyout portfolios.

Amortization: Payment of a loan or debt in installments over time. Also depreciation of an asset over time.

Auditor's Report: Recorded in the annual report, SFERS auditor's report tests to see if an organization's financial statements comply with Generally Accepted Accounting Principles. This is sometimes referred to as the clean opinion.

Collateralized Mortgage-Backed Securities: Derivative investments created by aggregating mortgages into pools and then selling interests that entitle owners to payments over time until the underlying debt is retired.

Commodities: Commodities are any marketable items produced to satisfy wants or needs. Examples include minerals such as iron ore, crude oil, and coal, and agricultural products such as coffee beans, rice, and wheat.

Compound Interest: The additional interest rate received when returns are invested over the long term. The formula for calculating compound interest is at http://www.thecalculatorsite.com/finance/calculators/compoundinterestcalculator.php.

Credit Default Swaps (CDS): A financial swap agreement that the seller of the CDS will compensate the buyer in the event of a loan default or other credit event. The buyer of the CDS makes a series of payments to the seller and, in exchange, receives a payoff if the loan defaults.

Derivative: A derivative instrument is a contract between two parties that specifies conditions (especially the dates, resulting values of the underlying variables, and nominal amounts) under which payments are to be made between the parties. Derivatives have been used to mask credit risk from third parties while protecting derivative counterparties.

Distressed Debt: A debt security in an unprofitable company that is likely to go bankrupt. This is considered to be a high-risk security with the potential for high returns because financial distress often precedes complete restructuring, which could keep the company from bankruptcy, or at least liquidation, enabling the security to be paid in full.

Failure Analysis: The process of collecting and analyzing data to determine the cause of a failure.

Funding Ratio: The Actuarial Liability divided by the Actuarial or Market Value of Assets.

Hedging: Reducing the risk on an investment by investing in another asset. Used frequently by institutional day traders (investment fund managers). For example, one could either perform a trade (future or forward) that is a promise to sell at a future price, or invest in an asset that is likely to negatively correlate with your original investment.

Investment Return Rate Assumption: This is a prediction as to what the future returns will be on the investments of the fund. In SFERS this is determined by a vote of the Board.

Investment Risk: The risks that an investor takes that the value of an asset will fall below the amount paid for the asset.

Private Equity: Private Equity (PE) Firms (also called "buyout firms") purchase controlling interest in non-public companies and then manage them in order to make them more profitable. They make the purchase with a combination of institutional investors who become limited partners, and bank loans on the credit of the purchased company itself. During the time they are managing the assets (the firms they control), the return on investment is estimated by an accounting firm hired by the PE firm itself, and the limited partners pay 2% per year, for up to 10 years, until the investment is "realized." Then any profits are shared between the PE firm first, which takes 20% of the profits, and the institutional investors. Although the press includes many articles, pro and con, about the success and the social consequences of PE, there are very few comparative studies, as the information on the investments is unregulated and a highly protected secret.

Real Estate Limited Partnerships: A limited partnership in which limited partners provide capital, and the general partner in turn manages the development of real estate, e.g., to build an apartment complex or housing subdivision. The general partner uses the investment money from the limited partners to sell or rent the property.

Securities Loan: The act of loaning a stock, derivative, or other security to an investor or firm. The borrower puts up collateral - cash, security or a letter of credit. The title or ownership of the security is transferred to the borrower.

Unfunded Actuarial Liability (UAL): The values of the benefits already earned exceed the assets in the fund.

Venture Capital: Private Equity investments in start-up firms.

Volatility: A statistical measure of the disparity of returns for a given security or market index. Low volatility means that an index remains relatively stable day-to-day. High volatility means that the price fluctuates wildly.

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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 <u>findings</u> 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.

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,

Edwin M. Lee
Mayor

San Francisco Employees' Retirement System

City and County of San Francisco
Employees' Retirement System
Office of the Executive Director

October 15, 2012

Honorable Judge Katherine Feinstein
Presiding Judge
Superior Court of California, County of San Francisco
400 McAllister Street, Room 008
San Francisco, CA 94102

Re: Response to 2011-2012 Civil Grand Jury Report - Investment Policies and Practices of the San Francisco Employees' Retirement System

Dear Judge Feinstein:

The following attachment is provided as the requested responses from the San Francisco Employees' Retirement System (SFERS) Board and the SFERS Executive Director to the 2011-2012 Civil Grand Jury report titled "Investment Policies and Practices of the San Francisco Employees' Retirement System". For ease of administration, they have been provided in the format used by the Controller's Office to track implementation of Civil Grand Jury recommendations.

The responses provided by the SFERS Board have been reviewed and approved by the SFERS Board. The responses provided by the SFERS Executive Director are mine.

Do not hesitate to contact me with any questions or comments at (415) 487-7015.

Respectfully submitted,

Jay Huish
Executive Director

Cc: The Honorable Edwin M. Lee
Ben Rosenfield, Controller
Angela Calvillo, Clerk of the Board of Supervisors
Members of the SFERS Board

Status of the Recommendations
by the 2011-12 Civil Grand Jury

California Penal Code Sections 933.05(a) and (b) requires the responding party to report for each recommendation of the Civil Grand Jury one of the following actions:

1. Recommendation Implemented	2. Will Be Implemented in the Future	3. Requires Further Analysis	4. Will Not Be Implemented: Not Warranted or Not Reasonable
- Date Implemented - Summary of Implemented Action	- Anticipated Timeframe for Implementation	- Explanation - Timeframe (Not to exceed six months from date of publication of grand jury report)	- Explanation

For each recommendation below, indicate one of the four actions you have taken or plan to take in the "Action Plan" column and provide the required explanation in the "2012 Response Text" column.

