SCERS
SACRAMENTO COUNTY
EMPLOYEES' RETIREMENT SYSTEM

Members of the Board of Retirement

Rick Fowler, President
Appointed by the Board of Supervisors

John B. Kelly, Vice President
Appointed by the Board of Supervisors

Keith DeVore, Vice President
Appointed by the Board of Supervisors

Steven L. Baird
Elected by the Miscellaneous Members

Michael DeBord
Elected by the Retired Members

James A. Diepenbrock
Appointed by the Board of Supervisors

Diana Gin
Elected by the Miscellaneous Members

Ben Lamera
Ex Officio, Director of Finance

Chris A. Pittman
Elected by the Safety Members

John Conneally
Elected by the Safety Members

Martha J. Hoover
Elected by the Retired Members

Executive Staff:

Richard Stensrud
Chief Executive Officer

Vacant
Chief Investment Officer

Robert L. Gaumer
General Counsel

Kathryn T. Regalia
Chief Operations Officer

John W. Gobel, Sr.
Chief Benefits Officer

M I N U T E S

RETIREMENT BOARD MEETING, WEDNESDAY, AUGUST 17, 2016

A regular meeting of the Retirement Board was held in the Sacramento County Employees' Retirement System Administrative Office, 980 9th Street, 19th Floor, Sacramento, California, on Wednesday, August 17, 2016, and commenced at 10:00 a.m.

OPEN SESSION:

PUBLIC COMMENT:

1. None heard.

MINUTES:

2. The Minutes of the July 20, 2016 regular meeting were approved on Motion by Mr. Pittman; Seconded by Mr. Baird. Motion carried (8-0).

CONSENT MATTERS:

Items 3-15

Item 7 was taken off the Consent Calendar for discussion in closed session at the request of Mr. Fowler. The remaining Consent Matters (Items 3-6 and 8-15) were acted upon as one unit upon a Motion by Mr. Kelly; Seconded by Mr. Pittman carried (8-0).

3. ANDERSON, Timothy: Granted a service-connected disability retirement.

CONSENT MATTERS (continued):

4. COX, Leslie T.: Granted a reciprocal nonservice-connected disability retirement.

5. DANIELS, Barbara J.: Granted a nonservice-connected disability retirement.

6. RODRIGUEZ, Gustavo M.: Granted a service-connected disability retirement.

8. Approved the proposed amendment to the SCERS Conflict of Interest Code.

9. Approved the proposed extension of the engagement with Nossaman LLP to provide real estate investment-related legal services.

10. Received and filed the Selected Fees and Costs for Outside Legal Services for the Quarter Ended June 30, 2016.

11. Received and filed the Semi-Annual Administrative Expense Report for the six months ended June 30, 2016.

12. Received and filed the Portfolio Re-Balancing Report for the Quarter Ended June 30, 2016.

13. Received and filed the Trading Cost Report for the Quarter Ended June 30, 2016.

14. Received and filed the July 2016 Monthly Investment Portfolio Activity Report.

15. Received and filed the July 2016 Monthly Investment Manager Compliance Report and Watch List.

CLOSED SESSION:

7. VIERRA, Gregg A.: Granted service-connected death benefits.

   Motion by Mr. Pittman to grant service connected death benefits; Seconded by Mr. DeBord. Motion carried (8-0).

OPEN SESSION:

ADMINISTRATIVE MATTERS:

16. Chief Executive Officer Richard Stensrud provided an update on developments affecting public retirement systems and on miscellaneous system and staff activities.

<u>ADMINISTRATIVE MATTERS (continued):</u>

Mr. Stensrud reported that SCERS would soon be holding an election for three seats on the Board of Retirement. Mr. Stensrud stated that the two retiree representative positions and one miscellaneous representative position would be on the ballot. Mr. Stensrud noted that the nomination period for the election would close on August 19 and that the voting period would be September 19 – September 30.

Mr. Stensrud reported the date of the November Board Meeting has been adjusted to Monday, November 7 to accommodate both the State Association of County Retirement Systems (SACRS) Fall Conference and the presentation of the annual actuarial valuation.

Mr. Stensrud reported that the California Association of Public Retirement Systems (CALAPRS) recently held its annual Principles of Pension Management for Trustees education program and that Board Member Steve Baird attended. Mr. Baird noted that the program was excellent and that there was a lot of beneficial information.

Mr. Stensrud reported that AB 1853, the bill initiated by SACRS pertaining to the operating authority of County Retirement Systems, was recently passed by the State Senate. Mr. Stensrud noted that the bill would now return to the State Assembly for a vote on the amendments that had been added to the bill by the State Senate.

