Sacramento County Employees' Retirement System

Executive Staff:

Richard Stensrud
Chief Executive Officer

Jeffrey W. States
Chief Investment Officer

John W. Gobel, Sr.
Chief Benefits Officer

Kathryn T. Regalia
Chief Operations Officer

M I N U T E S

RETIREMENT BOARD MEETING, NOVEMBER 18, 2004

The regular meeting of the Retirement Board was held in the Sacramento County Employees' Retirement System Administrative Office, U.S. Bank Plaza Building, 980 9th Street, 18th Floor, Sacramento, California, on November 18, 2004, at 1:00 p.m.

OPEN SESSION:

PUBLIC COMMENT:

1. Chief Executive Officer Richard Stensrud reported that SCERS Board Member William Johnson had been promoted to Captain, with responsibility for the Court facilities. Deputy County Counsel J. Steven Burris noted he had provided each Board member with materials concerning the requirements for annual financial disclosure of assets and income; disqualification in the event of conflict of interest; and limitations on the receipt of gifts.

MINUTES:

2. The Minutes of October 18, 2004 and October 21, 2004, were approved on motion made by Mr. Suter; Seconded by Mr. Hickox; Motion carried (7-0).

CLOSED SESSION:

DISABILITY MATTERS:

3. BAILEY, Nancy: Action was taken on the Application for Disability Retirement as indicated per attached confidential memorandum dated November 19, 2004.

4. CARROLL, Susan: Action was taken on the Application for Disability Retirement as indicated per attached confidential memorandum dated November 19, 2004.

5. DRAGGES, Michael: Action was taken on the Application for Disability Retirement as indicated per attached confidential memorandum dated November 19, 2004.

6. STEWART, R.B.: Action was taken on the Application for Disability Retirement as indicated per attached confidential memorandum dated November 19, 2004.

OPEN SESSION:

ADMINISTRATIVE MATTERS:

7. CEO Richard Stensrud summarized written materials (which have been placed in the record) reporting that a coordinated effort was underway to replace public employer defined benefit plans with defined contribution plans. Mr. Stensrud noted that this effort was being spearheaded by a proposal to amend the California Constitution to require that public employers only offer a defined contribution plan to newly hired employees. Mr. Stensrud further noted that the sponsor of the proposal had indicated that if it was unsuccessful in the legislature, he would pursue the measure as a ballot initiative. Mr. Stensrud noted that these efforts were of serious concern to advocates of defined benefit plans and that in such an environment it was critical that stakeholders in such plans act in a responsible and prudent manner. Discussion followed. Several Board members concurred that this was a serious matter which needed to be monitored closely. Discussion was held regarding the appropriate role of the SCERS Board in the debate and it was agreed that at this point educating stakeholders was paramount. No action was taken.

8. CEO Richard Stensrud advised the Board that the upcoming presentation by Paul Angelo, Vice President and Actuary with The Segal Company, of the SCERS Review of Economic Actuarial Assumptions for the June 30, 2004 Actuarial Valuation and the SCERS Actuarial Experience Study for the Period July 1, 2001 through June 30, 2004 contained a substantial amount of information and some very important recommendations. Mr. Stensrud encouraged the Board to take the time necessary to thoroughly consider Mr. Angelo's presentation and The Segal Company's recommendations, and suggested that it might be beneficial to extend the analysis and discussion to the December Board Meeting and defer action on the recommendations until that time. The Board concurred. Motion by Mr. Suter to receive and file the two reports; Seconded by Mr. Hickox; Motion carried (7-0).

   Mr. Angelo provided an overview of the two reports, noting the role of actuarial assumptions and actuarial experience in assuring the solid financial condition of the retirement system. Mr. Angelo explained that to properly project the cost and liabilities of the system, actuarial assumptions are made about future events. Mr. Angelo noted that each year the actuarial experience is compared against the various actuarial assumptions and, to the extent there were differences, the future contribution requirement is adjusted. Mr. Angelo explained that in certain instances, the actuarial experience may suggest that a deviation from the assumption is more than temporary, and in such a case, the actuary recommends a change in the assumption itself. Mr. Angelo noted that such a change has a greater effect on the current contribution requirements than an annual experience adjustment. Mr. Angelo noted that the two reports he was presenting contained recommended changes to several important assumptions which, if adopted, would have a measurable impact on the system's funded status and contribution requirements.

