

**PUBLIC SAFETY PERSONNEL RETIREMENT SYSTEM  
BOARD OF TRUSTEES MEETING  
DECEMBER 6, 2010**

**MINUTES**

Mr. Brian Tobin, Trustee, Chairman  
Ms. Lori Roediger, Trustee, Vice Chairperson – telephonic attendance  
Mr. Tim Dunne, Trustee  
Mr. Gregory Ferguson, Trustee  
Mr. Alan Maguire, Trustee  
Mr. Jeff McHenry  
Ms. Randie Stein

Mr. Jim Hacking, Administrator  
Ms. Tracey Peterson, Assistant Administrator, COO  
Mr. Marty Anderson, Chief Equities Analyst  
Ms. Gail Nova, Administration Manager  
Ms. Bridget Feeley, Internal Audit and Compliance Officer  
Mr. Paul Hemmes, Training/Audio Visual Specialist  
Ms. Cathy Nagy, Gabriel Roeder Smith & Company – telephonic attendance  
Mr. Mark Buis, Gabriel Roeder Smith & Company – telephonic attendance

1. Call to Order; Roll Call; Opening remarks.....Mr. Brian Tobin  
Board Chairman

Six members attended in person and Ms. Lori Roediger attended by conference call.

Mr. Tobin informed the Board that the goal of this special meeting is to follow through with our fiduciary responsibility to the beneficiaries of the Trust. Over many months, we have met about the issues to be discussed again today. This is not the first nor the last time this oard will discuss the issues on today's agenda.

About six years ago, the Board lowered the assumed earnings rate from 9% to 8.5%. Last year the assumed earnings rate was reduced from 8.5% to 8.25% which was established by the Board to fulfill their fiduciary responsibility. Mr. Tobin stated we are here today due to losses in 2000 – 2002 and the recent losses in 2008-09. The Board has worked on diversification of portfolio assets in order to achieve more stability and reduce risk. We have passed legislation to benefit the System by enabling us to use external portfolio managers. Now we need to look at our ability to pay the benefits that have been promised through the System. We have created and implemented governance policies that had never before existed. We are not meeting here as a result of the Arizona Republic eight day report on the pension plans of the state. It is coincidental that our meeting happens to occur just after that series of articles ran. That series is not driving this Board's agenda. The series, although it raised some tough issues, was incomplete and inaccurate in many respects. We are not here because the beneficiaries of our system have done anything wrong. They have paid their fair share to our System; so they should not bear an unfair burden in the process. However, it would be naive if we didn't appreciate the political pressure that the

Governor's office and our legislature are under as a result of both the Arizona Republic's series and other articles that have appeared throughout the media. The pressure these media articles create is real; but we must let calmer heads prevail. This Board has brought about reforms throughout the years and we must separate our actions as fiduciary from the political and cultural agendas. We must complete our decision-making as fiduciaries and direct our legislative consultants to move forward with the changes we propose in order to meet our goals and not react to political demands.

2. Discussion and possible **Action** regarding the approval of a proposed "goal," timeframe and process for restoring to a state of financial soundness the PSPRS Plan, the Correction Officers Retirement Plan (CORP) and Elected Officials' Retirement Plan (EORP) within a reasonable period of time. .. ..... Mr. Brian Tobin

Mr. Tobin stated that there is a need to formally adopt a funding goal for our Plans and a timeframe within which to achieve that goal. Then we can discuss and agree upon specific changes that will get our Plans to the stated goal in the stated timeframe with a high degree of probability of success. In previous meetings we talked about the goal of becoming 80% funded within 20 years with a 75% or higher probability of success.

Mr. Ferguson suggested a "Call to the Public". Mr. Maguire supported three minutes without redundancy.

