SCERS
SACRAMENTO COUNTY
EMPLOYEES' RETIREMENT SYSTEM



# M I N U T E S

## RETIREMENT BOARD MEETING, WEDNESDAY, MARCH 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, March 20, 2013, and commenced at 10:02 a.m.

## OPEN SESSION:

### PUBLIC COMMENT:

1. None heard.

### MINUTES:

2. The Minutes of the February 20, 2013 regular meeting were approved on Motion by Mr. DeVore; Seconded by Ms. O'Neil. Motion carried (8-0).

### CONSENT MATTERS:

Items 3-10

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

3. CAMERON, Paul R.: Denied a service-connected disability retirement.

**CONSENT MATTERS (continued):**

4. LINK, Laura L.: Granted a nonservice-connected disability retirement.

5. PETTITT, Janine M.: Denied a nonservice-connected disability retirement.

6. RUSSELL, Carola R.: Granted a nonservice-connected disability retirement.

7. TIDWELL, Edwin M.: Denied aservice-connected disability retirement.

8. YOUNG, Michelle E.: Denied a nonservice-connected disability retirement.

9. Approved a proposed amendment to the investment parameters for the international equity engagement with William Blair & Company.

10. Received and filed the February 2013 Monthly Investment Manager Compliance Report and Watch List.

**ADMINISTRATIVE MATTERS:**

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

Mr. Stensrud provided a reminder that the annual Form 700 Statement of Economic Interests was due at the end of March. Mr. Stensrud also mentioned that Board Members would be provided with methods to track reporting items for the Form 700 as well as education sessions that meet the continuing education requirements.

Mr. Stensrud reported that the California Association of Public Retirement Systems (CALAPRS) General Assembly took place March 2–5 in San Francisco. Mr. DeBord and Mr. Fowler attended and commented that excellent information was provided.

Mr. Stensrud reported that the State Association of County Retirement Systems (SACRS) Spring Conference is scheduled for May 13–17. Mr. Stensrud stated that any Board Members who wish to attend can contact Staff for assistance. Mr. Stensrud noted that the date of the SACRS Spring Conference would cause the May Board Meeting to be rescheduled to May 8.

Mr. Stensrud noted that the IFE Market Makers conference would be held June 26 – June 28. Mr. Stensrud stated that openings were limited and that Board Members who wish to attend should contact Staff for assistance.

Mr. Stensrud also noted that the SACRS Public Pension Investment Management Program would be held July 28 – July 31 at UC Berkeley. Mr. Stensrud stated that Board Members who wish to attend should contact Staff for assistance.

**ADMINISTRATIVE MATTERS (continued):**

Mr. Stensrud reported that on Tuesday, April 2, SCERS would be conducting a retirement planning seminar for those members who were late in their careers. Mr. Stensrud stated that registration was already full.

Mr. Stensrud reported that a number of investment items would be brought before the Board at the April meeting. Mr. Stensrud stated that the first recommendation for the new fixed income structure (i.e., the global fixed income mandate) would be presented. Mr. Stensrud noted that a second recommendation (i.e., for the opportunistic credit mandate) would follow in May or June. Mr. Stensrud also stated that the proposed real estate strategic plan would be presented, as well as proposed modifications to the overlay program. Finally, Mr. Stensrud noted that the final tranche of the interim hedge fund component would be implemented in early May and that an asset transition plan would be presented as part of that investment.

Mr. Stensrud reported that the Investment Staff would be traveling to meet with potential hedge fund managers in April.

Mr. Stensrud reported that analysis of private equity investment opportunities was ongoing, and a commitment had been made to a fund sponsored by H.I.G. Mr. Stensrud noted that Staff was close to finalizing a commitment which would be SCERS' first direct private equity investment in Asia. Mr. Stensrud also discussed how as a result of the due diligence process, a decision can be made to not make a commitment to a fund.

Mr. Stensrud reported that the annual active member statements would be sent out in April. Mr. Stensrud stated that these statements would cover members' contributions, interest, and service credits, among other information. Mr. Stensrud also reported that for the second consecutive year, SCERS would be sending out retired member statements as well. Mr. Stensrud noted that these statements would focus on the growth of the member's benefit over time. Mr. Stensrud stated that, including mailing services, the cost of creating and sending the statements was less than one dollar each, and he felt that the information and level of transparency that the statements provide more than justifies the cost.

12. Chief Benefits Officer John Gobel outlined the issues involved in the requested appeal of a benefit determination matter by SCERS member Mark Sabin.

