M I N U T E S

RETIREMENT BOARD MEETING, WEDNESDAY, FEBRUARY 20, 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, February 20, 2013, and commenced at 10:02 a.m.

OPEN SESSION:

PUBLIC COMMENT:

1. None heard.

MINUTES:

2. The Minutes of the January 16, 2013 regular meeting were approved on Motion by Ms. Wolford-Landers; Seconded by Ms. Valverde. Motion carried (8-0).

CONSENT MATTERS:

Items 3-14

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

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

3. CHARLSON, Mary Joy: Granted a nonservice-connected disability retirement.

4. COYKENDALL, Rachael V.: Denied a service-connected disability retirement.

5. GRAVENMEIR, Keshara A.: Denied a nonservice-connected disability retirement.

6. LITTLE, Kimberlee J.: Granted a reciprocal nonservice-connected disability retirement.

7. MARCUM, Roy A.: Granted service-connected death benefits.

8. Approved proposed cost-of-living adjustment (COLA) effective April 1, 2013, for SCERS' monthly benefit payments.

9. Approved the proposal to re-finance a real estate holding in the portfolio managed by Cornerstone Real Estate Advisors.

10. Received and filed the Portfolio Re-Balancing Report for the Quarter Ended December 31, 2012.

11. Received and filed the Trading Cost Report for the Quarter Ended December 31, 2012.

12. Received and filed the Semi-Annual Administrative Expense Report for the six months ended December 31, 2012.

13. Received and filed the Selected Fees and Costs for Outside Legal Services for the Quarter Ended December 31, 2012.

14. Received and filed the January 2013 Monthly Investment Manager Compliance Report and Watch List.

<u>ADMINISTRATIVE MATTERS:</u>

15. 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 California Association of Public Retirement Systems (CALAPRS) General Assembly would be March 2 - 5, 2013 in San Francisco.

    Mr. Stensrud noted that Mr. Fowler had recently attended the CALAPRS Trustees' Roundtable in San Jose and invited Mr. Fowler to comment on the program. Mr. Fowler stated that the Roundtable provided excellent presentations by investment professionals

ADMINISTRATIVE MATTERS (continued):

and that he had brought back materials from the presentations to share with the Board. Mr. Stensrud noted that the materials were available for the Board to review.

Mr. Stensrud also reported that Mr. Kelly and Mr. Conneally had recently attended the CALAPRS Advanced Board Leadership Institute at UCLA and invited them to comment on the program. Mr. Kelly and Mr. Conneally stated that the program was very informative and made them confident that SCERS and the SCERS Board are on the right track in terms of fulfilling their responsibilities.

Mr. Stensrud provided an update on the monthly hedge fund operational due diligence performed by the Investment Staff, alternative asset consultant Cliffwater, or strategic investment partner Grosvenor Capital Management regarding either the hedge fund direct investments or the separate account managed by Grosvenor.

Mr. Stensrud reported that the State Association of County Retirement Systems (SACRS) was sponsoring legislation focused on providing clarification and consistency regarding the disclosure of investment information related to alternative investments. Mr. Stensrud stated that the law currently includes an exemption from disclosure for certain investment information in the alternative space, particularly information that would compromise the success of the investment strategy. Mr. Stensrud noted that the rationale for the exemption is that funds would not want a system to invest in them if the fund had to disclose proprietary information key to the success of their strategy. Mr. Stensrud stated that SACRS is seeking to extend the protection from disclosure to comparable categories of information for other alternative investments, but that the amounts invested, the funds invested in, and the performance will continue to be reported.

Mr. Stensrud reported that legislation had been introduced to provide clarification to CalPEPRA. Mr. Stensrud noted that this legislation has support from the legislative committees and the administration. Mr. Stensrud stated that the legislation focused on technical cleanup and not on changing the substance of CalPEPRA. Mr. Stensrud reported that the legislation included some 1937-Act related provisions added at the request of SACRS. Mr. Stensrud stated that one provision would clarify that normal cost can be calculated via a flat contribution rate as opposed to an age-specific rate. Mr. Stensrud noted that SCERS currently uses the flat contribution rate. Mr. Stensrud stated that the other provision would clarify that the new tiers are not to be integrated with Social Security. Mr. Stensrud noted that SCERS has historically integrated all tiers with Social Security and has been taking this approach with the new tiers. Mr. Stensrud stated that SCERS would need to fix this retroactively, but that it was not a significant issue.

