MINUTES

RETIREMENT BOARD MEETING, THURSDAY, AUGUST 18, 2011

The 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 Thursday, August 18, 2011, and commenced at 11:00 a.m.

OPEN SESSION:

PUBLIC COMMENT:

1. Mr. Diepenbrock announced that SCERS had received the Government Finance Officers Association (GFOA) achievement award for excellence in financial reporting for SCERS' most recent comprehensive annual financial report (CAFR) and popular annual financial report (PAFR). Chief Executive Officer Richard Stensrud noted that this was the twelfth consecutive year SCERS had received this award for the CAFR and the second consecutive year for the PAFR. The Board joined with Mr. Diepenbrock in commending the staff for the awards.

MINUTES:

2. The Minutes of the July 21, 2011 regular meeting were approved on Motion by Ms. Gin; Seconded by Mr. Johnson. Motion carried (5-0).

CONSENT MATTERS:

Items 3-11

Item 3 was taken off the Consent Calendar for discussion in Closed Session. The remaining Consent matters (Items 4-11) were acted upon as one unit upon a Motion by Mr. Kelly; Seconded by Mr. Johnson. Motion carried (6-0).

3. BARONE, Susan J.: Moved to the Closed Session, Disability Matters.

4. DIAZ, Stacey D.: Granted a nonservice-connected disability retirement.

5. RAY, Loretta A.: Granted a nonservice-connected disability retirement.

6. MANISAP, Bouaphet: Referred back to referee for further proceedings.

7. Approved the final reconciliation of employer retirement contributions by the Superior Court, County of Sacramento for the 2010-2011 Fiscal Year

8. Received and filed the Selected Fees and Costs for Outside Legal Services for the Quarter Ended June 30, 2011.

9. Received and filed the Semi-Annual Administrative Expense Report for the six months ended June 30, 2011.

10. Approved the Final Budget for the 2011-2012 Fiscal Year.

11. Received and filed the July 2011 Monthly Investment Manager Compliance Report and Watch List.

CLOSED SESSION:

DISABILITY MATTERS:

3. Moved from Consent Matters at the recommendation of Mr. Stensrud.

   BARONE, Susan J.: Action postponed to a subsequent Retirement Board Meeting.

OPEN SESSION:

ADMINISTRATIVE MATTERS:

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

Mr. Stensrud reported that the Internal Revenue Service (IRS) had begun providing feedback to the Orange County Employees' Retirement System (OCERS) regarding that system's submission of a request for a qualified plan determination letter. Mr. Stensrud reported that Bob Blum, tax counsel for SCERS and other 1937 Systems, held a conference call to update the systems on the questions posed by the IRS. Mr. Stensrud stated that Mr. Blum feels that the process with OCERS will continue well into the fall and that it will be longer still before the IRS begins the process with other systems.

Mr. Stensrud reported on the sizable donation made to the California Foundation for Fiscal Responsibility (CFFR), an organization that is very active in efforts to revise public employee pension plans. Mr. Stensrud noted that the $150,000 donation cannot be used for political purposes due to the nature of the foundation that made the gift and the organization that received the gift, but that it could be used for other purposes including funding for the CFFR research activities.

Mr. Stensrud reported that a ballot initiative had been submitted that would require public retirement systems to invest 85% of their assets in California companies. Mr. Stensrud stated that the initiative defines California companies as those with 70% or more of their workforce located in California. Mr. Stensrud noted that this initiative was submitted by an individual, not an organization or political group.

Mr. Stensrud reported that the state legislature was back in session. Mr. Stensrud stated that the topic of pension reform was still being discussed.

Mr. Stensrud reported that candidates had been interviewed for the vacant Investment Officer position, but that he was not sufficiently pleased with the strength of the candidate pool to fill the position. Mr. Stensrud stated that the recruitment process would be revisited in the near future.