Mr. Stensrud reported on an item from the July Board Meeting which had been removed in order to gather additional information. Mr. Stensrud noted that the item, which involved the potential audit of SCERS' participating employers and their membership enrollment practices was still being analyzed to determine the best and most cost-effective way to perform such an audit. Mr. Stensrud noted that CalPEPRA requires that retirement systems be more engaged in ensuring that employees are properly enrolled in the retirement system. Mr. Stensrud stated that he anticipated that a recommendation in this regard would be brought to the Board soon.

17. Chief Operations Officer Kathy Regalia presented the proposed final SCERS budget for the 2016-2017 fiscal year. Ms. Regalia indicated that the final budget was substantially consistent with the preliminary budget request that the Board approved at the June meeting, with the exception of a minor staffing change.

    Motion by Mr. DeVore to accept the proposed final SCERS budget for the 2016-2017 fiscal year; Seconded by Mr. Kelly. Motion carried (8-0).

18. Chief Executive Officer Richard Stensrud introduced the discussion regarding the proposed issuance of a Request for Proposals (RFP) for data conversion services as the next phase of the IT Modernization Program.

ADMINISTRATIVE MATTERS (continued):

Mr. Stensrud noted that complete and accurate data is the cornerstone in any automated system, and that unless the data can be trusted as meeting those criteria there is the need for constant manual research and re-verification. Mr. Stensrud noted that because of the long history of data that is needed for defined benefit pension systems, data is both critical to the business and difficult to maintain. Mr. Stensrud noted that for these reasons it is likely there are quality issues with elements of SCERS' data, and that a significant amount of data profiling, cleansing, and migration work will need to be performed as part of the IT Modernization Program.

Mr. Stensrud introduced Brian Colker from Linea Solutions who reviewed the data conversion project and the proposed RFP.

Mr. Colker provided a summary of the IT Modernization Program and the Program's objectives. Mr. Colker stated that one of these objectives was to cleanse and convert SCERS' legacy data into a single integrated member data set. Mr. Colker explained that the entire data migration process is difficult, requires highly skilled technical resources, is time-consuming, and continues throughout the duration of an IT project. Mr. Colker noted that because of these requirements, most pension administration (PAS) and financial reporting system (FRS) implementation projects benefit from engaging a third-party data conversion and migration vendor. Mr. Colker noted that these vendors have expertise in providing data cleansing advice, guidance and services gained through extensive experience in working on comparable PAS and FRS system projects.

Mr. Colker discussed the importance of data, noting that systems are only as good as the underlying data.

Mr. Colker reviewed the scope and timing of the potential conversion. Mr. Colker then discussed the data conversion services vendor landscape and the potential procurement timeline.

Board Member Steve Baird raised questions regarding the timeline of the IT Modernization Program, questioning starting the data conversion project before a vendor had been determined for the PAS, and whether the data conversion should be done by the PAS vendor rather than a third party.

Mr. Colker explained that starting data conversion efforts 6-9 months prior to the PAS implementation allows time for the data conversion project team to focus on the conversion infrastructure, initial data profiling, and conversion processes. Mr. Colker also noted that the head start gives the data conversion project team the ability to send converted data to the PAS development team as the new system is delivered. Mr. Colker noted that this allows for testing to be performed using real data, which both validates that the system is working as designed and gives more opportunity to find data issues. Mr. Colker noted that

ADMINISTRATIVE MATTERS (continued):

a PAS vendor does not typically have the expertise to perform data conversion and therefore would outsource that task to a third party. Mr. Colker noted that by SCERS selecting and overseeing the data conversion vendor and project, SCERS would have a greater ability to assure that the data conversion would meet SCERS' needs.

Discussion followed.

Motion by Mr. Baird to adjust the proposed RFP for data conversion services to procure a vendor to convert only SCERS' microfiche data at this time, with the remainder of the data conversion to be performed once a PAS vendor had been selected; Motion did not obtain a Second.

Motion by Mr. Kelly to approve the proposed RFP for data conversion services; Seconded by Mr. DeVore. Motion carried (7-1), Mr. Baird dissenting.

19. Chief Executive Officer Richard Stensrud introduced the discussion regarding allocating the normal cost and the application of the COLA offset credit for members who reach the 30 years of service contribution cutoff.

Mr. Stensrud stated that these topics involve a small subset of SCERS members – i.e., members in the pre-PEPRA 'legacy tiers' who reach 30 years of service credit, and pursuant to the 1937 Act, are no longer required to make employee contributions for future service. Mr. Stensrud noted that the two decisions being presented for the Board's consideration could possibly be impacted by provisions in PEPRA that permit shifting members in legacy tiers to paying 50% of the 'Normal Cost' of the benefits.

Mr. Stensrud introduced Paul Angelo and Andy Yeung of Segal Consulting who discussed the issues and options available to the Board.

