MINUTES

RETIREMENT BOARD MEETING, DECEMBER 16, 2004

The special 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 December 16, 2004, at 11:00 a.m.

OPEN SESSION:

PUBLIC COMMENT:

1. Mr. Suter moved that the Board consider a Resolution honoring Deputy County Counsel J. Steven Burris on the occasion of his retirement as a non-Agenda item; Seconded by Mr. Norris. Motion carried (8-0). The Resolution was read aloud and a motion was made by Mr. Kelly that the Resolution be adopted; Seconded by Mr. Cox. Motion carried (8-0).

MINUTES:

2. The Minutes of November 18, 2004 were approved on motion made by Mr. Suter; Seconded by Mr. Hickox. Motion carried (8-0).

INVESTMENT MATTERS:

3-5. Tom Lightvoet of Mercer Investment Consulting and Chief Investment Officer Jeffrey States gave a brief introduction to the International World ex US/EAFE Small Cap Equity Investment Manager Search and provided comments on the two firms selected to make finalist presentations for the assignment to manage a portfolio of $50 million in non-US equity small cap stocks. This is a new portfolio that will provide added diversification within SCERS non-US developed country investments. The firms making presentations and their representatives were:

- AXA Rosenberg Investment Management represented by Bill Barnes, Director of Marketing and William Ricks, Chief Investment Officer for America.

- Acadian Asset Management represented by James Wylie, Senior Vice President and Raymond Mui, Senior Vice President and Portfolio Manager

The presenters addressed their respective firm's organization, investment philosophy, investment process, historic performance and team of investment professionals. Questions from the Board included inquiries regarding the investment process; the number of holdings in the portfolio and portfolio turnover; risk monitoring; management fees; and the availability of a commingled fund as an alternative to investing in a separate account. Each firm said they offered and would be willing to accept a performance based fee.

Discussion followed regarding the capabilities of each firm. Mr. Kelly indicated that he felt Acadian took more risk but also had provided a higher return. At the request of the Board, Mr. Lightvoet and CIO States indicated that their first choice would be AXA Rosenberg based on attribution data indicating AXA had a better information ratio over the periods analyzed and a less volatile investment process. A motion to hire AXA Rosenberg Investment Management was made by Mr. Hickox; Seconded by Mr. Norris; Motion carried (8-1), with Mr. Kelly voting No.

6. Mr. Lightvoet presented the Investment Portfolio Performance Report for periods ending September 30, 2004. He informed the Board that SCERS total fund had a return of 0.1%, net of fees, for the quarter and a return of 11.4% over the trailing twelve months. He commented on the asset class and individual manager performance and reviewed the recommendations for possible action in his written report. No action was taken on the recommendations, however, TCW Group and Capital Guardian will be added to the 'watch list' per the investment policy.

   The Board requested that Mr. Lightvoet and staff look into developing a methodology for evaluating the quality of policy decisions related to asset allocation and investment manager choices.

   It was noted that the largest deviation from the asset allocation model continues to be real estate. The Board requested that Mr. Lightovet and staff look at alternatives available to reach the allocation target more quickly and develop suggestions on how to invest the allocation outside of short-term fixed income.

   It was also noted that the performance report was being presented three months after the end of the quarter. After discussion regarding the advantages and disadvantages of having the report presented closer to the end of the quarter, the Board requested that going forward Mr. Lightvoet present the report at the second regular Board Meeting after the quarter end.

   The performance report was received and filed on a motion by Mr. Kelly; Seconded by Mr. Woods; Motion carried (9-0).

CLOSED SESSION:

DISABILITY MATTERS:

7. CONNER, Charles V.: Action was taken on the Application for Disability Retirement as indicated per attached confidential memorandum dated December 16, 2004.

OPEN SESSION:

INVESTMENT MATTERS: (continued)

8. Mark Lapman, President and CEO of Independence Investment LLC made a presentation to the Board regarding the history of the relationship between SCERS and Independence, including the placement of Independence on the 'watch list' because of poor performance. Mr. Lapman noted that Independence has a quantitative and qualitative investment process that is a low risk strategy intended, over time, to add approximately 100 basis points, net of fees, over the Russell 1000 growth index. He reviewed performance data from inception of the relationship to support his contention that Independence is meeting the performance objective for the portfolio. Mr. Lapman noted that poor performance in the second quarter of 2003 had suppressed overall performance, but that performance would be strong relative to the benchmark in the current quarter. Mr. Diepenbrock stated that he felt Independence was a strong manager with an investment process that should do well in the future. Mr. States noted that he also thought that the firm's investment process appeared to be well-suited to the current market environment and that they should be given more time to determine whether this would continue. The presentation book was received and filed on a motion by Mr. Kelly; Seconded by Mr. Hickox. Motion carried (9-0).