Mr. Stensrud further reported that the legislation to clarify CalPEPRA did not yet include any provision regarding what should be counted as pensionable compensation.

ADMINISTRATIVE MATTERS (continued):

Mr. Stensrud noted that SCERS has been taking an approach based on the actual language of the statute and restricting pensionable compensation to base pay.

Mr. Stensrud noted that a few years ago, legislation was introduced encouraging CalPERS and CalSTRS to make infrastructure investments in California. Mr. Stensrud further noted that the legislation required that investment decisions would still need to be considered using prudent fiduciary standards. Mr. Stensrud reported that legislation had been introduced to provide similar encouragement to 1937 Act systems. Mr. Stensrud stated that the potential law would require that SCERS look at California infrastructure investments, but there would be no mandate that SCERS make any such investments.

Mr. Stensrud reported that some 1937 Act systems were being sued over their attempts to implement CalPEPRA, but that so far, no lawsuits had been filed against SCERS. Mr. Stensrud stated that he believes this is largely because SCERS did not need to make many changes in order to comply with CalPEPRA.

Mr. Stensrud noted that he would be speaking at the Sacramento County Retired Employees Association (SCREA) spring luncheon, as well as the June luncheon for the Association of Sacramento County Sheriff's Department Veterans and Employees.

Mr. Stensrud noted that the annual Form 700 Statement of Economic Interests had been provided to the Board. Mr. Stensrud stated that the deadline to file is March 31, 2013.

16. Chief Executive Officer Richard Stensrud reviewed the proposed process and parameters for addressing the duty placed on retirement systems by CalPEPRA to determine whether an otherwise eligible element of compensation in the final average salary period will be excluded from the retirement benefit calculation because it was paid for the purpose of enhancing the member's retirement benefit (i.e., because it was intended to produce 'pension spiking').

Mr. Stensrud noted that SCERS has always reviewed compensation paid during a member's work career to assure that it was comprised of permissible pay elements, with a particular focus on the pay elements in the final average salary period that are used to determine the 'final compensation' utilized to calculate the member's retirement benefit. Mr. Stensrud explained that prior to CalPEPRA, the rules for determining whether a compensation element was eligible for pension benefit purposes were largely grounded in court decisions from the 1990s (the 'Ventura' decisions).

Mr. Stensrud explained that as a general matter, the Ventura rules stated that a compensation element paid in cash in the course of employment would be considered when calculating the pension benefit. Mr. Stensrud noted that the Ventura decisions also

ADMINISTRATIVE MATTERS (continued):

established exceptions to this general rule, whereby compensation paid in cash would not be considered when calculating the pension benefit. Examples included: (1) Payments for overtime; and (2) Payments made at and associated with the termination of employment (e.g., payments to cash-out accrued leave balances at retirement).

Mr. Stensrud explained that CalPEPRA largely codified the Ventura rules for members in SCERS prior to January 1, 2013, but that effective with retirement applications filed on or after that date, CalPEPRA mandates an expanded level of review of the pay elements in the final average salary period – i.e., to determine whether an otherwise permissible pay element was paid for the purpose of enhancing the member's retirement benefit. Mr. Stensrud noted that if SCERS determines that it was, the pay element is to be excluded from the final compensation used to calculate the retirement benefit.

Mr. Stensrud noted that CalPEPRA addresses final compensation differently for members joining SCERS on or after January 1, 2013, by placing broad restrictions on what qualifies as pension-eligible compensation (i.e., 'pensionable compensation'), including express exclusion of certain pay elements that would have been permitted by the Ventura cases.