CGJ Year	Report Title	Recommendation or Finding Number	Recommendation or Finding Text	Response Required From	Action Plan	2012 Response Text
2011-12	Investment Policies and Practices of the San Francisco Employees' Retirement System	F1	The San Francisco Employees' Retirement System Pension Fund is currently underfunded by more than $2 billion.	**SFERS Board** **SFERS Executive Director**	This item is a finding - there will be no action plan in response.	**SFERS Board:** As of the most recent SFERS Actuarial Valuation (July 1, 2011), the SFERS Unfunded Actuarial Liability was $2.285 billion. **SFERS Executive Director:** As of the most recent SFERS Actuarial Valuation (July 1, 2011), the SFERS Unfunded Actuarial Liability was $2.285 billion.
2011-12	Investment Policies and Practices of the San Francisco Employees' Retirement System	F2	The San Francisco Employees' Retirement System Board did not complete a "failure analysis" subsequent to the funding loss suffered in 2008-2009.	**SFERS Board** **SFERS Executive Director**	This item is a finding - there will be no action plan in response.	**SFERS Board:** We disagree with this Finding. The unrealized loss in market value of the SFERS Trust in 2008-2009 was not a "failure" of the SFERS investment policy, but rather the result of unprecedented conditions in the financial markets. In compliance with our long-standing policy and practice, the Retirement Board reviews the fund's investment performance each quarter. To prepare for that review, SFERS investment staff and the Retirement Board consultants conduct a comprehensive review and analysis of the investments and present their conclusions to the Retirement Board at its regularly scheduled meetings. This process was followed quarterly, before, throughout, and after 2008-2009. In addition, at the September 8, 2009 meeting, we reviewed the annual investment performance and approved recommended changes in the sub-asset class structure of the SFERS portfolio. The changes were recommended by investment staff and the consultant as a result of their review and analysis of the financial markets at the time. Moreover, at the October 13, 2009 meeting, we approved recommended changes to the Investment Policy Statement that were recommended to us. **SFERS Executive Director:** I disagree with this Finding. As is the SFERS Board's long-standing policy and practice, Retirement investment staff and consultants conducted a comprehensive review and analysis of the SFERS Trust investment performance and presented the results of its analysis to the SFERS Board on a quarterly basis throughout and after 2008-2009. The investment performance report of SFERS Trust investment outcomes for Plan Year 2008-2009 was presented to the SFERS Board at its regular meeting on September 8, 2009. The SFERS Board approved recommended changes in the sub-asset class structure of the SFERS portfolio at its September 8, 2009 SFERS Board meeting which were a result of investment staff and consultants' review and analysis of the then-current financial markets. In addition,the SFERS Board approved changes to the Investment Policy Statement as recommended by investment staff and consultants after completion of their extensive review and analysis at its regular meeting on October 13, 2009. The unrealized loss in market value of the SFERS Trust in 2008-2009 was not a "failure" of the SFERS investment policy, but rather the result of extraordinarily difficult financial markets.

Status of the Recommendations
by the 2011-12 Civil Grand Jury

California Penal Code Sections 933.05(a) and (b) requires the responding party to report for each recommendation of the Civil Grand Jury one of the following actions:

1. Recommendation Implemented - Date Implemented - Summary of Implemented Action	2. Will Be Implemented in the Future - Anticipated Timeframe for Implementation	3. Requires Further Analysis - Explanation - Timeframe (Not to exceed six months from date of publication of grand jury report)	4. Will Not Be Implemented: Not Warranted or Not Reasonable - Explanation

For each recommendation below, indicate one of the four actions you have taken or plan to take in the "Action Plan" column and provide the required explanation in the "2012 Response Text" column.

CGJ Year	Report Title	Recommendation or Finding Number	Recommendation or Finding Text	Response Required From	Action Plan	2012 Response Text
2011-12	Investment Policies and Practices of the San Francisco Employees' Retirement System	F3	The City must pay increasing contributions to the Fund due to underfunding.	**SFERS Board** **SFERS Executive Director**	This item is a finding - there will be no action plan in response.	**SFERS Board:** The SFERS consulting actuary prepares projections under several scenarios, using future long-term investment returns which estimate the City's required contribution rates into the future. The most recent projections, provided to us at the February 2012 meeting, demonstrate that the City's required contribution rate is anticipated to rise over the next two years as SFERS recognizes the deferred losses from Plan Year 2008-2009 under the plan's 5-year smoothing methodology for valuing Plan assets. These projections also indicate that under certain scenarios (e.g.the Plan achieves its assumed investment return on an annualized basis over the long term), the City's required contributions may decrease over time after fiscal 2014-2015 when SFERS recognizes its final installment of the deferred loss associated with Plan Year 2008-2009 under the 5-year smoothing methodology. We also note that increases in City contributions can be triggered by causes other than underfunding. **SFERS Executive Director:** The SFERS consulting actuary has prepared projections under several scenarios of future long-term investment returns which project the City's required contribution rates into the future. The most recent projections provided to the SFERS Board at its February 2012 regular meeting demonstrate that the City's required contribution rate is projected to rise over the next two years as SFERS recognizes the deferred losses from Plan Year 2008-2009 under the Plan's 5-year smoothing methodology for valuing Plan assets. These projections indicate that under certain scenarios (e.g.the Plan achieves its assumed investment return on an annualized basis over the long term), the City's required contributions may decrease over time after Plan Year 2014-2015 when SFERS recognizes its final installment of the deferred loss associated with Plan Year 2008-2009 under the 5-year smoothing methodology. Further, increases in City contributions can be triggered by causes other than underfunding of the SFERS Trust.
2011-12	Investment Policies and Practices of the San Francisco Employees' Retirement System	F4	The increases in pension contributions by the City are growing at a faster rate than expenditures on most other City services since 1999.	**SFERS Board** **SFERS Executive Director**	This item is a finding - there will be no action plan in response.	**SFERS Board:** The SFERS Board can neither confirm nor deny the validity of this Finding. **SFERS Executive Director:** The SFERS Executive Director can neither confirm nor deny the validity of this Finding.

Status of the Recommendations
by the 2011-12 Civil Grand Jury

California Penal Code Sections 933.05(a) and (b) requires the responding party to report for each recommendation of the Civil Grand Jury one of the following actions:

1. Recommendation Implemented	2. Will Be Implemented in the Future	3. Requires Further Analysis	4. Will Not Be Implemented: Not Warranted or Not Reasonable
- Date Implemented - Summary of Implemented Action	- Anticipated Timeframe for Implementation	- Explanation - Timeframe (Not to exceed six months from date of publication of grand jury report)	- Explanation

For each recommendation below, indicate one of the four actions you have taken or plan to take in the "Action Plan" column and provide the required explanation in the "2012 Response Text" column.

CGJ Year	Report Title	Recommendation or Finding Number	Recommendation or Finding Text	Response Required From	Action Plan	2012 Response Text
2011-12	Investment Policies and Practices of the San Francisco Employees' Retirement System	F5	The Fund can artificially reduce the City's estimated liabilities by increasing its investment return assumptions for future years.	**SFERS Board** **SFERS Executive Director**	This item is a finding - there will be no action plan in response.	**SFERS Board :** The Board takes issue with the implications behind this Finding. We, and staff and the consultants, are fiduciaries to the trust beneficiaries. We take the obligations to our beneficiaries seriously. As fiduciaries, we are obligated to insure there are sufficient assets to pay the benefits granted by the voters. That promise could be jeopardized by engaging in the activity described in this Finding. For that reason, we carefully consider the investment return assumptions on an annual basis, relying on the independent, consulting actuary for analysis and recommendation. Further, the consulting actuary is bound by the Code of Professional Conduct and Actuarial Standards of Practice set out by the Actuarial Standards Board which strictly prohibit any such "artificial" rate setting recommendation to the SFERS Board. **SFERS Executive Director:** The SFERS Board, staff and consultants are bound as legal fiduciaries to the beneficiaries of the SFERS Trust by the California Constitution, the City Charter, and/or by contract. As fiduciaries to the SFERS Trust, the SFERS Board, staff or consultant's participation in the activity described in this Finding would be strictly prohibited. Further, the SFERS Board's consulting actuarial firm upon whose recommendation the SFERS Board approves the investment return assumption is bound by the Code of Professional Conduct and Actuarial Standards of Practice set out by the Actuarial Standards Board which would strictly prohibit any such "artificial" rate setting recommendation to the SFERS Board.