Mr. Angelo noted that the Review of Economic Actuarial Assumptions addressed assumptions related to: (a) The investment return assumption, which is comprised of (i) the assumed inflation rate; (ii) the assumed real rate of return net of inflation; (iii) the assumed system expense rate; and (iv) the risk adjustment; and (b) The salary increase assumption, which is comprised of (i) the assumed inflation rate; (ii) the assumed rate of real 'across the board' pay increases; and (iii) the assumed rate of promotional and merit increases (as determined in the Actuarial Experience Study).

Mr. Angelo noted that the Actuarial Experience Study addressed assumptions related to: (a) Retirement rates; (b) Mortality rates; (c) Termination rates; (d) Disability incidence rates; (e) Merit and longevity salary increases; (f) Rates for the conversion of unused sick leave at retirement; and (g) Average age of members entering the system.

With respect to the investment return assumption, Mr. Angelo reported that The Segal Company was recommending that it be reduced from 8% to 7.75%. Mr. Angelo explained that the primary factor in the recommendation was the projection of a reduced real rate of return based on SCERS' asset allocation model and Segal's forecast of long term future market returns, which in turn, was based on projections provided by the investment consultants for Segal's 1937 County Employees' Retirement Law clients. Mr. Angelo noted that the lower actuarial investment return assumption was closer to, although still higher than the 7.22% investment return projected by Mercer Investment Consulting, SCERS' general investment consultant.

Extensive Board discussion followed, including discussion of the actuary's methodology in developing the real rate of return projection; the risk adjustment factor and its affect on the confidence level for achieving the assumed earnings rate; historic market performance and whether it was reasonable to expect that level of performance over the next ten to twenty years; and the inflation assumption.

The Board asked if Geoff Davey, Chief Financial Officer for the County, wished to make any comments regarding the recommendation to reduce the assumed earnings rate. Mr. Davey noted the County's concern about a possible reduction in the assumption since it would likely result in a significant increase in the employer contribution rate for retirement benefits. Mr. Davey noted that the assumed earnings rate had been as high as 9.5% in the late 1980s and had been gradually reduced to the current 8% assumption. Mr. Davey stated that notwithstanding a substantial budget impact, the County had supported that reduction in the assumed earnings rate since it was more realistic and would put the system on sounder financial footing. Mr. Davey questioned whether the recent and projected investment performance warranted a downward adjustment at this time, and whether the recommended earnings rate was too conservative. Mr. Davey also noted various retirement-related costs that the County was already seeking to address, including costs associated with pension obligation bonds, and the budgetary difficulties that would follow from adding to these costs. Mr. Davey suggested that it might be better that the retirement system be slightly under-funded since it would reduce the pressure on the County to grant benefit increases. Mr. Davey noted that he fully understood that the SCERS Board decision in this matter should not be unduly influenced by the potential financial impact to the County, but he concurred in the SCERS CEO's recommendation that it would be prudent to continue the analysis and discussion of the issues and defer action on the recommendation to the December meeting.

Further Board discussion followed, including discussion of the historic progression of the assumed earnings rate, the reasons for the reduction in that rate, and why it was necessary to issue pension obligation bonds. In particular, it was noted that a substantial factor in the decision to issue pension obligation bonds was to address the funding consequences of the County's decision to adopt enhanced retirement benefits. It was also noted that the SCERS Board had been considering the appropriateness of reducing the assumed earnings rate in various discussions with the actuary over the last few years.

Mr. Angelo then provided an overview of the various non-economic assumptions and the recommended changes in those assumptions. Discussion of this information was deferred to the December Board Meeting.

Action on the economic and non-economic assumptions was deferred to the December Board Meeting.