9. The R.V. Kuhn Public Fund Universe Analysis Report for June 30, 2004 was received and filed on motion by Mr. Kelly; Seconded by Mr. Hickox. Motion carried (9-0).

10. The Monthly Investment Management Compliance and Activity Report for November 2004, was received and filed on motion by Mr. Woods; Seconded by Mr. Suter. Motion carried (9-0).

11. A side letter with LSV Asset Management agreeing to a modification in the language of the investment guidelines to clarify which securities not contained in the portfolio benchmark could be purchased was received and filed on a motion by Mr. Kelly; Seconded by Mr. Suter. Motion carried (9-0).

ADMINISTRATIVE MATTERS:

12. Chief Executive Officer Richard Stensrud reported that, pursuant to Section 31523 of the 1937 Act, on December 7, 2004, the Board of Supervisors passed a resolution declaring that since there was only one candidate for the SCERS Board positions scheduled for election on December 10, 2004, an election was unnecessary, and the

nominees would be deemed elected. Accordingly, Mr. DeVore was re-elected as a miscellaneous representative; Ms. Wolford-Landers was elected as the retiree representative; and Mr. Cox was elected as the alternate retiree representative; all for terms commencing January 1, 2005.

Mr. Stensrud presented a report summarizing recent and pending activities at SCERS including: (1) an update on the implementation of the settlement in the 'Ventura' case; (2) an update on retroactive benefit enhancements for SCERS members employed by the Sacramento Metropolitan Fire District; (3) an update on the status of SCERS' annual audit and the preparation of the Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2004; (4) a report on retirement planning seminars conducted by SCERS staff; and (5) an update on the assessment of approaches for addressing SCERS' legal service needs.

Mr. Stensrud summarized recent media reports concerning developments affecting public employee retirement systems, including the proposal to replace defined benefit plans with defined contribution plans. Discussion followed. Mr. Stensrud also noted recent media reports discussing problems with respect disability retirement. Mr. Stensrud reported that he had directed SCERS staff to review the disability retirement process and develop recommendations for both improving efficiency in the processing of disability applications, and for enhancing confidence in the recommendations made by staff with respect to those applications. Mr. Stensrud noted that he anticipated that the staff analysis would lead to recommendations for Bylaw amendments and/or other formal action by the Board.

13. As an introduction to the presentation by Drew James and Andy Yeung of The Segal Company of the SCERS Actuarial Experience Study and the SCERS Review of Economic Actuarial Assumptions (which had been continued from the November meeting), and to facilitate the Board's discussion, Mr. Stensrud summarized information staff had gathered regarding the history of (1) the assumed rate of return; (2) the actual market return earned by the system; (3) the system's funded status; (4) the employer and employee contribution rates; (5) the various benefit enhancements that have been adopted by the County; and (6) the pension obligation bonds issued by the County. Discussion regarding the historic information followed. Deputy County Counsel Steve Burris then provided an overview of the fiduciary considerations relevant to the Board's decisions on actuarial matters.

Mr. James then provided an overview of the various assumption changes recommended in the reports. At the request of the Board, Mr. James addressed the projected cost impact associated with the recommended assumptions changes, including the cost associated with each specific recommendation. Extensive discussion followed regarding each recommendation, including the actuarial and/or economic basis for the recommended change; the magnitude of the change in each assumption relative to the experience; and whether similar assumption changes were being seen in other 1937 Act systems. Mr. Suter expressed concern with the basis for certain recommendations, in particular, the recommendation to change the assumed earnings rate. Mr. Norris also noted concerns regarding the proposed earnings rate.

Mr. Stensrud reported that staff had engaged in extensive discussions with the actuary regarding the recommended changes, including discussion of whether, and to what extent, The Segal Company could support alternative recommendations. Mr. Stensrud requested that the actuary identify the proposed assumptions that they believed might be addressed differently.

Mr. James responded that The Segal Company strongly endorsed the recommended assumption changes in the demographic areas since they were very moderate adjustments based on established actuarial experience.

With respect to the earnings assumption, however, Mr. James noted that while they believed the recommendation to reduce the assumed earnings rate to 7.75% was reasonable, appropriate and consistent with what they were recommending to other clients, this was an assumption where it would be reasonable for the Board to adopt a different rate based on the Board's assessment of future market performance. Discussion followed, during which several Board members expressed the view that given that virtually all investment experts were predicting lower market returns in the next ten-plus years it was prudent to lower the assumed earnings rate to 7.75%.

