SCERS
SACRAMENTO COUNTY
EMPLOYEES' RETIREMENT SYSTEM

M I N U T E S

RETIREMENT BOARD MEETING, WEDNESDAY, JANUARY 16, 2013

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, January 16, 2013, and commenced at 10:04 a.m.

OPEN SESSION:

PUBLIC COMMENT:

1. Alyssa Giachino from Unite Here Local 11 commented on recent personnel changes and recent sub-par performance by a fund managed by Cornerstone Real Estate Advisers. Ms. Giachino urged the Board to consider this information before making any further commitments to Cornerstone. Mr. Diepenbrock noted that while SCERS is reevaluating its real estate investments, no additional commitments have been made to Cornerstone at this time and that SCERS' investment consultants and Staff would continue to keep current with any personnel changes and performance issues at Cornerstone.

MINUTES:

2. The Minutes of the December 19, 2013 special meeting were approved on Motion by Mr. DeVore; Seconded by Mr. Conneally. Motion carried (8-0).

CONSENT MATTERS:

Items 3-8

The Consent matters were acted upon as one unit upon a Motion by Mr. Fowler; Seconded by Ms. Wolford-Landers. Motion carried (8-0).

3. BOSCH, Elaine M.: Granted a reciprocal nonservice-connected disability retirement.

4. LYNCH, Alvin: Granted a nonservice-connected disability retirement.

5. MCHENRY, Jeffrey L.: Granted a service-connected disability retirement.

6. RIVER, Guadalupe A.: Denied a service-connected disability retirement.

7. Approved recommendation to operate with a single Board Vice-President for the remainder of the 2012-2013 fiscal year.

8. Received and filed the December 2013 Monthly Investment Manager Compliance Report and Watch List.

ADMINISTRATIVE MATTERS:

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

   Mr. Stensrud responded to the public comment from Ms. Giachino. Mr. Stensrud noted that SCERS does not invest in the Cornerstone fund cited by Ms. Giachino and has no plans to invest in that fund. Mr. Stensrud noted that the Cornerstone fund in which SCERS does invest has performed well over the long history of the investment. Mr. Stensrud reported that SCERS was aware of the referenced personnel changes at the Cornerstone fund and had met with the new portfolio managers. Mr. Stensrud reported that Staff had been impressed with the new personnel and remained confident in Cornerstone's ability to maintain good performance. Mr. Stensrud noted that this view was also shared by SCERS' real estate consultant, the Townsend Group. Mr. Stensrud noted that being said, as with any manager experiencing personnel turnover, SCERS had placed Cornerstone on the investment manager Watch List and would monitor the situation. Mr. Stensrud reiterated the earlier comments by Mr. Diepenbrock that a real estate strategic plan analysis was being performed by Townsend, but at this juncture, no decisions had been made to increase allocations to existing managers, expand mandates with existing managers, or even add to the real estate allocation.

   Mr. Stensrud noted that at the February Board Meeting, the Investment Staff would be presenting the annual investment year in review report.

ADMINISTRATIVE MATTERS (continued):

Mr. Stensrud reported that the Investment Staff and general investment consultant Strategic Investment Solutions (SIS) were moving forward with two investment manager searches for the fixed income asset class: A non-U.S. fixed income mandate and an opportunistic credit fixed income mandate. Mr. Stensrud noted that the first investment manager recommendation is expected to be for the non-U.S. fixed income mandate at the March Board Meeting, followed by an investment manager recommendation for the opportunistic credit fixed income mandate at the April Board Meeting.

Mr. Stensrud reported that Staff was continuing to monitor developments regarding the implementation of CalPEPRA by the other public retirement systems in California.

Mr. Stensrud reported that due to the expiration of the current contract with SCERS' independent outside auditor, a decision would have to made regarding how to address SCERS' annual audit needs. Mr. Stensrud noted that Macias Gini & O'Connell had served as the outside auditor since 2000, with two extensions of the initial contract. Mr. Stensrud noted that given the long tenure of the relationship, the standard practice would be to issue a request for proposals (RFP) for a new auditor. Mr. Stensrud further noted, however, that the previous RFP had only yielded two respondents and the marketplace had not changed since that time. Accordingly, Mr. Stensrud requested feedback from the Board on whether they felt issuance of a new RFP was warranted. Discussion followed and the Board expressed its desire that efforts be undertaken to identify other potential candidates for the audit engagement, and thereafter a decision would be made regarding whether a full RFP process would be necessary.