9. CEO Richard Stensrud presented a recommendation that the Board authorize a modification to the errors and omissions insurance coverage requirement in the Request for Proposal for Professional Auditing Services issued February 20, 2004, and the further recommendation that the Board President be authorized to execute a contract with outside auditors Macias, Gini & Company consistent with that modification. Motion by Mr. Suter; Seconded by Ms. Wolford-Landers; Motion carried (7-0).

10. CEO Richard Stensrud noted that with the concurrence of the Board, former CEO John Descamp had engaged Johnson & Associates to perform a compensation study of the four 'at will' SCERS management positions, plus the position of Retirement Services Manager. Mr. Stensrud noted that Johnson & Associates had been engaged to perform a similar study on two previous occasions, the last being in July 2002. Mr. Stensrud noted that the Board had previously established certain internal and external relationship guidelines for setting executive salaries and that the current study had both adhered to those guidelines and had utilized the same methodology as the past studies. Mr. Stensrud explained that Doug Johnson of Johnson & Associates would be presenting the results of the study, including salary recommendations. Mr. Stensrud noted that with the exception of the recommendations regarding the CEO,

on which he would defer to the pleasure of the Board, he concurred in the recommendations of Johnson & Associates. Mr. Stensrud noted that the proposed implementation schedule for the salary adjustments, if approved, was similar to the implementation schedule that had been presented to the Board of Supervisors in their recent decision to provide equity salary adjustments to unrepresented County management personnel.

Mr. Johnson presented the results of the compensation study performed by his firm. Mr. Johnson explained the methodology utilized in the study and the rationale for the internal and external relationship guidelines incorporated in the analysis and recommendations.

Mr. Suter stated that he had questions regarding the soundness of the methodology used in the study, including why certain retirement systems were used for comparison. Mr. Johnson noted that he believed the comparison universe struck a reasonable balance of systems that were larger and smaller than SCERS. Mr. Johnson also explained that the universe consisted of systems that would be considered primary competitors with SCERS in securing top flight executives. Mr. Suter stated that in addition to his reservations about the study, he felt Mr. Stensrud had been put in awkward position in having to bring this study to the Board. Accordingly, Mr. Suter moved that the study be sent to an ad hoc compensation committee for further discussion and analysis. The motion died for lack of a Second.

Ms. Wolford-Landers asked Mr. Johnson if the study had considered the compensation level of comparable positions in the County. Mr. Johnson replied that the study had not considered non-retirement County positions because there was a sufficient universe of more directly comparable positions in retirement systems.

Mr. Hickox moved that the salary recommendations of the Johnson & Associates study, as proposed by the CEO, be adopted; Seconded by Mr. DeVore. Motion carried on roll call vote: Ayes (5) – Mr. DeVore; Mr. Woods; Mr. Diepenbrock; Mr. Hickox; Mr. Johnson. Nays (2) – Ms. Wolford-Landers; Mr. Suter. Abstain (1) – Mr. Norris.

Mr. Suter noted that the implementation of the County's recent equity adjustments had changed from that being considered when Mr. Stensrud had recommended an implementation schedule for the SCERS adjustments and moved that the implementation schedule be modified to match the County schedule. Motion died for lack of a Second.

Mr. Johnson noted that no action had been taken with respect to the recommendation in the Johnson & Associates study regarding the CEO and moved that the recommendation in the Johnson study be adopted for the CEO and implemented in the same manner as the adjustment for the other positions; Seconded by Mr. Suter. Motion carried (7-0).

INVESTMENT MATTERS:

11. Chief Investment Officer Jeffrey States reminded the Board that in August 2004 MetLife, Inc. had announced that it was selling State Street Research & Management Company and SSR Realty Advisors (SSR) to BlackRock, Inc. Mr. States noted that the investment management agreement with SSR Realty Advisors requires SCERS approval of any change in control of the manager or the assignment of the investment management. Mr. States explained that in order to facilitate the Board's consideration, Robert Kapito, Vice Chairman of BlackRock, Inc. had been invited to the meeting to explain the acquisition and to discuss their plans for SSR once the transaction is complete. Mr. Kapito indicated that BlackRock does not currently have an equity real estate capability, although they have significant experience with real estate debt. He explained that the acquisition of SSR broadens their capability in real estate and is an important addition to their investment management program. He indicated that SSR would be kept as a separate unit within BlackRock and continue to operate out of New Jersey. Also present to answer questions were Fred Lieblich, President of SSR; Jill Hatton, Managing Director of SSR; and Fernando Nasmyth, Senior Portfolio Manager of SSR. The assignment of the Investment Management Agreement between Sacramento County Employees' Retirement System and MacFarlane Partners Limited Partnership, dated July 13, 1995, as amended and assigned to SSR Realty Advisors BlackRock, Inc. was approved on a motion by Mr. Woods; Seconded by Mr. Suter; Motion carried (6-0).