Mr. Stensrud reported on a request from Mr. Jerry Fillingim that SCERS endorse a broad social/political initiative known as the 'Main Street Contract' (MSC). Mr. Stensrud noted that he had provided information to the Board regarding this request and absent other direction from the Board he would advise Mr. Fillingim that proposals like the MSC were not something on which SCERS takes a position.

ADMINISTRATIVE MATTERS (continued):

13. Paul Angelo and Andy Yeung of The Segal Company (Segal) presented the Actuarial Experience Study for the Period July 1, 2007 through June 30, 2010 and updated tables for calculating the purchase price of additional retirement credit (ARC).

Mr. Angelo and Mr. Yeung reported that Segal was recommending several changes to the demographic actuarial assumptions to bring the assumptions in line with actual experience. The recommended changes included: (1) Changes in the retirement probability levels for various age increments to reflect lower expected retirement rates; (2) Changing the mortality rates by adopting a more current mortality table that reflects longer life expectancies; (3) Reducing the assumptions regarding the probability of becoming disabled to reflect the fact that the actual rate of disability retirements is lower than expected; and (4) Increasing the sick leave conversion assumption for Safety members to reflect the fact that Safety members are reaching retirement with higher sick leave accruals than expected.

Mr. Angelo and Mr. Yeung reported that Segal was recommending no changes to the salary growth assumptions. They noted that while County budgetary constraints could mean that salary growth might be lower than expected in the near term, the salary growth assumptions were long term in nature (i.e., 20-30 years), and the current salary growth assumptions continued to be reasonable over the longer timeframe. They also noted that if the actual salary growth in a given year fell short of the assumption, it would produce an actuarial gain which would produce a downward adjustment in the employer contribution rate for the following year.

Mr. Angelo and Mr. Yeung reported that members who purchase additional retirement credit (ARC) are more likely to retire earlier than projected by the current assumptions used in establishing the price for the ARC purchase. They reported, therefore, that Segal was recommending that the retirement rate assumptions be modified to bring them in line with the actual ARC experience to help assure that the ARC pricing continues to be cost neutral to SCERS.

Motion by Ms. O'Neil to receive and file the Actuarial Experience Study and to adopt the actuarial assumptions recommended in the report; Seconded by Mr. Hickox. Motion carried (8-0).

Motion by Mr. Kelly to adopt the updated tables to be used for calculating the Additional Retirement Credit purchase prices for SCERS members; Seconded by Ms. Wolford-Landers. Motion carried (8-0).

INVESTMENT MATTERS:

14. Pete Keliuotis of Strategic Investment Solutions, Inc. (SIS) presented the Investment Performance Report for the Quarter Ended June 30, 2011.

Mr. Keliuotis reported that the Total Fund (TF) return for the second quarter, including the impact of the overlay program, was 1.2% gross of fees. The TF return was 0.3% above the return of the policy index benchmark which had a return of 0.9%. The overlay program had no impact on performance for the quarter.

Mr. Keliuotis reported that on a comparative basis, the return for the quarter was 10 basis points below the Public Funds $1+ Billion Median return of 1.3%. The TF return ranks in the 56th percentile in the State Street/ICC Universe, which is the ranking universe used by SIS. All major asset classes experienced positive returns for the quarter. Longer term, the five and ten-year returns of 4.1% and 5.6%, ranked below the median among large public plans (4.8% and 5.7%, respectively).

Mr. Keliuotis reported that for SCERS' fiscal year ending June 30, 2011, the TF return gross of fees, including the impact of the overlay program was 22.7%, which was 0.2% above the return of the policy index benchmark of 22.5%. The TF fiscal year return was 1.0% above the Public Funds > $1Billion Median return of 21.7%, and ranks in the 30th percentile in the State Street/ICC Universe.