California Penal Code Sections 933.05(a) and (b) requires the responding party to report for each recommendation of the Civil Grand Jury one of the following actions:

1. Recommendation Implemented	2. Will Be Implemented in the Future	3. Requires Further Analysis	4. Will Not Be Implemented: Not Warranted or Not Reasonable
- Date Implemented - Summary of Implemented Action	- Anticipated Timeframe for Implementation	- Explanation - Timeframe (Not to exceed six months from date of publication of grand jury report)	- Explanation

For each recommendation below, indicate one of the four actions you have taken or plan to take in the "Action Plan" column and provide the required explanation in the "2012 Response Text" column.

CGJ Year	Report Title	Recommendation or Finding Number	Recommendation or Finding Text	Response Required From	Action Plan	2012 Response Text
2011-12	Investment Policies and Practices of the San Francisco Employees' Retirement System	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.	**SFERS Board** **SFERS Executive Director**	This item is a finding - there will be no action plan in response.	**SFERS Board:** We vehemently disagree with this Finding. First, there is no basis in fact that the 7.66% assumed investment return rate is "unrealistically high". The annualized investment returns that SFERS has achieved over the past 20 years (8.17% net of manager fees) strongly support our decisions related to investment returns. Further, the annualized investment return for the the three years since 2008-2009 is 11.71% and demonstrates our prudence in setting the assumed rate of return at 7.66%. Second, the Civil Grand Jury's characterization of our motives and concerns in setting the assumed investment return rate is wholy unsubstantiated, and reckless in that light. As set forth above, we, staff and our consultants, are fiduciaries to the beneficiaries. It is our primary obligation to ensure that the SFERS trust assets are sufficient to pay the promised benefits. The Board takes its obligations seriously. **SFERS Executive Director:** The SFERS Executive Director vehemently disagrees with this Finding. First, there is no basis for the assertion that the 7.66% assumed investment return rate is "unrealistically high". The annualized investment returns that SFERS has achieved over the past 20 years (8.17% net of manager fees) strongly support the decisions made by the SFERS Board over the past 20 years related to long-term investment return assumptions for the SFERS Trust. Further, the annualized investment return for the SFERS Trust for the three years since 2008-2009 is 11.71%. Second, the Civil Grand Jury's characterization of the SFERS Board's motives and concerns in setting the assumed investment return rates is wholy unsubstantiated and reckless. The SFERS Board, Executive Director, staff and consultants are bound as legal fiduciaries to the beneficiaries of the SFERS Trust by the California Constitution, the City Charter and/or by contract. As fiduciaries to the SFERS Trust, the SFERS Board, Executive Director/staff or consultant's participation in the activity described in this Finding would be strictly prohibited.
2011-12	Investment Policies and Practices of the San Francisco Employees' Retirement System	F7	Studies show that public funds with low-risk investment policies perform as well as or better than those with high-risk policies.	**SFERS Board** **SFERS Executive Director**	This item is a finding - there will be no action plan in response.	**SFERS Board:** The SFERS Board can neither confirm nor deny the validity of this Finding. **SFERS Executive Director:** The SFERS Executive Director can neither confirm nor deny the validity of this Finding.

Status of the Recommendations
by the 2011-12 Civil Grand Jury

California Penal Code Sections 933.05(a) and (b) requires the responding party to report for each recommendation of the Civil Grand Jury one of the following actions:

1. Recommendation Implemented - Date Implemented - Summary of Implemented Action	2. Will Be Implemented in the Future - Anticipated Timeframe for Implementation	3. Requires Further Analysis - Explanation - Timeframe (Not to exceed six months from date of publication of grand jury report)	4. Will Not Be Implemented: Not Warranted or Not Reasonable - Explanation

For each recommendation below, indicate one of the four actions you have taken or plan to take in the "Action Plan" column and provide the required explanation in the "2012 Response Text" column.

CGJ Year	Report Title	Recommendation or Finding Number	Recommendation or Finding Text	Response Required From	Action Plan	2012 Response Text
2011-12	Investment Policies and Practices of the San Francisco Employees' Retirement System	R1	San Francisco Employees' Retirement System Board address the $2 billion dollar [sic] 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 courses of action.	**SFERS Board** **SFERS Executive Director**	**Will Not Be Implemented: Not Warranted**	**SFERS Board:** Throughout 2011, City officials, community groups, labor organizations and concerned members of the public engaged in discussions to address concerns over SFERS' funding. Their collaboration resulted in Proposition C, approved by the voters in November 2011. The reform measures approved by City voters will significantly address SFERS funding levels over the next 15 to 20 years. In addition, under the California Constitution and the Charter, the SFERS Board has plenary authority and fiduciary responsibility for the investment of the SFERS trust asets. We engage expert investment and actuarial consultants to support us in our role as fiduciaries. We cannot delegate our investment authority or fiduciary responsibility to the recommended task force. City officials, community groups and the public have other avenues (public comment at SFERS Board meetings or direct communication with the SFERS Board) to express "courses of action" on any subject that they would recommend to the SFERS Board. **SFERS Executive Director:** As pointed out in the report, by authority of the California Constitution and the City Charter, the SFERS Board has the plenary authority and fiduciary responsibility for the investment of the SFERS Trust. The SFERS Board also engages expert investment and actuarial consultants to support them in their role as fiduciaries. The SFERS Board cannot delegate their investment authority or fiduciary responsibility nor let another entity, such as the recommended task force, influence their investment decisions. City officials, community groups and the public have other avenues (public comment at SFERS Board meetings or direct communication with the SFERS Board) to express "courses of action" on any subject that they would recommend to the SFERS Board. The challenge of addressing the underfunding of the Plan is well known to the SFERS Board, staff and consultants and courses of action have been or are in the process of being implemented to address this challenge. Among them, independent from the SFERS Board, previous efforts similar to the task force recommended by the Civil Grand Jury by City officials, community groups, labor organizations and the public have resulted in pension reform measures approved by City voters which will significantly address SFERS funding levels over the next 15 to 20 years.

Status of the Recommendations
by the 2011-12 Civil Grand Jury

California Penal Code Sections 933.05(a) and (b) requires the responding party to report for each recommendation of the Civil Grand Jury one of the following actions:

1. Recommendation Implemented	2. Will Be Implemented in the Future	3. Requires Further Analysis	4. Will Not Be Implemented: Not Warranted or Not Reasonable
- Date Implemented - Summary of Implemented Action	- Anticipated Timeframe for Implementation	- Explanation - Timeframe (Not to exceed six months from date of publication of grand jury report)	- Explanation

For each recommendation below, indicate one of the four actions you have taken or plan to take in the "Action Plan" column and provide the required explanation in the "2012 Response Text" column.