Mr. Angelo explained that if member contributions are no longer being paid by a member who qualifies for the 30 year cutoff of contributions, the funding for future benefit accruals for that member must be obtained from some other source. Mr. Angelo explained that prior to PEPRA, the funding was provided by the employer by making an upward adjustment in the employer contribution rate applicable to each member in this category sufficient to cover what was no longer being paid by the member. Mr. Angelo noted that this resulted in the cost being paid as the benefits accrued just as it would have been if the member had been paying his/her contributions. Mr. Angelo noted that the provisions in PEPRA that permit shifting members in legacy tiers to paying 50% of 'normal cost' of the benefits raises the question of whether the pre-PEPRA approach for securing the funding to cover the contributions no longer being paid by the member can or should be maintained, or whether some other allocation of the unpaid Normal Cost should be utilized.

ADMINISTRATIVE MATTERS (continued):

Mr. Angelo presented four options identified by Segal for allocating the normal cost for members who reach the 30 years of service contribution cutoff: (1) Allocate the cost to the unfunded actuarial accrued liability (UAAL) which is paid off by the employer over the multi-year amortization period ascribed to actuarial gains and losses; (2) Specifically allocate the cost to the employer by increasing the employer Normal Cost contribution rate paid for all members in the membership group and tier of the member whose contributions are cutoff; (3) Allocate the cost to all the members still contributing in the membership group and tier of the member whose contributions have been cutoff; and (4) Allocate the cost equally to the employer and the members still contributing in the membership group and tier of the member whose contributions have been cutoff. Mr. Angelo and Mr. Yeung discussed the cost impact on the employer and member normal cost of the four options.

Mr. Stensrud recommended that the Board adopt the second option. Mr. Stensrud noted that the 30 years of service contribution cutoff has been a component of the 1937 Act for a number of years, and as such, it is presumed that the employer understands that certain members will reach the contribution cutoff, and when that happens, as with any time the funding falls short of that required to fully fund the benefits, the employer is responsible for covering that cost shortfall. Mr. Stensrud noted that this has been the longstanding practice with respect to the 30 years of service contribution cutoff.

Mr. Stensrud suggested that the second option is the approach that is most consistent with the longstanding view and practice. Mr. Stensrud noted that it calls for the employer to cover the unpaid cost on an immediate basis rather than push the cost into the future by allocating it to the UAAL, where it will be paid over time, and be more costly as a result.

Mr. Stensrud noted that while PEPRA mandates certain things for PEPRA tier members, such as paying 50% of normal cost, it permits but does not require that legacy members pay 50% of normal cost. Mr. Stensrud stated that it does not appear, therefore, that PEPRA requires that the cost for the contribution cutoff be allocated differently than it has in the past. Rather, it appears PEPRA permits a different allocation approach for the contribution cutoff cost if it is agreed upon by the employer and the members.

Mr. Stensrud noted that to-date, the County has not negotiated a different allocation of the cost for the 30 years of service contribution cutoff with its employees. Mr. Stensrud suggested that if that should happen, the Board can re-consider the cost allocation approach that should be utilized.

Discussion followed.

With respect to the second decision to be made by the Board, Mr. Angelo explained that normal Cost is comprised of two components, the cost to fund the base benefit and the cost to fund the COLA that most benefits will receive when paid to a member during retirement. Mr. Angelo noted that the cost of the COLA component has always been

ADMINISTRATIVE MATTERS (continued):

evenly divided between the employer and the member (i.e., 50% paid by each), but a number of years ago, the SCERS Board established a reserve to offset a portion of the members' future COLA contribution rate. Mr. Angelo explained that each year, as part of the valuation, the actuary takes the balance in the reserve and determines the amount of COLA contribution offset that will be applied to the next year's member COLA rates based on the projected future service that will accrue for all the legacy members in the valuation.

Mr. Angelo explained that prior to PEPRA, for members who were no longer contributing due to the 30 year contribution cutoff, the COLA contribution offset provided on behalf of that member continued to be applied to the calculation of the Normal Cost paid by the employer. That is, the employer's contribution rate was increased to cover the contributions no longer being paid by the member, however, the COLA offset component continued to be applied to the total Normal Cost, thereby reducing the overall Normal Cost paid by the employer. Mr. Angelo suggested that the reasoning is the COLA contribution offset is not a contribution made by the member, but rather, a contribution made by SCERS on behalf of the member to assist in funding the eventual benefit.

Mr. Angelo noted, however, that because there is a set amount of funding that can be applied each year via the COLA contribution offset, if the COLA contribution offset is applied on behalf of members who no longer contribute, the COLA contribution offset rate for those members who are still contributing is lower than it would be if the non-contributing members were excluded from the allocation of the available COLA contribution offset funding. Mr. Angelo suggested that the question becomes whether the COLA contribution rate offset should applied in a way that reduces cost that would otherwise be paid by the employer or whether the offset should be applied in a manner that provides the greatest reduction in the cost paid by members who are still contributing toward their benefits.