Mr. Keliuotis noted that at the asset class level, fiscal year outperformance occurred, gross of fees, in the domestic equity, domestic fixed income, hedge fund and real estate segments. Underperformance occurred in the international equity and private equity segments. In the opportunistic segment, the credit strategies in aggregate outperformed the Barclays Capital Aggregate benchmark, and the commodities strategies in aggregate outperformed the Dow Jones UBS Commodities Index benchmark.

Motion by Mr. Johnson to receive and file the quarterly report and to approve the recommendations made in the presentation; Seconded by Mr. Hickox. Motion carried (8-0).

15. Patrick Thomas and John Meier of Strategic Investment Solutions, Inc. presented SCERS' asset/liability analysis and the recommended asset allocation model. The makeup of the new asset allocation model:

- Reduces the domestic equity allocation and slightly increases the international equity allocation.
- Increases the allocations to hedge funds and private equity.
- Establishes a new asset class – Real Assets – which will include core real estate, commodities, infrastructure and 'hard' assets.

INVESTMENT MATTERS (continued):

- Shifts the REIT investments to the equity asset classes.

- Maintains the Opportunities asset class, but re-defines it as being tactical in nature, meaning that it does not have a target allocation, but rather, has an allocation range of 0% to 5% depending on whether there are suitable tactical investment opportunities.

- Maintains the current allocation level for fixed income.

Mr. Meier explained that the benefits of the new asset allocation model include:

- Providing a higher expected return (and real rate of return) than the current asset allocation with only a relatively small increase in the expected standard deviation. This translates to higher expected asset levels and funded status, and lower employer contribution rates, across virtually the entire range of potential investment performance. Even under the worst case investment return scenarios the new allocation is projected to do only slightly poorer than the current allocation. The overall risk/reward analysis shows that the move to the new allocation is warranted.

- Performing better than the current allocation across different economic environments, illustrating that the new allocation produces a better 'all-weather' portfolio than the current allocation.

- Increasing the diversification levels relative to various sources of risk in the portfolio.

- Maintaining more than sufficient liquidity even in stressed environments.

Mr. Meier also noted that the new asset allocation model would have performed marginally better than the current portfolio in various historic 'high stress' market scenarios, including the 2007-2008 market meltdown.

Discussion followed.

Motion by Ms. Gin to receive and file the presentation regarding the SCERS' asset/liability analysis and to approve the recommended asset allocation model; Seconded by Ms. Valverde. Motion carried (8-0).

16. SCERS Investment Staff and Cliffwater, LLC presented the sub-asset class allocation plan for hedge funds, the investment manager structure for hedge funds, the twelve month investment plan for hedge funds, and the hedge fund investment implementation plan.

INVESTMENT MATTERS (continued):

Staff provided an overview of SCERS' current hedge fund program, including why and how SCERS has invested in hedge funds. Staff outlined how SCERS' hedge fund program can be improved by constructing a direct hedge fund portfolio that is diversified globally and by strategy. This is intended to: (1) Lower risk by achieving diversification across multiple strategies beyond equity long/short; (2) Enhance returns over the long-term by virtue of strategy diversification; and, (3) Lower costs by investing directly with hedge fund managers.

Cliffwater and Staff presented a proposed hedge fund structure featuring multiple hedge fund strategies with different weighting ranges for the strategies. Cliffwater and Staff recommended targeting 22 funds in the direct hedge fund program with a range of 18-30 funds to achieve the optimal diversification benefits. Cliffwater and Staff also recommended that a single hedge fund represent no more than 1.5% SCERS' total fund and that any one hedge fund manager or fund represent no more than 10% of SCERS' Hedge Fund portfolio.