Mr. Stensrud explained that for pre-January 1, 2013 members, CalPEPRA provides guidance regarding pay elements that could meet the criteria of being paid for the purpose of enhancing the pension benefit through the following examples: (1) Compensation previously paid in-kind or to a third party on behalf of the member but converted to cash payment to the member in the final compensation period; (2) A one-time or ad hoc payment not given to similarly situated members in the same grade or class; and (3) Severance or separation pay received by the member while employed. Mr. Stensrud noted that beyond that, however, CalPEPRA does not provide a specific definition of what would cause a pay element to be considered as paid for the purpose of enhancing the member's retirement benefit.

Mr. Stensrud explained that nevertheless, CalPEPRA requires that SCERS establish a procedure for assessing and determining whether an element of compensation was paid to enhance the member's retirement benefit. Mr. Stensrud noted that CalPEPRA provides SCERS with tools for this task by declaring that SCERS can audit the employer to determine whether compensation has been reported correctly, including the authority to require the employer to provide information or make records available for inspection. Mr. Stensrud noted that CalPEPRA also places a duty on the employer to correctly report compensation to SCERS, and if SCERS determines that the employer has knowingly failed to comply with this duty – i.e., the employer knew or should have known that the compensation reported was not compensation earnable – then SCERS may assess the employer a reasonable amount to cover the cost of the audit or any necessary adjustment or correction.

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

Mr. Stensrud also noted CalPEPRA provides that the employer and/or the member shall have an opportunity to present evidence that the pay element was not paid for the purpose of enhancing the member's retirement benefit. If, despite such evidence SCERS were to conclude that the pay element must be excluded from the benefit calculation, the employer and/or the member can seek judicial review of that determination.

Mr. Stensrud outlined the proposed process and parameters that will be utilized by SCERS in carrying out the review mandated by CalPEPRA.

Mr. Stensrud explained that the process reflected certain key principles: (1) It would be efficient, take into account available resources and not unduly delay the issuance of the first retirement check; (2) It would produce sufficient evidence and documentation to support the recommended determination regarding the pay elements; (3) The level of review would correspond to the degree to which the compensation exceeds a baseline benchmark and/or the nature of the pay element in question; (4) Responsibility for obtaining/providing necessary information would be sensibly allocated between SCERS Staff and the employer and/or member; (5) Consistency in approach and outcome would be central; and (6) It would reflect that due process has been provided in the determination by giving the employer and employee a reasonable opportunity to provide information to support their belief that a pay element should be included in the calculation of the retirement benefit.

Mr. Stensrud discussed the burden of proof, scope of review and basic steps in the process. Mr. Stensrud outlined the communication on the process that would be provided to participating employers and retiring members.

Mr. Stensrud noted that SCERS would not delay the receipt of retirement benefits due to the final compensation review, but if the review was still underway when the first benefit check was otherwise ready to be issued, an amount commensurate with the pay element(s) in question would be held back from the retirement benefit until the review had been completed. Mr. Stensrud noted that in such a case future benefit payments would be adjusted appropriately, including payment of any retroactive amounts due.

Mr. Stensrud stated that if and when a pay element is excluded, a refund of member contributions on the pay element will be provided by the employer.

Discussion followed.

Motion by Ms. Wolford-Landers to approve the recommended process and parameters for reviewing and determining whether a pay element in the final compensation period will be included for the purposes of calculating a member's retirement benefit; Seconded by Mr. Fowler. Motion carried (8-0).

INVESTMENT MATTERS:

17. Chief Executive Officer Richard Stensrud introduced the presentation of the 2012 Investment Year in Review.

Mr. Stensrud noted that this marked the third annual Investment Year in Review. Mr. Stensrud stated that the purpose of the review was to: (1) Summarize the major events and developments of the past year, including investment performance; (2) Remind the Board of what had been accomplished over the year; (3) Highlight the decisions that were made, the rationale for those decisions and the direction(s) established going forward; and (4) Preview the investment program projects, issues and objectives for the year to come

Mr. Stensrud noted that this is the first Investment Year in Review that is calendar year based, and that this would be the practice going forward.