Mr. Gobel explained that Mr. Sabin wished to purchase four years of prior public service related to previous employment with Sutter Hospital. Mr. Gobel explained that the issue with the desired purchase was whether employment with a non-governmental agency qualified under the law for a public service purchase. Mr. Gobel stated that based on the express language of the County Employees Retirement Law of 1937 only employment with a government agency was eligible for the service purchase. Mr. Gobel also noted that a recent Department of Labor opinion clarified the distinction between government agencies and not-for-profit organizations. Mr. Gobel stated that the decision by Staff and its reason had been communicated to Mr. Sabin in writing on three occasions over the past few years.

## ADMINISTRATIVE MATTERS (continued):

Mr. Sabin addressed the Board and stated that he believes the work he performed at Sutter Health hospital constituted public service and therefore qualified for a prior public service purchase.

Discussion followed, and outside counsel Lance Kjeldgaard was asked if the 1937 Act gave the Board any discretion with respect to the type of employment that qualifies for a public service purchase. Mr. Kjeldgaard stated that there was no discretion under the law, and further noted that the issue is not with the nature of the work performed in Mr. Sabin's prior employment, but with the nature of the entity that employed Mr. Sabin. It was also noted by the Board that there are important material differences between a governmental entity and a not-for-profit corporation.

Motion by Mr. Fowler to accept Staff's recommendation and deny the appeal by Mark Sabin of a benefit determination decision; Seconded by Ms. Wolford-Landers. Motion carried (8-0).

14. This item was taken up out of order to accommodate the schedule of another presenter.

Chief Operations Officer Kathryn Regalia presented a proposed request for proposals for independent audit services. Ms. Regalia noted that upon receipt of the responses, an evaluation committee would be formed to review the proposals and requested that a Board Member serve on the committee. Mr. Fowler offered to serve on the committee.

Motion by Mr. DeVore to approve the proposed request for proposals for independent audit services; Seconded by Ms. Wolford-Landers. Motion carried (8-0).

## INVESTMENT MATTERS:

15. This item was taken up out of order to accommodate the schedule of another presenter.

Jamie Feidler of Cliffwater, LLC presented the Alternative Assets Investment Performance Report for periods ending September 30, 2012 and December 31, 2012, including information regarding the hedge fund, private equity, real assets, and opportunities portfolios.

Mr. Feidler reported that SCERS' hedge fund portfolio was up 2.4% in the fourth quarter of 2012 and up 8.3% overall in 2012, outperforming the absolute policy benchmark (3 Month T-Bills + 5%) which was up 1.3% in the fourth quarter of 2012 and up 5.1% overall in 2012. Mr. Feidler noted that SCERS' hedge funds outperformed the HFRI Equity Hedge Index in the fourth quarter of 2012, which was up 1.3%, and has outperformed overall in 2012 where the index was up 4.7%.

**<u>INVESTMENT MATTERS (continued):</u>**

Mr. Feidler reported that the net investment rate of return (“IRR”) of SCERS’ private equity portfolio was up 2.7% since inception compared to the Venture Economics Private Equity Index up 6.7% and the multiple of total value to paid in capital (“TVPI”) is 1.05x since inception. Mr. Feidler noted that SCERS’ private equity portfolio shows lower relative returns due to the early phase/cycle of investments (j-curve affect) compared to the index.

Mr. Feidler reported that, through September 30, 2012, SCERS’ real assets portfolio IRR was 7.2% compared to SCERS’ real assets portfolio benchmark (CPI + 5%) IRR of 7.5% and SCERS’ TVPI was 1.2x.

Mr. Feidler reported that SCERS’ opportunistic portfolio generated a net IRR of 8.0% as of September 30, 2012 which has outperformed SCERS’ long-term benchmark (SCERS’ actuarial rate of return) of 7.5%, but has underperformed SCERS’ intermediate benchmark (SCERS’ total portfolio policy weighted return) of 8.8%.

Motion by Ms. Wolford-Landers to receive and file the quarterly performance report; Seconded by Ms. O’Neil. Motion carried (8-0).

17. This item was taken up out of order to accommodate the schedule of another presenter.

Chief Investment Officer Scott Chan introduced the educational presentation by Strategic Investment Solutions (SIS) and SCERS Investment Staff regarding global fixed income strategies.

Mr. Chan stated that while historically SCERS’ fixed income portfolio has performed well and fulfilled its goals, a significant portion of its success can be traced to a 30+ year bond rally and declining U.S. interest rates. Mr. Chan noted that with interest rates at multi-decade lows and the ten year Treasury near 2%, the long-term trend could reverse and create an unfavorable environment. Mr. Chan stated that a sharp rise in interest rates would likely lead to losses in fixed income. Mr. Chan further stated that the current environment for bonds will make it increasingly challenging for SCERS to continue to achieve its objectives for the fixed income portfolio.