12. The International-World ex US/EAFE Small Cap Equity Manager Search Report was presented by Tom Lightvoet, Mercer Investment Consulting. Following discussion of the capabilities of three managers recommended for consideration n the report, Acadian Asset Management and AXA Rosenberg Investment Management were selected as finalists in the search on a motion by Mr. DeVore; Seconded by Mr. Woods; Motion carried (6-0). The finalist managers will be invited to make presentations at the December 16, 2004 meeting.

13. The International-World ex US/EAFE Equity-Core Equity Manager Search Report was presented by Tom Lightvoet, Mercer Investment Consulting. Following discussion of the capabilities of the six managers recommended for consideration in the report, Fisher Investments-Foreign Equity, INVESCO International Equity and MFS Investment Management International Equity were selected as finalists in the search on a motion by Mr. Woods; Seconded by Mr. Suter; Motion carried (6-0). The finalist managers will be invited to make presentations at the January 20, 2004 Board meeting.

14. Chief Investment Officer States recommended the Board approve SCERS Resolution No. 2004-08 authorizing the Board President to sign the Investment Management Agreement with LSV Asset Management for the management of a $200 million Non-US Developed Country Large Cap Value Equity portfolio. SCERS Resolution No. 2004-08 was adopted on a motion by Mr. Suter; Seconded by Mr. Woods; Motion carried (6-0).

15. The Post Trade Analysis for the Oppenheimer portfolio transition was received and filed on a motion by Mr. Woods; Seconded by Mr. Norris; Motion carried (6-0).

16. The Monthly Investment Management Compliance and Activity Report for October 2004 was received and filed on a motion made by Mr. Suter; Seconded by Mr. Woods; Motion carried (6-0).

The meeting was adjourned at 4:40 p.m.

MEMBERS PRESENT: James A. Diepenbrock, President; Ronald Suter, 1st Vice-President; Mark Norris (arrived 1:29), Treasurer; Members Keith DeVore, Winston Hickox (left 3:35), William Johnson, Steven Soto, Nancy Wolford-Landers (left at 3:30), and Robert Woods (arrived at 1:16).

MEMBERS ABSENT: John B. Kelly, 2nd Vice-President; and Member William Cox.

OTHERS PRESENT: Richard Stensrud, Chief Executive Officer; Kathryn Regalia, Chief Operations Officer, John Gobel, Sr., Chief Benefits Officer; Suzanne Likarich, Retirement Services Manager; Steven Burris, Deputy County Counsel; Diana Ruiz, Deputy County Counsel; Jeff Beyers, Employees Benefits Office; George Appel; Paul Angelo, The Segal Company; Doug Johnson, Johnson and Associates; Nancy Bailey; R.B. Stewart; Tom Lightvoet, Mercer Investment Consoling; Fred Lieblich, Jill Hatton and Fernando Nasmyth; SSR Realty Advisors; Rob Kapito, BlackRock, Inc.; and Virginia Hayes, Executive Secretary.

Respectfully submitted,

SACRAMENTO COUNTY EMPLOYEES'
RETIREMENT SYSTEM

RICHARD STENSRUD,
Chief Executive Officer

APPROVED: ________________________________
JAMES A. DIEPENBROCK, President

DATE: ________________________

cc: Retirement Board (11); Clerk, Board of Supervisors (6); County Counsel (2); County Executive; Employee Organizations (21); Sacramento County Retired Employees' Association; SCERS Member Districts (11); and The Sacramento Bee.