CGJ Year	Report Title	Recommendation or Finding Number	Recommendation or Finding Text	Response Required From	Action Plan	2012 Response Text
2011-12	Investment Policies and Practices of the San Francisco Employees' Retirement System	**R2**	Adopt a realistic and consistent formula for estimating the assumed expected investment return rate.	**SFERS Board** **SFERS Executive Director**	**Recommendation Implemented**	**SFERS Board:** We have had a long-standing policy and practice in place to develop all economic and demographic actuarial assumptions, including the investment return assumption, in compliance with Actuarial Standards of Practice set out by the Actuarial Standards Board. As a result of this policy and practice, in December 2011, we voted to phase in a reduction of the long-term investment return assumption from 7.75% to 7.50%, over a 3-year period beginning July 1, 2011. This decison was based on the consulting actuary's recommendation and was consistent with our capital markets outlook as confirmed by our investment consultants, actual plan experience, and the directional trend in economic assumptions being recommended to public plans nationally by public plan actuaries. The annualized investment return that SFERS has achieved over the past 20 years [8.17% net of manager fees] supports our decision, as well as the fund's annualized investment returns of 11.71% since July 1, 2009. **SFERS Executive Director:** The SFERS Board has a long-standing policy and practice in place to develop all economic and demographic actuarial assumptions, including the investment return assumption, in compliance with Actuarial Standards of Practice set out by the Actuarial Standards Board. As a result of this policy and practice, in December 2011, the Retirement Board voted to phase in a reduction of the long-term investment return assumption from 7.75% to 7.50%, over 3-year period beginning July 1, 2011, as recommended by the Board's consulting actuarial firm and consistent with the Board and investment consultant's capital markets outlook, actual plan experience, and the directional trend in economic assumptions being recommended to public plans nationally by public plan actuaries. Historically, the annualized investment return that SFERS has achieved over the past 20 years [8.17% net of manager fees] supports the decisions that the SFERS Board has made over this same time period related to long-term investment return assumptions. Further, the SFERS Trust has annualized investment returns of 11.71% since July 1, 2009.

Status of the Recommendations
by the 2011-12 Civil Grand Jury

California Penal Code Sections 933.05(a) and (b) requires the responding party to report for each recommendation of the Civil Grand Jury one of the following actions:

1. Recommendation Implemented - Date Implemented - Summary of Implemented Action	2. Will Be Implemented in the Future - Anticipated Timeframe for Implementation	3. Requires Further Analysis - Explanation - Timeframe (Not to exceed six months from date of publication of grand jury report)	4. Will Not Be Implemented: Not Warranted or Not Reasonable - Explanation

For each recommendation below, indicate one of the four actions you have taken or plan to take in the "Action Plan" column and provide the required explanation in the "2012 Response Text" column.

CGJ Year	Report Title	Recommendation or Finding Number	Recommendation or Finding Text	Response Required From	Action Plan	2012 Response Text
2011-12	Investment Policies and Practices of the San Francisco Employees' Retirement System	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.	**SFERS Board** **SFERS Executive Director**	**Recommendation Implemented**	**SFERS Board:** This recommendation embodies the fiduciary due diligence that we have embedded in our investment policies and procedures over the past decades. In accordance with our long-standing policies, there were thorough, in-depth analyses conducted by investment staff and consultants before, throughout and after 2008-2009, the results of which were reported to us on a quarterly basis at our public meetings. Specifically, at our September 8, 2009 meeting, they presented us with a comprehensive analysis of the investment outcomes for Plan Year 2008-2009, and recommended changes in the investment portfolio's sub asset class structure as a result of their review and analysis of the then-current financial markets. Thereafter, based on these findings, we approved changes to the Investment Policy Statement at our October 13, 2009. These reports are available to the public. **SFERS Executive Director:** This recommendation embodies the fiduciary due diligence that the Retirement Board has embedded in its investment policies and procedures over the years. In accordance with the Retirement Board's long-standing investment policies, there were thorough, in-depth analyses conducted by investment staff and consultants before, throughout and after 2008-2009, the results of which were reported to the nRetirement Board on a quarterly basis at its public meetings. SFERS investment staff and consultants completed a comprehensive analysis of the SFERS Trust investment outcomes for Plan Year 2008-2009, the results of which were presented to the SFERS Board at its regular meeting on September 8, 2009. SFERS investment staff and consultants also presented recommended changes in the sub-asset class structure of the SFERS portfolio at the September 8, 2009 SFERS Board meeting which were a result of their review and analysis of the then-current financial markets. In addition, SFERS investment staff and consultants completed an extensive review and analysis of the SFERS Investment Policy Statement and presented recommended changes to the Investment Policy Statement to the SFERS Board at its regular meeting on October 13, 2009. These reports are available to the public.

Status of the Recommendations
by the 2011-12 Civil Grand Jury

California Penal Code Sections 933.05(a) and (b) requires the responding party to report for each recommendation of the Civil Grand Jury one of the following actions:

1. Recommendation Implemented - Date Implemented - Summary of Implemented Action	2. Will Be Implemented in the Future - Anticipated Timeframe for Implementation	3. Requires Further Analysis - Explanation - Timeframe (Not to exceed six months from date of publication of grand jury report)	4. Will Not Be Implemented: Not Warranted or Not Reasonable - Explanation

For each recommendation below, indicate one of the four actions you have taken or plan to take in the "Action Plan" column and provide the required explanation in the "2012 Response Text" column.

CGJ Year	Report Title	Recommendation or Finding Number	Recommendation or Finding Text	Response Required From	Action Plan	2012 Response Text
2011-12	Investment Policies and Practices of the San Francisco Employees' Retirement System	R4	Investigate, quantify and address all the major risks in the portfolio and make this information public.	SFERS Board SFERS Executive Director	Recommendation Implemented	**SFERS Board:** We have a long-standing strategic business initiative related to analyzing, quantifying and reporting of investment risks in the SFERS portfolio. Most recently, the investment risk management intitiative was documented in the SFERS Strategic Plan, which we adopted at our October 12, 2011 meeting. SFERS has retained a risk consultant and licensed a risk measurement and reporting software program to facilitate staff's review, analysis and reporting of investment risk exposures in the SFERS portfolio. The results of the investment risk analysis have been reported to us on a monthly basis since February 2011. SFERS investment staff has fully intergrated the public (U.S. and international) equity portfolio into the risk analysis and is in the process of integrating the fixed income portfolio. All of the reports and presentation materials are available to the public. **SFERS Executive Director:** The SFERS Board has a long-standing business initiative related to the analyzing, quantifying and reporting of investment risks in the SFERS portfolio. Most recently, the investment risk management intitiative was documented in the SFERS Strategic Plan adopted by the SFERS Board at its October 12, 2011 regular meeting. SFERS has retained a risk consultant and licensed a risk measurement and reporting software program to facilitate investment staff's review, analysis and reporting of investment risk exposures in the SFERS portfolio. The results of the investment risk analysis has been reported to the SFERS Board on a monthly basis since February 2011. SFERS investment staff has fully intergrated the public (U.S. and international) equity portfolio into the risk analysis and has begun the integration of the fixed income portfolio. Further, the Investment Committee of the SFERS Board has received periodic briefings by SFERS investment staff and consultant over the past five years. All of the reports and presentation materials presented to the SFERS Board related to the investment risk management initiative are available to the public and the Civil Grand Jury.
2011-12	Investment Policies and Practices of the San Francisco Employees' Retirement System	R5	Investigate less volatile and risky investment policies that would attain sufficient returns for the San Francisco Employees' Retirement System Pension Fund.	SFERS Board SFERS Executive Director	Recommendation Implemented	**SFERS Board:** We routinely analyze a full range of investment policies and opportunities in relation to the goals of the SFERS Trust. **SFERS Executive Director:** The SFERS Board has a long-standing policy and practice in place to analyze the full range of investment policies and opportunities in relation to the goals of the SFERS Trust. As reported by the Retirement Board's general investment consultant, as of June 30, 2012, the risk level of the SFERS portfolio, measured by standard deviation of returns, was below the median peer (public funds with assets over $1 billion) over the trailing one, three and five-year periods.