Mr. Stensrud recommended that the Board continue to apply the COLA contribution rate offset on behalf of all legacy members, including members no longer contributing due to the 30 years of service contribution cutoff. Mr. Stensrud noted that continuing the current practice would not 'take something away' from the members still contributing, and conversely, changing the practice would 'take something away' from the employer. Mr. Stensrud also noted that maintaining the current practice is an 'equitable offset' to the fact that the employer and not the members will be covering the cost not being paid by members who no longer contribute.

Discussion followed.

Motion by Mr. DeVore to approve the allocation to the employer of non-covered normal cost for members in the legacy tiers who reach the 30 years of service contribution cutoff and that the application of the COLA offset credit to the Normal Cost for such members be continued; Seconded by Mr. Pittman. Motion carried (8-0).

INVESTMENT MATTERS:

20. Barry Dennis of Verus Advisory, Inc. presented the Investment Performance Report for the Quarter Ended June 30, 2016.

Mr. Dennis reported that the Total Fund (TF) return for the second quarter, including the impact of the overlay program, was 1.9% gross of fees. The TF return was 0.2% above the policy index of 1.7%, and 0.1% above the allocation index return of 1.8%. The TF return without the impact of the overlay program was also 1.6%.

Mr. Dennis reported that on a comparative basis, the return for the quarter was above the Public Funds $1+ Billion Median return of 1.8%. The TF return ranks in the 42nd percentile in the InvestorForce Universe, which is the ranking universe used by Verus. All of the major asset classes experienced positive returns for the quarter, except for the international equity asset class.

Mr. Dennis reported that at the asset class level, quarter outperformance occurred, gross of fees, in the fixed income and opportunistic segments. Underperformance occurred in the domestic equity, international equity, absolute return, and private equity segments.

Mr. Dennis reported that for the just completed fiscal year, the TF return gross of fees, including the impact of the overlay program was -0.6%, which was 2.1% below the return of the policy index benchmark return of 1.5%, and 1.8% below the allocation index return of 1.2%. The return of the TF for the fiscal year without the impact of the overlay was 0.2%. The TF fiscal year-to-date return was 0.8% below the Public Funds $1+ Billion Median return of 0.2%, and ranks in the 75th percentile in the InvestorForce Universe.

Mr. Dennis reported that the annualized TF return gross of fees for three years of 5.9% is 0.7% below the policy index benchmark for the same period. The annualized TF return gross of fees for five years of 6.2% is 0.4% below the policy index benchmark for the period. The TF gross of fees return of 8.2% since the inception of SIS's data in June of 1986 is 0.3% below the Total Benchmark return of 8.5% for the period, but above SCERS' actuarial investment return assumption which has ranged from 8.25% to 7.50% (currently) during the period.

Motion by Mr. Kelly to receive and file the quarterly report; Seconded by Mr. DeBord. Motion carried (8-0).

The meeting was adjourned at 12:24 p.m.

MEMBERS PRESENT: Rick Fowler, John B. Kelly, Keith DeVore, Steven L. Baird, Michael DeBord, Ben Lamera, Chris Pittman, John Conneally and Martha J. Hoover.

MEMBERS ABSENT: James A. Diepenbrock and Diana Gin.

OTHERS PRESENT: Richard Stensrud, Chief Executive Officer; Robert L. Gaumer, General Counsel; Kathryn T. Regalia, Chief Operations Officer; John W. Gobel, Sr., Chief Benefits Officer; Steve Davis, Deputy Chief Investment Officer; Suzanne Likarich, Retirement Services Manager; Thuyet Dang, Senior Accounting Manager; JR Pearce, Investment Officer; John Lindley, IT Administrator; Barry Dennis and John Nicolini, Verus Advisory, Inc; Jamie Feidler, Cliffwater LLC; Paul Angelo and Andy Yeung, Segal Consulting; Brian Colker, Linea Solutions; John Kennedy, Nossaman LLP; Dan Boulger and Mark Musser, DTech; Eric Leavitt, Empower Retirement; Barbara Daniels; Buelah Leeper; Christina Vierra; and Deborah Bassett.

Respectfully submitted,

Richard Stensrud
Chief Executive Officer and
Secretary of the Retirement Board

APPROVED: ______________________________
Rick Fowler, President

DATE: ______________________________

cc: Retirement Board (11); Board of Supervisors (6); County Counsel; County Executive (2); Internal Services Agency (2); County Labor Relations; Employee Organizations (20); Sacramento County Retired Employees' Association; SCERS Member Districts (10); Elected Officials (3); Superior Court of California, County of Sacramento; Amervest Company, Inc.; Mark Merin; John R. Descamp; and The Sacramento Bee.