3. Call to the Public

**This is the time for the public to comment. Members of the Board of Trustees may not discuss items that are not specifically identified on the agenda, except to address criticism from the public. Therefore, pursuant to A.R.S. § 38-431.01(H), the Board of Trustees' reaction to any public comment is limited to addressing criticism or recommending that the Board of Trustees or Staff respond or study such comment or schedule the subject matter for further consideration at a later date after appropriate notice.**

Mr. Jim Mann, Executive Director of the Fraternal Order of Police (FOP) Labor Council, stated that the FOP, during the upcoming legislative session, will evaluate proposed changes to our retirement system. He said the FOP believes that any proposals must be legal, ethical, and fair. The Arizona Republic series on public employee pensions unfairly left the impression that every retired police officer enjoys a plush retirement. That is simply not the case. The Republic story failed to point the blame to the real villains. Mr. Maguire asked, with all due respect, how this is relevant to one of our agenda items. Mr. Mann then stated the FOP believes the real cause for the retirement system's investment losses has been corporate greed and securities fraud. The PSPRS portfolio included investments in some of those corporations. Law enforcement is increasingly dangerous work, yet Arizona law enforcement officers take on that work willingly. No one joins the police and fire departments to get rich; so it stings when the media paints us as greedy or as receiving benefits we have not earned. We have played by the rules as have our retirees. We have done more with less just like every family in this horrific economy. What we have never done is abdicate our responsibility to protect the community.

Mr. Brian Livingston, Executive Director of the Arizona Police Association (APA), stated he would go directly to the problem as he sees it with PSPRS. First, we had a very poor investment strategy at the turn of the century. We failed to diversify our fund enough to allow for an upturn or a downturn in the market, which negatively impacted the System. He said he is pleased that the Board developed the strategy to adequately diversify the investments. His question was why didn't it happen sooner? Why did we invest so heavily in high tech stocks at the turn of the

century when everyone else was getting out of those stocks? Second, he stated he sees in many of the reports an attack on the Cost of Living Adjustment (COLA) system. COLA's are meant for retirees who have made their contributions into this System and deserve to safeguard their retirement. It is not there to enhance their retirements; it is there to maintain stability in their retirement. By taking COLAs away, you would penalize those who have made the System what it is. It is an easy way out. Third, we need to address the legal costs this System has paid out over the years. \$200,000 to \$300,000 per month is an inappropriate use of funds to pay for legal services. Only recently has this been addressed by the Board when they changed how and when we determine to go to outside consultants. He continued by saying he has not seen action by this Board to find out who authorized numerous transactions (over 20 of them) to seek legal opinions on certain questions. He has not seen the Board act to try to recover some of the costs for the poor advice given by those legal advisers. He continued by saying, as I see this, it is an attack on the System itself and those who are a part of it. I see a challenge to PSPRS to enter into a two tier system which would penalize those who will come into the Plans at a future date. These Plans were put in place to entice people to enter our profession. Without those enticements, we will see a vacuum in terms of people wanting to enter at a future date. There is no enticement to work in the police profession for 25 years; there is no enticement to say let's get rid of DROP because we know the average police officer only stays in the DROP program for 2.5 years. The police profession is inherently dangerous. Anything that tells a police officer they must stay longer will inhibit our continued growth. The cities have not decided to hire new personnel and we have no influx of funds, yet there are those who want to blame those who are receiving funds and who have paid their dues into this system. He stated he believes a reevaluation is in order.

A discussion was held regarding the policy for members of the Board to address those who answer the Call to the Public. Mr. Hacking stated that as long as the matter raised pertains to what is on the agenda, the question can be asked by a member of the Board of Trustees to the member of the public.

Mr. Maguire stated that, for the record, he disagrees with that view.

Another member of the public addressed the Board of Trustees, Ms. Barbara Maglish, a retiree. She thanked the Board members for looking at this situation and stated the Arizona Republic did not have all of the facts. She was at a Fund Manager Meeting in April 2009 in which she brought up the issue of DROP. About a year ago, many employers were here as were employee representatives to talk about the solvency of our program and DROP was brought up. As a retiree, she stated she appreciates her retirement, since that is all she has and she needs to make sure it is preserved and protected. The basic concept was to provide care for the retirees. Let's be realistic, she added, regarding the economic situation and make some sacrifices so that our retirement is protected both for retirees and those currently paying into it. Regarding the COLAs, 4% is way beyond the inflation rate. We need to look at DROP and take it out of our pension fund itself because there are payouts which come out of the fund which do not come from the DROP people. We can set up a contributory annuity plan for 5 years for DROP so that we do not touch the basic pension fund itself. Realistically, we need to do something.