Mr. Stensrud reported that there had been a high level of interest in the purchase of Additional Retirement Credit (ARC) following the passing of the CalPEPRA legislation, which ended the ability to make an ARC purchase after December 31, 2012.

Mr. Stensrud reported that there would be a California Association of Public Retirement Systems (CALAPRS) Trustees' Roundtable on February 8, 2013 and that information regarding this meeting would be available soon. Mr. Stensrud also reported that CALAPRS was conducting a new education program titled the Advanced Board Leadership Institute January 29-31, 2013, at UCLA. Mr. Stensrud noted that Mr. Kelly and Mr. Conneally would be in attendance.

Mr. Stensrud noted that the annual Form 700 Statement of Economic Interests had been provided to the Board. Mr. Stensrud reminded the Board that the deadline to file the Form is March 31, 2013. Mr. Stensrud noted that legal counsel Lance Kjeldgaard was available to answer any questions regarding the Form.

Mr. Stensrud noted that it was the first meeting for new Board Member Chris Pittman and welcomed Mr. Pittman to the Board.

ADMINISTRATIVE MATTERS (continued):

10. Chief Executive Officer Richard Stensrud requested that the Board increase the contract amount for the engagement with Nossaman LLP to provide legal services related to disability retirement determinations, and discussed potential modifications to the disability determination process that would help mitigate such costs in the future, and increase efficiency in addressing disability applications. Mr. Stensrud noted that Staff would return to the Board at a future date with specific recommendations for the Board's consideration.

    Discussion followed.

    Motion by Ms. Wolford-Landers to approve the recommended increase in the authorized contact amount for the engagement with Nossaman LLP to provide legal services related to disability retirement determinations; Seconded by Mr. Fowler. Motion carried (8-0).

INVESTMENT MATTERS:

11. Chief Investment Officer Scott Chan provided a presentation on the proposed engagement with Grosvenor Capital Management LLC to facilitate reaching the target allocation level in the hedge fund asset class through an interim hedge fund component (SCARF B).

    Mr. Chan explained that SCARF B is a customized, separate account portfolio of hedge fund managers, diversified across multiple strategies, asset classes, and regions. Mr. Chan stated that SCARF B is the optimal approach to bring the hedge fund allocation in line with its target level because SCARF B will provide true hedge fund exposure, with the risk and return attributes the hedge fund asset class is expected to provide to the overall investment portfolio. Mr. Chan noted that SCARF B will satisfy the additional goal of ample liquidity to draw down and fund the direct hedge fund program. Mr. Chan further noted that SCARF B was a cost effective solution and can be implemented seamlessly.

    Mr. Chan reviewed the implementation plan for SCARF B. Mr. Chan stated that the funding of SCARF B would occur in two tranches. The first tranche would be funded on February 1, 2013, and the second tranche would be funded in conjunction with a reduction in the equity asset class to bring it in line with its target allocation level in May, 2013.

    Discussion followed.

    Motion by Mr. DeVore to approve the proposed engagement with Grosvenor Capital Management LLC to establish SCARF B to facilitate reaching the target allocation level in the hedge fund asset class; Seconded by Ms. Wolford-Landers. Motion carried (8-0).

12. Deputy Chief Investment Officer Steve Davis reviewed recommended changes to the investment options used in the portfolio overlay program managed by State Street Global Advisors (SSGA).

INVESTMENT MATTERS (continued):

Mr. Davis stated that the overlay program serves two primary functions for SCERS: (1) Rebalances SCERS' asset allocation to achieve its policy targets, as defined by SCERS' asset allocation policy; and (2) Eliminates performance drag from residual cash in investment managers' portfolios. Mr. Davis noted that the overlay program rebalances to SCERS' target allocations using a 'quarterly with bands' method, where rebalancing occurs on a quarterly basis unless the bands are breached on an intra-quarter basis.

Mr. Davis discussed the relationship between the overlay program and the target allocation levels used in rebalancing. Mr. Davis noted that with approval of the new asset allocation in 2011, Staff and consultants (SIS and Cliffwater) have been taking steps to restructure each asset class, but in some cases, the process would take a few years to complete. Mr. Davis explained that for this reason, the overlay program was continuing to use the old allocation targets. Mr. Davis stated that a further reason the new asset allocation was not being used for the overlay program was because of a desire for better proxy solutions for the alternative asset classes. Mr. Davis noted, however, that with the implementation of SCARF B, Staff and SIS recommended the asset class bands used by the overlay program for hedge funds be expanded. Mr. Davis explained that the failure to expand the bands would cause the overlay program to effectively 'undo' the effect of the addition of SCARF B. Mr. Davis noted that Staff plans to return to the Board in the next few months with a broader recommendation for moving from SCERS' old asset allocation to SCERS' new asset allocation for purposes of the overlay program.