Status of the Recommendations
by the 2011-12 Civil Grand Jury

California Penal Code Sections 933.05(a) and (b) requires the responding party to report for each recommendation of the Civil Grand Jury one of the following actions:

1. Recommendation Implemented - Date Implemented - Summary of Implemented Action	2. Will Be Implemented in the Future - Anticipated Timeframe for Implementation	3. Requires Further Analysis - Explanation - Timeframe (Not to exceed six months from date of publication of grand jury report)	4. Will Not Be Implemented: Not Warranted or Not Reasonable - Explanation

For each recommendation below, indicate one of the four actions you have taken or plan to take in the "Action Plan" column and provide the required explanation in the "2012 Response Text" column.

CGJ Year	Report Title	Recommendation or Finding Number	Recommendation or Finding Text	Response Required From	Action Plan	2012 Response Text
2011-12	Investment Policies and Practices of the San Francisco Employees' Retirement System	**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 Employees' Retirement System Pension Fund.	**SFERS Board** **SFERS Executive Director**	**Will Not Be Implemented: Not Warranted and Not Reasonable**	**SFERS Board:** The findings of these types of comparison studies are routinely reviewed as part of the due diligence required as fiduciaries to the SFERS Trust. These comparison studies have tangential relevance to our decisions for SFERS, so the time and expense required to replicate these comparison studies are unwarranted and unreasonable. **SFERS Executive Director:** It is not reasonable for the SFERS Board to require investment staff and consultants to replicate these or similar studies. The SFERS Board, staff and consultants routinely review the findings of these types of comparison studies as part of the due diligence required as fiduciaries to the SFERS Trust.

CITY AND COUNTY OF SAN FRANCISCO
OFFICE OF THE CONTROLLER

Ben Rosenfield
Controller

Monique Zmuda
Deputy Controller

October 1, 2012

Honorable Judge Feinstein
Presiding Judge
San Francisco Superior Court
400 McAllister Street – Room 008
San Francisco, CA 94102-4512

Dear Judge Feinstein:

The following attachment is provided in response to several reports from the 2011-2012 Civil Grand Jury regarding the City's Arts Commission, Municipal Transportation Agency, and Employee Retirement System. For ease of administration, they have been provided in the format used to track implementation of Civil Grand Jury recommendations.

Please extend my thanks to the Civil Grand Jury for their service. Thank you for your time, and do not hesitate to contact me with any questions or comments at (415) 554-7500.

Sincerely,

Ben Rosenfield
Controller
City and County of San Francisco

Status of the Recommendations
by the Civil Grand Jury
2010-11

California Penal Code Section, 933.05 (b), requires the responding party to report for each recommendation of the Civil Grand Jury one of the following actions:

1. Recommendation Implemented	2. Will Be Implemented in the Future	3. Requires Further Analysis	4. Will Not Be Implemented: Not Warranted or Not Reasonable
- Date Implemented - Summary of Implemented Action	- Anticipated Timeframe for Implementation	- Explanation - Timeframe *(Not to exceed six months from date of publication of Grand Jury report)*	- Explanation

For each recommendation below, indicate one of the four actions you have taken or plan to take in the "Action Plan" column and provide the required explanation in the "2012 Response Text" column.

CGJ Year	Report Title	Finding or Recommendations	Response Required	Action	2012 Response Text
2011-2012	*Better MUNI Service Needed, Without Switchbacks*	F7. MUINI has failed to fully implement basic technological improvements in the system.	Office of the Controller	Partially agree	The SFMTA has worked to implement various technological improvements and upgrades to existing systems. These investments, of course, are financially constrained given limited resources available for service, maintenance, infrastructure, and other priority needs.
2011-2012	Better MUNI Service Needed, Without Switchbacks	F8. MUNI's newest and most advanced control centers lack adequate operating personnel and cannot communicate directly with MUNI drivers.	Office of the Controller	Agree	The newest control centers lacks some key functionality and has been understaffed. Plans are in place and underway for improvements in both areas.
2011-2012	Better MUNI Service Needed, Without Switchbacks	F9. MUNI has failed to conduct and publish monthly rider surveys as recommended in the FY 2008 and 2010 quality review.	Office of the Controller	Agree	The quality review recommendation for monthly surveys is not a requirement. MTA does do a significant amount of public outreach and opinion-testing through hearings and comment cards. Other survey efforts are also performed such as the annual city survey and MTA's own rider surveys performed to comply with Federal requirements. While the monthly rider surveys suggested in the FY 2008 and FY 2010 quality reviews are not a requirement, the SFMTA reports that they will commence monthly surveys later this fiscal year.