4. Discussion and possible Action regarding the approval of a proposed "goal" timeframe and process for restoring to a state of financial soundness the PSPRS Plan, the Correction Officers Retirement Plan (CORP) and the Elected Officials' Retirement Plan (EORP) within a reasonable period of time.....Mr. Brian Tobin

Mr. Tobin stated that in previous Board meetings no vote was taken regarding the goal of restoring to financial soundness the three Plans within 20 years. Mr. Hacking added that in prior meetings there has been a consensus of the Board members on the funding goal, the timeframe

and the probability level, but no formal vote was taken. However, there seemed to be agreement that we need to reverse the downward sloping funding trend and the upward sloping required contribution trend in order to restore the three Plans to a funding ratio of 80% or higher within a period not to exceed 20 years with a probability of success of 75% or higher.

Mr. Maguire stated that this is the more important of the two agenda items listed, since this will shape the subsequent decisions. It is worthy of considering how we got to where we are by focusing on the rates of return in past years, the fundamental structure of the System, and the prior conduct of the Board members in terms of carrying out their fiduciary duties. But the biggest issue is the question of who pays for whose retirement benefits. We are underfunded, meaning there are not sufficient current assets, given the projected rate of return, to insure there will be adequate resources to meet the accrued and projected liabilities based upon the current benefit structure. The only goal should be 100 % funding; but how long will it take to get there, and what will be the equity and fairness of the steps necessary to get there? The challenge we face is how much burden do we put on current members of the System? We have to sacrifice for the next generation. The System's Plans, by virtue of their 20 year full retirement benefit provisions, tend to have a shorter average life of employment than other systems and that compounds the problem. To achieve proper balance, one needs to talk about what is to happen over the next generation; when is the appropriate time to reach full funding; what are reasonable conservative earnings estimates; and what are the reasonable assumptions that should be used in making the calculation. If we are wrong, all we will end up doing is pushing the pain down the road.

Ms. Stein stated the general consensus of the discussion is whether 80% funded with a 75% probability of achieving that goal within 20 years is appropriate. She stated that she is personally not comfortable with that goal because it is not high enough. We should strive to meet the goal within a shorter amount of time and look to meet a 90% funded ratio within 15-17 years instead of 20 years.

Mr. Maguire inquired of Mr. Hacking regarding how the analysis of the investment returns was determined. In response, Mr. Hacking stated Gabriel, Roeder Smith & Co. (GRS) asked the investment consulting firm New England Pension Consultants (NEPC) what the forecast was for future returns from the various markets in which we have assets deployed based on the asset allocation in place as of 6/30/10. They responded that over time, on average, the market return on assets deployed should give us on average rate of return of 8% and we also expect the actively managed portfolios to contribute on average another half of one percent to the total return leading to an 8.5% per year average return. However, because of the volatility, there are going to be years better and worse than 8.5% and when the return is better than 9%, one half of the excess over 9% goes into the reserves and does not help the underlying fund. Mr. Maguire said that, given that our investment consultant was used to give us the rate of return forecast, the real question would be what would other investment consulting firms think the investment forecast should be. He informed the Board that the volatility of returns and the probability of the long term rate of return should be examined separately for us to make a rational decision. We also need to talk about the payroll assumptions.

Mr. Dunne added that all of us want to move these Plans to the highest level of funding as soon as possible. We are actively working to improve the situation and we need a starting point. All assumptions can be changed as we go forward, but for the time being, having a starting point with which we can begin to work to create a form of agreement among all of our members is important. It will require sacrifice on everyone's part.