Motion by Mr. Fowler to approve the recommended changes to the hedge fund allocation bands used in the portfolio overlay program; Seconded by Ms. Wolford-Landers. Motion carried (8-0).

13. Chief Executive Officer Richard Stensrud reviewed a recommended modification to the investment implementation protocol for the opportunities asset class.

Mr. Stensrud noted that the Board had previously approved investment implementation protocols for all of the alternative asset classes. Mr. Stensrud stated that the recommended modification to the investment implementation protocol for the opportunities asset class would make it be similar to the implementation protocol for the hedge fund asset class. Mr. Stensrud noted that this would include the Board authorizing Staff, in conjunction with the consultants, to identify and commit to investments in the opportunities asset class.

Mr. Stensrud stated that Staff would follow the same reporting protocol where the Board would be notified that a potential opportunity was being reviewed and would be presented with information on the nature of the investment, how and why it is being considered, and analysis of where Staff and consultants believe would be an appropriate place to draw from in order to fund this particular investment. Mr. Stensrud further stated that, absent a show of concern from the Board, Staff and consultants would move forward to make the investment commitment if it proved to pass through the due diligence process successfully.

INVESTMENT MATTERS (continued):

Ms. Wolford-Landers noted that an amended investment policy statement was not included in the materials presented to the Board. Mr. Stensrud explained that the changes were detailed in the materials presented to the Board, but an amended policy document had not been prepared. It was decided that upon approval of the proposed changes, Staff would incorporate them into the existing policy and report back to the Board when the amended policy document was available for review.

Motion by Ms. Wolford-Landers to approve the recommended modifications to the investment implementation protocol for the opportunities asset class, with the amended policy statement to follow; Seconded by Mr. DeVore. Motion carried (8-0).

14. Chief Executive Officer Richard Stensrud reviewed the proposed policy regarding fiduciary standards in private equity investments.

Mr. Stensrud discussed the differing approaches to incorporating the fiduciary standard of care in private equity investment engagements. Mr. Stensrud noted the different ways in which fiduciary standards are expressed, and described their pros and cons. Mr. Stensrud explained that managers vary in their willingness to accept a particular fiduciary standard of care, and in some cases, managers will not accept any fiduciary standard of care at all. Mr. Stensrud explained that this latter position was most frequently seen in the venture capital segment of private equity.

Mr. Stensrud noted that SCERS and other investors would continue to press venture capital managers to accept fiduciary status. Mr. Stensrud explained, however, that many venture capital managers hold the view that what they do is sufficiently specialized and unique that if a party wants to be able to get access to their expertise, the investor will have to do so under the manager's terms. Mr. Stensrud noted that because venture capital is generally considered to be an important part of a private equity portfolio, and since access to the top venture capital managers is critical to successfully investing in the space, managers will continue to have the leverage to be able to control certain terms, including fiduciary standards.

Mr. Stensrud stated that the key in such a situation is to perform thorough due diligence on the manager, and obtain a sufficient level of confidence that, based on the manager's record and practices in the past, the manager will exhibit a high level of integrity and professionalism in its dealings with investors.

Mr. Stensrud explained that the proposed policy on evaluating fiduciary standards was intended to reflect how the issue of fiduciary standards will be assessed by the Staff and consultant when considering an investment opportunity and to provide confirmation to the Board that the issue has been addressed properly. Mr. Stensrud noted that proposed policy would be added as a supplement to the overall Investment Policy Statement for the private equity asset class.

INVESTMENT MATTERS (continued):

Motion by Ms. Gin to approve the proposed policy regarding fiduciary standards in private equity investments; Seconded by Ms. Valverde. Motion carried (8-0).

15. Chief Executive Officer Richard Stensrud reviewed the proposed liquidity policy for hedge fund investments.

Mr. Stensrud noted that measuring and managing investment liquidity is a key component of SCERS' investment program. Mr. Stensrud noted that the liquidity of individual hedge fund investments will vary, but overall, the hedge fund asset class is intended to provide a level of liquidity between the high liquidity of traditional public markets investments (stocks and bonds) and the lower liquidity of private equity.