Mr. Stensrud noted that in 2011 the focus was on the architecture and structure of the investment program while in 2012 the focus was on construction and implementation in the investment program.

Mr. Stensrud noted that the investment performance was strong, not only in 2012, where the investment return of 13.7% was 1.1% above the benchmark, but over the long term where the annualized return of 8.4% for the last twenty-six years was above SCERS' long term actuarial investment return assumption of 7.5%.

Mr. Stensrud discussed how the strategic direction, asset allocation, return and risk parameters and investment policies established by the SCERS Board are implemented through a collaborative partnership between SCERS' Investment Staff, investment consultants, and key investment partners. Mr. Stensrud noted that a strong internal Investment Staff is central to successful execution of the investment program, and that going forward it would be vital for SCERS to maintain the high quality of its Investment Staff by attracting and retaining top tier investment professionals.

Chief Investment Officer Scott Chan explained that an overarching goal for 2012 had to create investment value through enhanced returns, lower risk, and lower costs. Mr. Chan discussed how the asset allocation model had been structured to accomplish these goals. Mr. Chan explained that a key implementation factor was the selection of investment managers in the asset class structure.

Deputy Chief Investment Officer Steve Davis reviewed the performance in 2012 and goals for 2013 in the domestic equity, international equity, and the private equity asset classes.

Mr. Chan reviewed the performance and goals in the fixed income and real assets asset classes.

INVESTMENT MATTERS (continued):

Investment Officer Bharat Indurkar reviewed the performance and goals for the hedge fund and the opportunities asset classes.

Mr. Davis provided an overview of the other investment activities that were performed in 2012 and the goals for such projects in 2013.

Mr. Indurkar reviewed the Board education presentations provided during 2012.

Mr. Chan concluded the presentation by discussing how SCERS' Investment Staff, consultants, and strategic partners will integrate their strengths to achieve more together in 2013.

Motion by Ms. Wolford-Landers to receive and file the 2012 Investment Year in Review report; Seconded by Mr. Fowler. Motion carried (8-0).

18. Patrick Thomas of Strategic Investment Solutions presented the Investment Performance Report for the Quarter Ended December 31, 2012.

Mr. Thomas reported that the Total Fund (TF) return for the fourth quarter, including the impact of the overlay program, was 1.8% gross of fees. Mr. Thomas noted that the TF return was 0.6% below the return of the policy index benchmark, which had a return of 2.4%, and 0.2% below the allocation index return of 2.0%. The overlay program had a negative impact of 0.2% during the quarter. Mr. Thomas reported that on a comparative basis, the return for the quarter was 0.2% below the Public Funds $1+ Billion Median return of 2.1%.

Mr. Thomas reported that at the asset class level, quarter outperformance occurred, gross of fees, in the domestic equity, domestic fixed income, hedge fund, and opportunistic segments. Mr. Thomas reported that underperformance occurred, gross of fees, in the international equity, private equity, and real assets segments.

Mr. Thomas reported that, for the 2012 calendar year, the TF return gross of fees, including the impact of the overlay program was 13.7%, which is 0.3% above the return of the policy index of 13.4%, and 1.1% above the allocation index of 12.6%. The TF calendar year return was 0.7% above the Public Funds $1+ Billion Median return of 13.0%, and ranks in the 29th percentile in the InvestorForce Universe, which is the ranking universe used by SIS.

Mr. Thomas reported that at the asset class level, calendar year outperformance versus the policy benchmark has occurred, gross of fees, in the domestic equity, international equity, domestic fixed income, hedge fund, real assets, and opportunistic segments. Mr. Thomas reported that underperformance occurred, gross of fees, in the private equity segment.

INVESTMENT MATTERS (continued):

Mr. Thomas reported that the annualized TF return gross of fees for three years of 8.9% is 0.2% below the policy index benchmark for the period. The annualized TF return gross of fees for five years of 2.0% is 0.8% below the policy index benchmark for the period. The TF gross of fees return of 8.4% since the inception of SIS' data in June of 1986 is 0.3% below the Total Benchmark return of 8.7% for the period.