<b>MOTION 12-49-10</b>	At 4:53 p.m.
<b>Motion:</b>	To have a goal of restoring the three Plans by 2030 to a funding ratio of 80% or higher within 20 years with a probability of achieving that goal of at least 75%. (Motion was amended to include the "within 20 years.")
<b>Moved by:</b>	Mr. Tim Dunne
<b>Seconded by:</b>	Mr. Greg Ferguson
<b>Discussion:</b>	Mr. Maguire stated that, based on the analysis and discussion, it is clear to him that the target percentage is too low and the time period too long with the result that future employees covered by these Plans will bear a burden based upon obligations incurred for current employees. Ms. Stein informed the Board she is having a hard time contemplating this in a vacuum without knowing the specific changes about which we are speaking. Would there be support tabling the current motion and moving to the next agenda item to see if we can make progress? Mr. Tobin stated he thought we should first set the goal even though the goal could be changed by this Board at another meeting. Ms. Stein responded she is more interested in the stakeholders' positions regarding which benefits are more or less changeable or what contribution rates are more or less changeable. We need to hear more from them. Mr. Tobin added that the game plan today is to set a general goal, talk about some potential changes for the system and ask for additional work from GRS. We will come back and refine the details at a later date; but a menu of options is needed in order to start.
<b>In Favor:</b>	
<b>Motion Passes:</b>	

A substitute motion:

<b>MOTION 12-50-10</b>	At 5:10 p.m.
<b>Motion:</b>	To amend the motion to achieve 90% funding with 75% probability within 17 years.
<b>Moved by:</b>	Ms. Randie Stein
<b>Seconded by:</b>	Mr. Alan Maguire
<b>Discussion:</b>	Ms. Stein asked whether we should use the assumptions already embedded in the System and whether or not those underlying assumptions are accurate. Mr. Ferguson added there is a problem if you decrease the time from 26 years to 17 or 18 years. The employer rates will skyrocket and not be acceptable to anyone. When you have a new employee, they want to know what they will make today. They are not interested in what their retirement will be in the distant future.
<b>Opposed</b>	Mr. Ferguson, Mr. McHenry, Mr. Tobin, and Mr. Dunne.
<b>In Favor:</b>	Ms. Stein, Mr. Maguire, Ms. Roediger
<b>Motion Passes:</b>	Substitute motion does not pass 4 to 3.

Mr. Tobin noted the Board is back to the original motion: To have a goal to restore to 80% funded or higher within 20 years with a 75% or higher probability of achieving that goal within that timeframe.

The discussion continued with Mr. Maguire asking for assurance that this motion will not preclude members of the Board from requesting and receiving actuarial analysis regarding investment returns that are more likely to have a higher probability of being realized than what we are currently using. Mr. Tobin gave Mr. Maguire his word. Mr. Ferguson stated that he does not think anyone on this board, even the Chairman, has authority to ask for actuarial studies and that such requests should come from the full Board. Mr. Maguire agreed that decisions for expenditures of money on actuarial work should come from the Board, but the members of the Board must be equipped in the court of public opinion and must understand all options.

<b>MOTION 12-51-10</b>	At 5:20 p.m.
<b>Motion:</b>	To have a goal to restore the PSPRS Plans to 80% funded or higher within 20 years with a 75% or higher probability of achieving the goal within the stated timeframe. (Motion was amended to specify 20 years.)
<b>Moved by:</b>	Mr. Dunne
<b>Seconded by:</b>	Mr. Ferguson
<b>Discussion:</b>	
<b>Opposed:</b>	Mr. Maguire
<b>In Favor:</b>	Mr. Dunne, Mr. McHenry, Ms. Roediger, Ms. Stein, Mr. Ferguson, and Mr. Tobin
<b>Motion Passes:</b>	Motion passes 6 to 1

Mr. Maguire informed the members of the board that he voted no since we are unclear about what we are going to do regarding all of the options.

5. Development, discussion, and possible **Action** to approve a set of changes to the PSPRS Plan that can then be embodied in a legislative proposal and used as a model for similar changes to the CORP and the EORP. ....Mr. Brian Tobin

Mr. Tobin reminded the Board of Trustees we are looking at changes in the PSPRS Plan which will then be applied in the context of the EORP and CORP. A set of specific proposals will be reviewed with those constituency groups that are served by each of the Plans. Mr. Hacking stated that the problems that need to be addressed are common to all of the Plans.