Mr. Stensrud asked the actuary if, in light of the discussions with staff regarding the actual experience associated with terminated members withdrawing funds from SCERS, whether The Segal Company believed an adjustment in its initial recommendation regarding the withdrawal rate assumption would be reasonable and appropriate. Mr. James and Mr. Yeung reported that they did, in fact, believe that an adjustment was reasonable and appropriate and noted that such an adjustment would lower the cost impact associated with that assumption.

Mr. Stensrud noted that the actuary was recommending use of a new assumption to 'pre-fund' the cost associated with the conversion of sick leave into service credit at retirement. Mr. Stensrud asked if this was a recommendation the actuary was making to other 1937 Act clients, and whether, as an alternative, it would be reasonable and prudent to maintain the current practice. Mr. James and Mr. Yeung reported that The Segal Company was, in fact, making this recommendation to other clients, and while they believed that establishing a funding stream for such costs was prudent, the current practice was also reasonable. Discussion followed on the relative merit of the current versus the recommended approach.

Mr. Stensrud noted that with respect to the recommended assumption regarding salary growth, he had invited Geoff Davey, Chief Financial Officer for the County to provide information to the actuary regarding recent salary experience and whether the observed salary growth was likely to be seen in the future. Mr. James and Mr. Yeung reported that they had reviewed the information provided by Mr. Davey, but had concluded that the recommended change in the salary growth assumption had already taken Mr. Davey's remarks into consideration.

Mr. Davey was invited to provide the County's view of the recommended assumption changes. Mr. Davey noted the substantial fiscal impact of the proposed changes and that they would result in a significant, and unplanned, increase in employer contributions. Mr. Davey noted that the County had taken various steps to address retirement costs in an effort to create near-term budget flexibility, and that the cost increase associated with the new assumptions would likely eliminate that flexibility. Mr. Davey expressed reservations about the need to adopt the new assumptions at this time, and suggested that it would be wiser to wait for more experience to see if the changes were truly warranted.

Extensive discussion followed, including remarks from Supervising Deputy County Counsel Michelle Bach and Deputy County Counsel Steve Burris regarding the potential ramifications and considerations associated with adopting assumptions different from those recommended and/or endorsed by the actuary.

Mr. Stensrud asked the actuary if the recommended assumptions (including the revised withdrawal rate assumption) were to be adopted by the Board, whether it would be reasonable to phase-in the cost impact of the changes over a multi-year period, and whether they had endorsed such an approach with any of their other clients. Mr. James and Mr. Yeung responded that such an approach would be reasonable and that they had recently worked with another 1937 Act system on a two year phase-in. Mr. James and Mr. Yeung noted, however, that such an approach does require a special disclosure footnote in the plan sponsor's financial statements.

The actuaries were asked what the cost impact would be if a two year phase-in was adopted. Mr. James and Mr. Yeung responded that the immediate cost impact would be cut in half (i.e., an approximate 3.18% increase), but that some slight additional cost would have to added to the second year given the graduated phase-in.

After further discussion, Mr. Woods made a motion to adopt the assumption changes recommended by the actuary (utilizing the revised withdrawal rate assumption), with the cost impact of the new assumptions to be phased-in over two years; Seconded by Mr. Kelly. Motion carried on a roll call vote: Ayes (7): Mr. Cox; Mr. Kelly; Mr. DeVore; Mr. Woods; Mr. Johnson; Mr. Hickox; and Mr. Diepenbrock. Nays (2): Mr. Norris and Mr. Suter.

The meeting was adjourned at 3:40 p.m.

MEMBERS PRESENT: James A. Diepenbrock, President; Ronald Suter, 1st Vice-President; John B. Kelly, 2nd Vice-President; Mark Norris, Treasurer; Members William Cox, Keith DeVore, Winston Hickox, William Johnson, Steven Soto (arrived 11:30), Nancy Wolford-Landers, and Robert Woods (arrived at 11:10).

MEMBERS ABSENT: None

OTHERS PRESENT: Richard Stensrud, Chief Executive Officer; Jeffrey W. States, Chief Investment Officer; Kathryn Regalia, Chief Operations Officer, John Gobel, Sr., Chief Benefits Officer; Suzanne Likarich, Retirement Services Manager; Steven Burris, Deputy County Counsel; Michele Bach, Deputy County Counsel; Diana Ruiz, Deputy County Counsel; Geoff Davey, County Chief Financial/Operations Officer; George Appel; Andy Yeung and Drew James, The Segal Company; Mark Lapman and John Forelli, Independence Investment LLC; Raymond Mui and James Wylie, Acadian Asset Management; Bill Barnes and William Ricks, AXA Rosenberg Investment Management; Tom Lightvoet, Mercer Investment Consulting; 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.