CGJ Year	Report Title	Finding or Recommendations	Response Required	Action	2012 Response Text
2011-2012	Better MUNI Service Needed, Without Switchbacks	R2. Contact and learn from comparable transit systems that do not resort to switchbacks as a regular solution to their problems	Office of the Controller	2. Will be implemented in the future	The Controller's Office is engaged in a multi-year effort with the Municipal Transportation Agency (MTA) to improve MTA services. This effort, the Transportation Effectiveness Project (TEP) includes a variety of service improvements to address operating issues and to speed up MUNI service throughout the system. Addressing switchbacks along with other line management challenges are part of the TEP. In addition, the Controller's Office conducts quarterly benchmarking reports comparing San Francisco to other jurisdictions. MUNI services will be included in this benchmarking effort in upcoming fiscal quarters.
2011-2012	Better MUNI Service Needed, Without Switchbacks	R3. The Controller audit MUNI funds to determine if there are additional resources that may be available to rectify delays and scheduling problems.	Office of the Controller	1. Recommendation implemented	The Controller's Office conducts annual performance audits of the Municipal Transportation Agency and financial audits of selected issues and contracts. All audits include work to determine if MTA resources are being used effectively and efficiently and if funds could be better used. In addition, MTA has had multiple efforts in the last three fiscal years to identify new revenue sources and operating support. Finally, as noted above, MTA is engaged in a service improvement program (the TEP) whose central goal is to speed travel time throughout the system. This audit and project focus is ongoing.
2011-2012	When There's Smoke . . . The Need to Strengthen the Art Commission's Cultural Legacy	R3. Encourage the creation of a non-profit organization dedicated to raising funds to meet program and operational needs.	Office of the Controller	4. Will not be implemented	Many civic functions such as Recreation and Park and the Library benefit from non-profits formed to further their purposes. The Art Commission could similarly benefit. However this action is not within the Controller' Office authority. We would assist with appropriate city accounting and financial arrangements should a non-profit be formed to support the Art Commission.
2011-2012	When There's Smoke . . . The Need to Strengthen the Art Commission's Cultural Legacy	R4. Improve the orientation and training of Commissioners to provide them with a clear understanding of their administrative responsibilities and roles in budgeting, personnel management, city processes, and their role as ambassadors to the public to increase awareness of art opportunities in the community.	Office of the Controller	3. Requires further analysis	Complete and ongoing training is helpful for commissions to effectively discharge their duties, although we have not undertaken a review of the SFAC's training program. The Controller's Office can assist with training in public financial management and oversight roles for Commissioners, if requested by the SFAC. Comparable training has been provided by the Controller's Office to other City commissions, non-profit boards, and other public bodies.

CGJ Year	Report Title	Finding or Recommendations	Response Required	Action	2012 Response Text
2011-2012	When There's Smoke . . . The Need to Strengthen the Art Commission's Cultural Legacy	F18. Art maintenance is more appropriately an operating rather than capital cost as it is a day-to-day responsibility of SFAC.	Office of the Controller	Diasgree	Art maintenance expenditures could appropriately be treated as an operating expense up to certain thresholds determined by standard accounting practices. The City's standard practice is to include planning for maintenance of capital assets through the City's capital planning process. Ultimately all uses -- whether for maintenance, capital, or operating expenditures -- draw from the same funding sources and are adopted in the City's annual budget.
2011-2012	When There's Smoke . . . The Need to Strengthen the Art Commission's Cultural Legacy	F19. Art maintenance is inappropriately treated as a capital expense by City government.	Office of the Controller	Diasgree	Art maintenance expenditures could appropriately be treated as an operating expense up to certain thresholds determined by standard accounting practices. The City's standard practice is to include planning for maintenance of capital assets through the City's capital planning process. Ultimately all uses -- whether for maintenance, capital, or operating expenditures -- draw from the same funding sources and are adopted in the City's annual budget.
2011-2012	When There's Smoke . . . The Need to Strengthen the Art Commission's Cultural Legacy	R9. Re-designate maintenance and conservation of the Collection as an operating expense of the SFAC rather than a capital budget item	Office of the Controller	Disagree	Art maintenance expenditures could appropriately be treated as an operating expense up to certain thresholds determined by standard accounting practices. The City's standard practice is to include planning for maintenance of capital assets through the City's capital planning process. Ultimately all uses -- whether for maintenance, capital, or operating expenditures -- draw from the same funding sources and are adopted in the City's annual budget.
2011-2012	When There's Smoke . . . The Need to Strengthen the Art Commission's Cultural Legacy	R10. Redirect and dedicate $1 million, over two years, of the Grants for the Arts/Hotel Tax Fund on a one-time basis to the Arts Commission to fund the inventory, maintenance, storage, de-accessioning, exhibition and installation of the existing Collection located in the City, at San Francisco International Airport, and at other City properties.	Office of the Controller	4. Will not be implemented	This action is not in the authority of the Controller. Appropriation of funds is the authority of the Mayor and Board of Supervisors under the budgetary and financial provisions of the Charter.

CGJ Year	Report Title	Finding or Recommendations	Response Required	Action	2012 Response Text
2011-2012	When There's Smoke . . . The Need to Strengthen the Art Commission's Cultural Legacy	R11. Designate Hotel Tax Funds from the initial $1 million for the development of educational print, on-line and phone app materials to showcase the existing Civic Art Collection located in the City, at San Francisco International Airport, and at other City properties to make the Collection more accessible to City residents and visitors.	Office of the Controller	4. Will not be implemented	This action is not in the authority of the Controller. Appropriation of funds is the authority of the Mayor and Board of Supervisors under the budgetary and financial provisions of the Charter
2011-2012	When There's Smoke . . . The Need to Strengthen the Art Commission's Cultural Legacy	R12. Designate Hotel Tax Fund monies of 1% of the value of the Collection (up to $900,000) on an annual basis for the maintenance and care of the Collection.	Office of the Controller	4. Will not be implemented	This action is not in the authority of the Controller. Appropriation of funds is the authority of the Mayor and Board of Supervisors under the budgetary and financial provisions of the Charter.
2011-2012	When There's Smoke . . . The Need to Strengthen the Art Commission's Cultural Legacy	R15 SFAC hold public hearings about the Cultural Centers and their short- and long-term funding (for programs and facility maintenance), facility, and safety needs to develop an action plan to secure the Cultural Centers	Office of the Controller	3. Requires further analysis	This action is not in the authority of the Controller.]We would be willing to assist the SFAC in analysis needed to prepare a productive public hearing process.
2011-2012	When There's Smoke . . . The Need to Strengthen the Art Commission's Cultural Legacy	F28. The Street Artists annual fees since 2000 have increased in large part due to the costs of defending the Program Manager for violations of the Sunshine ordinances from the Street Artists	Office of the Controller	Disagree	Confirming this finding would require further analysis of the Street Artist Program's revenues and expenses, although generally speaking rising labor and benefit (and not legal) costs have been the dominant drivers of the City's expenditures in recent years.

CGJ Year	Report Title	Finding or Recommendations	Response Required	Action	2012 Response Text
2011-2012	When There's Smoke . . . The Need to Strengthen the Art Commission's Cultural Legacy	R19. Legal expenses for the Sunshine Ordinance defense be paid from an account, other than the Street Artist Fund.	Office of the Controller	Disagree	Legal expenses are an operating cost of the Street Artist Program and are appropriately paid from the special revenue fund that supports the Program. This is standard public accounting practice for simliarly-funded City programs. The Mayor and the Board of Supervisors have the authority, through the City's annual budget process, to provide a General Fund subsidy to the program, to cover legal or other costs.
2011-2012	When There's Smoke . . . The Need to Strengthen the Art Commission's Cultural Legacy	F34 For general operating and SFAC Gallery exhibition expenses, SFAC relies on public funds that are designated by Charter for "maintenance of a symphony orchestra...."	Office of the Controller	Disagree	While the SFAC receives approximately $800,000 annually from the SF Symphony, this amount is legally distint from the Charter-required allocation of property tax funds to the SF Symphony.
2011-2012	When There's Smoke . . . The Need to Strengthen the Art Commission's Cultural Legacy	F35. Since 1935, SFAC has chosen the San Francisco Symphony as recipient of those funds.	Office of the Controller	Agree	This is a correct statement.
2011-2012	When There's Smoke . . . The Need to Strengthen the Art Commission's Cultural Legacy	F36. SFAC is without legal or practical recourse if SFS revoked its annual contribution of 40% of those funds given to SFAC.	Office of the Controller	Disgree	If the SF Symphony revoked its gift to the SFAC, the SFAC would have the ability to request funds from other sources through the City's budget process, ultimately driven by decisions of the Mayor and Board of Supervisors.