For all earnings over 9%, one half of those excess earnings go into the COLA and the other half into the underlying fund. As a result, the actuaries have told us that the COLA, in its present form, restricts us from achieving our assumed earnings rate. Even though we have an 8.25% earnings rate assumption currently, they suggest the best we could ever achieve would be a 6.6 to 6.7% earnings rate because the remainder of the assumed rate is diverted to the COLA account. The COLA mechanism is a huge barrier to funding the underlying Plans. If we continue with the COLA in its current form, the only way to move forward will be to change our assumed earnings rate to 6.7% but that would result in a significant spike in employer contribution rates that would be unsustainable for the System.

The Board was asked by Mr. Tobin to discuss the restrictive COLA provision to see if there is a consensus to move forward with this alternative to help the System maintain financial stability. To be considered would be the concept that if the funding ratio is between 70-80% inflows into the Plans' Reserves would be limited to 25% of the excess earnings over 9%. If the funding ratio is less than 70%, no new funds will flow into the Reserves. If the funding ratio is over 80%, then things would operate as normally with one-half of the excess earnings over 9% going to the Reserves as set forth in current statutes.

Alternative 4a, a restrictive COLA program based on Market Value of Assets for existing actives and new hires mentioned in the prior paragraph, as provided by GRS, changes the funding ratio to 74.8% reducing the contribution rate by almost 9% for a total change of about 19.9% at the ultimate normal cost. The employees pay 7.65% stated Ms. Cathy Nagy of GRS.

Mr. Tobin stated the discussions are about changes for all current actives and retirees. At a later date discussions will be held regarding changes for new hires only.

<b>MOTION 12-52-10</b>	At 5:42 p.m.
<b>Motion:</b>	To approve the restrictive COLA provision. If the funding ratio (at Market Value) is between 70-80%, the in-flow is limited to 50% of what otherwise would flow into the COLA reserve. If the funding ratio (at Market Value) is less than 70%, there is no new in-flow, and if it is over 80%, the normal rules would apply.
<b>Moved by:</b>	Mr. Tim Dunne
<b>Seconded by:</b>	Mr. Greg Ferguson
<b>Discussion:</b>	Mr. Hacking stated this is one of the provisions that significantly improves the funding ratios of the Plans. As funding goes up, the employer rates automatically go down. Mr. Ferguson stated that the retirees forego their COLA for a time to drop the rate. Mr. Hacking said that with a combination of plan changes, employer rates will go down. Mr. Tobin added there is some pain along the way. We need to provide a menu of things to do.
<b>In Favor:</b>	Unanimous
<b>Motion Passes:</b>	Passes

The meeting continued with a discussion regarding Alternative 5 which Mr. Tobin described as follows: All benefits remain the same with an additional increase in employee contributions of 4% phased in over four years. This also includes a "maintenance of effort" provision so that when the employee contribution rate goes up, the employer contribution rates would be calculated without regard to the employee rate increase. Otherwise as the employee rate rises, the employer rate would decrease, resulting in no net gain to the underfunded Plans. This means the employee rate would raise 1% per year until it got to 11.65% and maintain that until such time as the employer and employee rates become equal, at which time they would move down in tandem. The employer minimum rates would remain.

<b>MOTION 12-53-10</b>	At 6:07 p.m.
<b>Motion:</b>	To approve alternative 5 which would add an additional 4% to the member contribution rate phased in over four years with a "maintenance of effort" provision and the corresponding reduction over time when the rates start declining steadily.
<b>Moved by:</b>	Mr. Tim Dunne
<b>Seconded by:</b>	Mr. Alan Maguire
<b>Discussion:</b>	
<b>In Favor:</b>	Unanimous
<b>Motion Passes:</b>	Passes

At this point in the discussion, Ms. Nagy stated that the factors or provisions that have the most actuarial and financial impact are the COLA, a longer working life, the multiplier and the age at which retirement benefits can start being collected.