Staff explained that since it will take several years to construct a direct hedge fund portfolio, by utilizing a Hedge Fund Strategic Partner (HFSP), SCERS can build a broadly diversified hedge fund portfolio within a short-time frame - approximating four months. Accordingly, Staff noted that a request for information had been issued to SCERS' current hedge fund of funds managers (Grosvenor and Blackstone) regarding their capability to serve as a HFSP. Staff explained that in addition to building a broadly diversified customized hedge fund portfolio, the HFSP will share resources and transfer knowledge to assist with SCERS' direct hedge fund platform, including: (1) Reports and current assessments on hedge fund managers; (2) Portfolio construction methods; (3) Access to the same contract terms and fee discounts; (4) Top down macro insights affecting hedge fund portfolios and opportunities; (5) Risk management and portfolio monitoring services; (6) Advice on the organizational structure; and (7) Updates on regulatory, accounting or concerns in the industry.

After evaluating the firm's respective capabilities in providing SCERS with a customized separate account, Staff and Cliffwater recommended that Grosvenor be selected as SCERS' strategic partner for the purpose of building a customized separate account. Staff and Cliffwater noted that both firms were capable of doing an excellent job as the HFSP, but that they believed that Grosvenor provided the best fit for the assignment.

Staff and Cliffwater noted that the HFSP engagement will be overseen by Staff and Cliffwater to assure that the construction of both the separate account and overall hedge fund program will be consistent with the guidelines and expectations approved by the Board.

INVESTMENT MATTERS (continued):

Staff and Cliffwater presented a twelve month hedge fund investment plan, focusing on the following three components: (1) Implementation of the customized separate account; (2) Implementation of the direct hedge fund program; and, (3) Integration of the separate account with the direct hedge fund investments.

Staff also proposed a hedge fund implementation protocol, under which the screening and decision process for making or modifying hedge fund investments is delegated to the Staff and Cliffwater, while preserving the Board's oversight of how the analysis is unfolding and the Board's ability to raise questions and concerns regarding a proposed investment decision.

Motion by Ms. O'Neil to approve the sub-asset class allocation plan for hedge funds; Seconded by Mr. Hickox. Motion carried (8-0).

Motion by Mr. Johnson to select Grosvenor Capital Management as a strategic partner within SCERS' hedge fund portfolio to manage a customized and diversified separate account hedge fund portfolio; Seconded by Ms. Wolford-Landers. Motion carried (8-0).

Motion by Mr. Kelly to approve the proposed twelve month investment plan for hedge funds; Seconded by Mr. Johnson. Motion carried (8-0).

Motion by Ms. Wolford-Landers to approve the proposed implementation protocol for making hedge fund investments; Seconded by Mr. Hickox. Motion carried (8-0).

The meeting was adjourned at 2:15 p.m.

MEMBERS PRESENT: James A. Diepenbrock, John B. Kelly, William D. Johnson, Diana Gin, Winston H. Hickox (arrived at 11:01 a.m.), Kathy O'Neil (arrived at 11:05 a.m.), Julie Valverde (arrived at 11:05 a.m.), Nancy Wolford-Landers (arrived at 11:03 a.m.), John Conneally (arrived at 11:32 a.m.), and Michael DeBord.

MEMBERS ABSENT: Robert L. Woods.

OTHERS PRESENT: Richard Stensrud, Chief Executive Officer; James G. Line, General Counsel; Kathryn T. Regalia, Chief Operations Officer; John W. Gobel, Sr., Chief Benefits Officer; Suzanne Likarich, Retirement Services Manager; Thuyet Ziyalan, Accounting Manager; Scott Chan, Deputy Chief Investment Officer; Steve Davis, Investment Officer; John Lindley, IT Administrator; Diana Ruiz, Deputy County Counsel; Paul Angelo and Andy Yeung, The Segal Company; Pete Keliuotis, Patrick Thomas, and John Meier, Strategic Investment Services, Inc;

Jamie Fiedler and Steve Nesbitt, Cliffwater LLC; David Devine, County of Sacramento; David Allen and Dan Rainsbury, David Allen & Associates Attorneys.

Respectfully submitted,

Richard Stensrud
Chief Executive Officer and
Secretary of the Retirement Board

APPROVED: ____
James A. Diepenbrock, 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.