CGJ Year	Report Title	Finding or Recommendations	Response Required	Action	2012 Response Text
2011-2012	When There's Smoke . . . The Need to Strengthen the Art Commission's Cultural Legacy	F37. The manner in which SFAC funds its operations by a giveback donation of SFS monies creates, at the least, an appearance of fiscal impropriety and violates the Intent of the 1935 Charter amendment.	Office of the Controller	Disagree	The City's budget is in compliance with Charter Section 16.106 that requires an annual appropriation for a municipal symphony. The SFAC is in compliance with the acceptance of gifts, granted by Charter Section 5.100.
2011-2012	When There's Smoke . . . The Need to Strengthen the Art Commission's Cultural Legacy	F38. GFTA funds the San Francisco Symphony for over $600,000 annually for operating expenses	Office of the Controller	Agree	This is a correct statement.
2011-2012	When There's Smoke . . . The Need to Strengthen the Art Commission's Cultural Legacy	R22. The Arts Commission/Symphony Agreement comply with the intent of the full amount of the tax revenues go toward Symphony operating expenses.	Office of the Controller	1. Rec implemented	The City's budget Is In compliance with Charter Section 16.106 that requires an annual appropriation for a municipal symphony. The SFAC is in compliance with the acceptance of gifts, granted by Charter Section 5.100.
2011-2012	When There's Smoke . . . The Need to Strengthen the Art Commission's Cultural Legacy	R23. Redirect Hotel Tax Fund money allocated to the SFS by GFTA to the SFAC.	Office of the Controller	4. Will not be implemented	This action is not in the authority of the Controller. The Controller's Office monitors and acts to maintain the Hotel Tax Fund's compliance with Charter and Code requirements. Grants for the Arts has programmatic authority over their grants and allocations.

CGJ Year	Report Title	Finding or Recommendations	Response Required	Action	2012 Response Text
2011-2012	Investment Policies and Practices of the San Francisco Employees' Retirement System	F1. The San Francisco Employees' Retirement System Pension Fund is currently underfunded by more than $2 billion.	Office of the Controller	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.
2011-2012	Investment Policies and Practices of the San Francisco Employees' Retirement System	F2. The San Francisco Employees' Retirement System Board did not complete a "failure analysis" subsequent to the funding loss suffered in 2008-09.	Office of the Controller	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.
2011-2012	Investment Policies and Practices of the San Francisco Employees' Retirement System	F3. The City must pay increasing contributions to the Fund due to underfunding.	Office of the Controller	Agree	At the February 2012 meeting of the SFERS Board, SFERS consulting actuaries provided projections using various investment return scenarios. Those scenarios anticipate that City contribution rates are likely to rise at least through FY 2014-15 when SFERS recognizes its final installment of deferred losses associated with FY 2008-09 under the Plan's five-year smoothing policy. Whether City contributions must continue to rise after FY 2014-15 as a percentage of payroll will depend on future investment returns along with the results of annual reevaluations of other actuarial assumptions.
2011-2012	Investment Policies and Practices of the San Francisco Employees' Retirement System	F4. The increases in pension contributions by the City are growing at a faster rate than expenditures on most other City services since 1999.	Office of the Controller	Agree	I agree, although the City had no required pension contributions to SFERS in FY 1998-99 due to surplus funding of the Plan at that time. Thus it is not possible to calculate a growth rate on percentage terms from that base year. Looking at more recent 3-year growth between FY 2008-09 and FY 2011-12, the City's growth in employer share contributions to SFERS was from $112 million in FY 2008-09 to $385 million in FY 2011-12, for an average annual growth of 50.8%. This is indeed a much faster growth rate than on other expenditures, such as salaries (0.1% average annual growth over this period) or health benefits for active employees (5.9% average annual growth).

CGJ Year	Report Title	Finding or Recommendations	Response Required	Action	2012 Response Text
2011-2012	Investment Policies and Practices of the San Francisco Employees' Retirement System	F5. The Fund can artificially reduce the City's estimated liabilities by increasing its investment return assumptions for future years.	Office of the Controller	Disagree	Fund investment return assumptions are set by the SFERS Board, and I disagree with characterizing any decision by the SFERS Board as "artificial." Board decisions regarding investment return assumptions are made in public after hearing recommendations from professional actuaries. The Board has a fiduciary duty to Plan beneficiaries and as such has a responsibility to maintain the long-term health of the Plan.
2011-2012	Investment Policies and Practices of the San Francisco Employees' Retirement System	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.	Office of the Controller	Disagree	Fund investment return assumptions are set by the SFERS Board. Board decisions regarding investment return assumptions are made in public after hearing recommendations from professional actuaries. The Board has a fiduciary duty to Plan beneficiaries and as such has a responsibility to maintain the long-term health of the Plan.
2011-2012	Investment Policies and Practices of the San Francisco Employees' Retirement System	F7. Studies show that public funds with low-risk investment policies perform as well as or better than those with high-risk policies.	Office of the Controller	Requires further research	I do not have personal knowledge as to the accuracy of this finding.
2011-2012	Investment Policies and Practices of the San Francisco Employees' Retirement System	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 courses of action.	Office of the Controller	4. Will not be implemented	This recommendation implies that the challenge of addressing the underfunding of the plan is unknown to the System and that an approach toward closing this gap is not in place. Neither implication is true. The funding status of the plan has been the subject of a great deal of attention by the SFERS Board, the Mayor, Board of Supervisors, plan beneficiaries, and the electorate in the past two years. The Charter and

**Status of the Recommendations
by the Civil Grand Jury
2010-11**

CGJ Year	Report Title	Finding or Recommendations	Response Required	Action	2012 Response Text
2011-2012	Investment Policies and Practices of the San Francisco Employees' Retirement System	R2. Adopt a realistic and consistent formula for estimating the assumed expected investment return rate.	Office of the Controller	1. Rec implemented	I believe this recommendation has already been implemented within the framework of the existing SFERS Board processes. The SFERS Board will continue to consider changes to their assumed expected investment return rate on a regular basis under its existing procedures.
2011-2012	Investment Policies and Practices of the San Francisco Employees' Retirement System	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.	Office of the Controller	1. Rec implemented	I believe this recommendation has already been implemented. While the term "failure analysis" is not used by SFERS, I believe 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.
2011-2012	Investment Policies and Practices of the San Francisco Employees' Retirement System	R4. Investigate, quantify and address all the major risks in the portfolio and make this information public.	Office of the Controller	1. Rec implemented	I believe this recommendation has already been implemented. The SFERS Board Strategic Plan, adopted at the Boards 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.
2011-2012	Investment Policies and Practices of the San Francisco Employees' Retirement System	R5. Investigate less volatile and risky investment policies that would attain sufficient returns for the San Francisco Employees' Retirement System Pension Fund.	Office of the Controller	1. Rec implemented	This recommendation has been implemented. This recommendation has been implemented by SFERS to the extent that a range of investment options are discussed and implemented by the Plan.