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

19. Chief Investment Officer Scott Chan and Jennifer Young from The Townsend Group provided an educational presentation regarding the real estate sub-asset class component of the real assets asset class.

Mr. Chan reported that Staff and Townsend have been assessing and analyzing SCERS' real estate assets in order to develop a long-term investment strategy. Mr. Chan stated that this presentation would show some of the analysis and discuss preliminary conclusions based on that analysis.

Mr. Chan provided an overview of SCERS' real estate assets and the different segments of the total plan in which they lie, including real assets, opportunities, and equities. Mr. Chan noted that the real estate program represents 13.5% of SCERS' total plan assets as of September 30, 2012, comprised of separate accounts, commingled funds, and REIT structures. Mr. Chan stated that Staff and Townsend have been working to determine the optimal portfolio allocation by risk category and vehicle.

Ms. Young reviewed SCERS' private core real estate, consisting of two active US open-end core funds (OECFs) and two active separate accounts managed by BlackRock and Cornerstone, respectively. Ms. Young discussed the benefits and issues to consider with OECFs, as well as with separate accounts. Ms. Young noted that SCERS' separate accounts have outperformed the OECFs over all periods. Ms. Young stated that the core portfolio optimization analysis suggests continuation of the hybrid model for SCERS, with a bias toward separate accounts. Ms. Young noted that the two approaches are complementary and a hybrid structure helps mitigate risk.

Ms. Young discussed the real estate program benchmark analysis performed by Staff and Townsend. Ms. Young stated that SCERS' performance data suggested a higher correlation to the NFI-ODCE index as opposed to the NPI index, supporting a future recommendation to shift the benchmark.

INVESTMENT MATTERS (continued):

Ms. Young then reviewed SCERS' private non-core real estate, consisting of US-based value added and opportunistic investments. Ms. Young stated that the value added portfolio contained three closed-end 2007 vintage investments, which have each underperformed their targets and the SCERS' benchmark since inception. Ms. Young also stated that the opportunistic portfolio included four closed-end fund vehicles, each with attractive short-term returns, but that Townsend projects each of these four funds will liquidate by the end of 2013. Ms. Young reported that future non-core investments will be allocated based on available capital if and when they offer attractive risk/return attributes relative to other possible tactical investments across the portfolio.

Ms. Young stated that within the non-core program, the focus in 2013 would be on: (1) Accessing and sourcing "best ideas" opportunities in real estate; (2) Taking advantage of non-core market opportunities through a "manufacture to core" strategy with existing managers; (3) Establishing the process for execution; and (4) Expanding SCERS' geographic footprint to include non-US investments. Ms. Young reviewed Townsend's views of different geographical regions of the world, including the Americas, Europe, and Asia.

Mr. Chan concluded the presentation by summarizing the preliminary assessment of the strategic plan analysis to-date. Mr. Chan stated that Staff and Townsend would provide education regarding the global real estate opportunity set to assist when considering whether to provide the capability in the asset class structure to invest 0%-30% in global core and non-core real estate opportunities.

Motion by Ms. Wolford-Landers to receive and file the educational presentation regarding the real estate sub-asset class; Seconded by Ms. O'Neil. Motion carried (8-0).

The meeting was adjourned at 12:50 p.m.

MEMBERS PRESENT: James A. Diepenbrock, John B. Kelly, Richard B. Fowler II, Kathy O'Neil, Chris A. Pittman, Julie Valverde, Nancy Wolford-Landers, and John Conneally.

MEMBERS ABSENT: Keith DeVore, Diana Gin, and Michael DeBord.

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; Bharat Indurkar, Investment Officer; John Lindley, IT Administrator; Lance Kjeldgaard, Outside Counsel; Patrick Thomas, Strategic Investment Solutions, Inc; Jennifer Young, The Townsend Group; and Diana Ruiz, Deputy County Counsel.

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.