Mr. Tobin added that if we make things too complicated, they will be less likely to pass the legislature. Maybe we need to take more time and make changes in incremental steps.

Mr. Maguire wished to look at alternative 8a, which calls for a 2% compound capped COLA for new hires. It was stated by Mr. Tobin there would be two sections of the law to consider: how the COLA is funded and the percent the Board will set for it. He suggested moving forward with some clearly defined initiatives in order to go through the process this year in the legislature with less ambiguity.

Mr. Dunne wished to review Alternative 9 which modifies the existing high 36 consecutive months compensation to a 60 month compensation period for the PSPRS Plan. Mr. Maguire stated that we need to look at the effects of compensation patterns.

<b>MOTION 12-54-10</b>	At 6:17 p.m.
<b>Motion:</b>	To adopt Alternative 9 and to change the 36 consecutive month average compensation to a 60 month compensation for PSPRS Plan new hires.
<b>Moved by:</b>	Mr. Dunne
<b>Seconded by:</b>	Mr. Maguire
<b>Discussion:</b>	
<b>In Favor:</b>	
<b>Motion Passes:</b>	

Mr. Dunne amended the motion.

<b>MOTION 12-55-10</b>	At 6:30
<b>Motion:</b>	To amend the motion to adopt Alternative 9 to change the 36 consecutive month average compensation to a 60 month compensation for both PSPRS Plan current actives and new hires.
<b>Moved by:</b>	Mr. Dunne
<b>Seconded by:</b>	Mr. Maguire
<b>Discussion:</b>	
<b>Opposed:</b>	Mr. Ferguson, Mr. Mc Henry
<b>In Favor:</b>	Mr. Maguire, Mr. Dunne, Ms. Stein, Ms. Roediger, Mr. Tobin.
<b>Motion Passes:</b>	Motion passes 5 to 2.

Mr. Maguire wished to talk about the interest rate credited to DROP accounts and how to phase out of it.

<b>MOTION 12-56-10</b>	At 6:58 p.m.
<b>Motion:</b>	To cap the interest rate credited to DROP accounts at 2% per year for new hires and current actives who are not yet in DROP.
<b>Moved by:</b>	Mr. Tim Dunne
<b>Seconded by:</b>	Mr. Alan Maguire
<b>Discussion:</b>	Mr. Maguire added we need to look at other changes in DROP as well as this one.
<b>In Favor:</b>	Unanimous
<b>Motion Passes:</b>	Passes

## 6. Call to the Public

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Mr. Brad Foust, representing the Pima County Sheriff's Retirement Board spoke to the Board regarding the need to consider a 25 year retirement for new hires in order to protect people who are not in it at this time. It will become a better retirement than anyone in the public domain will be able to receive.

Mr. Pete Dunn, representing the Arizona Judges Association, informed the Board that a long line of cases based on the contract clause severely restricts the changes you proposed today for current actives.

Mr. Greg Ferguson said he had attended a NCPERS retirement meeting and their blended actuarial study for most of the U. S. retirement systems found, if retirement is extended to 25 years, it actually costs the system more because of the payment of benefits for five more years.

In closing, Mr. Tobin summarized that the choices that must be made are difficult, but the Board is trying to do what is best for the System as a whole.

- 7. Set the next meeting date.

The next meeting will be held on Wednesday, December 15, 2010 at 1:00 p.m.

- 8. Adjournment

<b>MOTION 12-57-10</b>	At 7:15 p.m.
<b>Motion:</b>	To adjourn the meeting.
<b>Moved by:</b>	Mr. Maguire
<b>Seconded by:</b>	Mr. Dunne
<b>Discussion:</b>	
<b>In Favor:</b>	Unanimous
<b>Motion Passes:</b>	Passes

The meeting was adjourned at 7:15 p.m.

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Brian Tobin, Trustee, Chairman

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Lori Roediger, Trustee, Vice Chairperson

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Tim Dunne, Trustee

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Greg Ferguson, Trustee

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Alan Maguire, Trustee

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Jeff McHenry, Trustee

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Randie Stein, Trustee