CGJ Year	Report Title	Finding or Recommendations	Response Required	Action	2012 Response Text
2011-2012	Investment Policies and Practices of the San Francisco Employees' Retirement System	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 Employees' Retirement System Pension Fund.	Office of the Controller	3. Requires further analysis	SFERS actuarial consultants produce various benchmarks and comparisons as part of the analyses they provide the SFERS Board. I cannot tell whether a replication of the precise studies cited would be a cost-effective use of resources.

BOARD of SUPERVISORS

City Hall
Dr. Carlton B. Goodlett Place, Room 244
San Francisco 94102-4689
Tel. No. 554-5184
Fax No. 554-5163
TDD/TTY No. 544-5227

DATE: August 16, 2012

TO: Members of the Board of Supervisors

FROM: Angela Calvillo, Clerk of the Board

SUBJECT: 2011-2012 Civil Grand Jury Report

We are in receipt of the San Francisco Civil Grand Jury (CGJ) report released August 16, 2012, entitled: **Investment Policies and Practices of the San Francisco Employees' Retirement System.** (Attached)

Pursuant to California Penal Code Sections 933 and 933.05, the Board must:

1. Respond to the report within 90 days of receipt, or no later than November 15, 2012.
2. For each finding:
   - agree with the finding or
   - disagree with the finding, wholly or partially, and explain why.
3. For each recommendation:
   - agree with the recommendation or
   - disagree with the recommendation, wholly or partially, and explain why.

Pursuant to San Francisco Administrative Code Section 2.10, in coordination with the Committee Chair, the Clerk will schedule a public hearing (File No. 120843) before the Government Audit and Oversight Committee to allow the Board the necessary time to review and formally respond to the findings and recommendations.

The Budget and Legislative Analyst will prepare a resolution (File No. 120844), outlining the findings and recommendations for the Committee's consideration, to be heard at the same time as the hearing on the report.

Attachment

c: Honorable Katherine Feinstein, Presiding Judge
Mario Choi, Foreperson, 2011-2012 San Francisco Civil Grand Jury
Mayor's Office
Ben Rosenfield, Controller
Cheryl Adams, Deputy City Attorney
Rick Caldeira, Deputy Clerk

Orig: Alisa / Joy
c: COB, Leg Dep.
cpage

SUPERIOR COURT OF CALIFORNIA
COUNTY OF SAN FRANCISCO
CIVIL GRAND JURY

RECEIVED
BOARD OF SUPERVISORS
SAN FRANCISCO
2012 AUG 13 AM 10:33

August 13, 2012

Angela Calvillo
Clerk of the Board of Supervisors
City Hall, Room 244
San Francisco, CA 94102

Dear Ms. Calvillo,

The 2011 – 2012 San Francisco Civil Grand Jury will release its report entitled, "Investment Policies and Practices of the San Francisco Employees' Retirement System," to the public on August 16, 2012. Enclosed is an advance copy of this report. Please note that by order of the Presiding Judge of the Superior Court, Hon. Katherine Feinstein, this report is to be kept confidential until the date of release.

California Penal Code section 933.5 requires the responding party or entity identified in the report to respond to the Presiding Judge of the Superior Court within a specified number of days. You are required by code to respond to this report no later than November 15, 2012. For each finding of the Civil Grand Jury, the response must either:

1) Agree with the finding; or
2) Disagree with it, wholly or partially, and explain why.

Further, as to each recommendation made by the Civil Grand Jury, the responding party must either indicate:

1) That the recommendation has been implemented, with a summary explanation of how it was implemented;
2) That the recommendation has not been implemented, but will be implemented in the future, with a timeframe for implementation;
3) That the recommendation requires further analysis, with an explanation of the scope of that analysis and a timeframe for the officer or agency head to be prepared to discuss it (less than six months from the release of the report); or
4) That the recommendation will not be implemented because it is not warranted or reasonable, with an explanation of why that is. (California Penal Code sections 933, 933.05)

400 McAllister Street, Room 008
San Francisco, CA 94102-4512
Phone: 415-551-3605

Please provide your responses to the findings and recommendations in this report to Judge Feinstein, with an informational copy sent to the Grand Jury Office at the below address.

Very truly yours,

Mario Choi, Foreperson Pro Tem
2011 – 2012 Civil Grand Jury

400 McAllister Street, Room 008
San Francisco, CA 94102-4512
Phone: 415-551-3605

Print Form

Introduction Form

By a Member of the Board of Supervisors or the Mayor

Time stamp
or meeting date

I hereby submit the following item for introduction (select only one):

- [x] 1. For reference to Committee: Government Audit and Oversight Committee
  An ordinance, resolution, motion, or charter amendment.
- [ ] 2. Request for next printed agenda without reference to Committee.
- [ ] 3. Request for hearing on a subject matter at Committee:
- [ ] 4. Request for letter beginning "Supervisor   inquires"
- [ ] 5. City Attorney request.
- [ ] 6. Call File No.   from Committee.
- [ ] 7. Budget Analyst request (attach written motion).
- [ ] 8. Substitute Legislation File No.
- [ ] 9. Request for Closed Session (attach written motion).
- [ ] 10. Board to Sit as A Committee of the Whole.
- [ ] 11. Question(s) submitted for Mayoral Appearance before the BOS on

Please check the appropriate boxes. The proposed legislation should be forwarded to the following:

- [ ] Small Business Commission
- [ ] Youth Commission
- [ ] Ethics Commission
- [ ] Planning Commission
- [ ] Building Inspection Commission

Note: For the Imperative Agenda (a resolution not on the printed agenda), use a different form.

Sponsor(s):

Clerk of the Board

Subject:

Board Response - Civil Grand Jury Report - Investment Policies and Practices of the San Francisco Employees' Retirement System

The text is listed below or attached:

Resolution responding to the Presiding Judge of the Superior Court on the findings and recommendations contained in the 2011-2012 Civil Grand Jury report entitled "Investment Policies and Practices of the San Francisco Employees' Retirement System" and urging the Mayor to cause the implementation of accepted findings and recommendations through his/her department heads and through the development of the annual budget.

Signature of Sponsoring Supervisor: Madeleine Licavoli

For Clerk's Use Only:

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