Mr. Stensrud discussed the key factors governing liquidity in hedge fund investments, including the lockup period (the period of time that must pass before an investor can withdraw funds), gate (the maximum amount of funds that can be withdrawn in a given time period), withdrawal frequency and notification period (the dates that investors can notify and redeem partnership interests) and withdrawal penalty fee (the fee that is paid by an investor to withdraw funds early).

Mr. Stensrud noted that the typical lockup period is less than three years, but some hedge fund investments require a longer lockup period. Mr. Stensrud explained that there are various reasons why it may be beneficial for SCERS to invest in hedge funds that feature longer lockup periods, including lower fees and the ability to access investment strategies that require and reward a longer investment period. Mr. Stensrud noted, however, that any limitation on liquidity must be considered relative to the hedge fund portfolio as a whole, and the total fund. Mr. Stensrud explained that for this reason, the Hedge Fund Investment Policy Statement (Hedge Fund IPS) adopted by the Board places various limitations on investments in funds with less liquid terms, and that one of those requirements is that investment in hedge funds with lockups greater than two years must be approved by the Board.

Mr. Stensrud noted that at a previous Board Meeting, Staff had suggested that it might be appropriate to amend the hedge fund investment policy statement to grant Staff authority to commit to hedge funds with lockups less than three years, but that a lockup greater than three years would need approval by the Board. Mr. Stensrud noted that the Board expressed a preference that there not be hard limits on lockups, and that Staff and consultant exercise their professional judgment regarding whether a given lockup was appropriate.

Mr. Stensrud stated that the proposed liquidity policy for hedge fund investments was intended to outline how Staff and consultant would exercise the delegated discretion. Mr. Stensrud explained that the proposed policy outlined the parameters that will be utilized in assessing, not just lockup periods, but the general liquidity element of hedge fund

INVESTMENT MATTERS (continued):

investments for the purpose of confirming that the investment is suitable relative to its individual liquidity provisions and that the investment is suitable relative to the liquidity profile of the broader hedge fund portfolio.

Motion by Mr. DeVore to approve a proposed liquidity policy for hedge fund investments; Seconded by Ms. Gin. Motion carried (8-0).

16. Janelle Plaza and Bryan Carroll of Claren Road Asset Management provided an educational presentation on the firm's long/short corporate credit strategy.

Ms. Plaza provided an overview and history of the firm. Ms. Plaza stated that the firm was founded in 2006 by four partners and that it currently has assets under management of approximately $6.9 billion.

Mr. Carroll reviewed the portfolio characteristics, including that the portfolio seeks to hedge all observable interest rate exposure and maintain a liquid portfolio that is actively traded. Mr. Carroll discussed the fixed income asset class and credit as a medium for investing.

Mr. Carroll noted that the credit markets have experienced tremendous growth in the last 20 years, that dealer capital has been significantly reduced, and that volatility will likely be elevated for the foreseeable future. Mr. Carroll reviewed the supply and demand in the credit market. Mr. Carroll also reviewed the current debt issues in Europe, Japan, and the U.S., and potential solutions to those issues.

Discussion followed.

Motion by Mr. Fowler to receive and file the educational presentation by Claren Road Capital Management regarding the firm's long/short corporate strategy; Seconded by Ms. Wolford-Landers. Motion carried (7-0).

The meeting was adjourned at 1:52 p.m.

MEMBERS PRESENT: James A. Diepenbrock, Keith DeVore, Richard B. Fowler II, Diana Gin (departed at 1:30 p.m.), Chris A. Pittman, Julie Valverde, Nancy Wolford-Landers, John Conneally, and Michael DeBord.

MEMBERS ABSENT: John B. Kelly and Kathy O'Neil.

OTHERS PRESENT: Richard Stensrud, Chief Executive Officer; Scott Chan, Chief Investment Officer; Kathryn T. Regalia, Chief Operations Officer; John W. Gobel, Sr., Chief Benefits Officer; Steve Davis, Deputy Chief Investment Officer; Suzanne Likarich, Retirement Services Manager; Bharat Indurkar, Investment Officer; John Lindley, IT Administrator; Lance Kjeldgaard, Outside Counsel; Stephen Masarik and Patrick Thomas, Strategic Investment Solutions, Inc; Jamie

Feidler, Cliffwater, LLC; Janelle Plaza and Bryan Carroll, Claren Road Asset Management; and Alyssa Giachino, Unite Here Local 11.

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.