Mr. Chan stated that in November, with that in mind, the Board authorized a new fixed income structure to better achieve SCERS’ fixed income goals by improving diversification and enhancing expected returns within the fixed income portfolio, while also balancing and retaining the fixed income portfolio’s capability to diversify SCERS’ total fund and act as an “anchor to safety.” Mr. Chan noted that SCERS’ new fixed income structure includes the following elements: (1) The retention of SCERS’ existing bond managers with reduced percentage allocations; (2) An allocation of 15% of SCERS’ bond portfolio to global fixed income including emerging market debt; and (3) A 10% allocation to an opportunistic credit portfolio.

**INVESTMENT MATTERS (continued):**

Pete Keliuotis from SIS provided a review of the global fixed income objectives discussed the various points of decision that a manager can consider in constructing a global fixed income portfolio. Mr. Keliuotis and Steve Masarik from SIS discussed the traditional versus opportunistic/flexible approach to the portfolio management for such a mandate and the rationale for choosing the opportunistic/flexible approach over the traditional approach based on the current environment.

Mr. Chan noted that there is the potential for the flexible opportunistic approach to produce a portfolio that is more concentrated and as a result, the returns would be more volatile. Mr. Chan stated, however, that selecting an investment manager that can successfully navigate risks with a robust risk management framework will be key. Mr. Chan further stated that while the volatility of returns may increase, it will be offset by the size of the mandate and lower correlations at the total fund level. Finally, Mr. Chan noted that Staff and SIS believe a broader fixed income program will provide a more balanced risk and return profile for SCERS.

Discussion followed, including the importance of understanding that the global fixed income mandate will operate differently than domestic fixed income mandates.

Motion by Ms. Wolford-Landers to receive and file the educational presentation by SIS and SCERS Investment Staff regarding global fixed income strategies; Seconded by Ms. O'Neil. Motion carried (8-0).

**ADMINISTRATIVE MATTERS:**

13. This item was taken up out of order to accommodate the schedule of The Segal Company.

Chief Executive Officer Richard Stensrud introduced the modified employer and employee contribution rates recommended by The Segal Company for the new CalPEPRA tiers.

Mr. Stensrud noted that the contribution rates for the new CalPEPRA tiers for the current fiscal year and next fiscal year had initially been prepared based on the assumption that as with the pre-existing tiers, the new tiers would continue to be integrated with Social Security. Mr. Stensrud noted, however, that it was understood that legislation would follow CalPEPRA to proved clarification regarding the initial bill. Mr. Stensrud reported that it was now clear that the follow up legislation will declare that Social Security integration does not apply to the CalPEPRA tiers, and accordingly, it was necessary to modify the employer and employee contribution rates.

Paul Angelo and Andy Yeung of The Segal Company participated via phone and discussed the modification of the contribution rates. Mr. Angelo and Mr. Yeung noted that modifications were made to the employer and employee contribution rates for the new CalPEPRA tiers for the period January 1, 2013 through June 30, 2013, as well as for the

**ADMINISTRATIVE MATTERS (continued):**

2013-2014 fiscal year. Mr. Stensrud noted that it was being recommended that the revised contribution rates for the current year be implemented at first opportunity in order to minimize the need to make retroactive corrections of employer and employee contributions.

Motion by Ms. Wolford-Landers to adopt the modified employer and employee contribution rates recommended by The Segal Company for the new CalPEPRA tiers; Seconded by Mr. DeVore. Motion carried (8-0).

**INVESTMENT MATTERS:**

16. Jennifer Young of The Townsend Group presented the quarterly performance report on real estate investments for the quarter ended December 31, 2012.

Ms. Young reported that SCERS' total real estate portfolio returned 3.3% during the fourth quarter of 2012, outperforming the benchmark (NCREIF Property Index + 100 basis points) by 0.5%. Ms. Young noted that the real estate portfolio's return for 2012 was 18.6%, outperforming the benchmark which returned 11.5%.

Ms. Young reported that SCERS' core real estate portfolio returned 2.3% during the fourth quarter, outperforming the benchmark by 0.5%. Ms. Young noted that, for 2012, SCERS' core real estate portfolio has returned 13.3%, outperforming the benchmark by 1.8%.

Ms. Young reported that, within core real estate, SCERS' separate account portfolio continued to outperform the commingled fund investments. Ms. Young stated that the separate accounts returned 2.4% for the quarter and 14.1% for 2012 overall, compared to 2.1% and 11.1% respectively for the commingled funds.

Ms. Young reported that SCERS' public REIT portfolio returned 5.5%, compared to a fourth quarter return of 5.8% for the FTSE NAREIT Global REIT Index and 2.6% for the FTSE NAREIT (domestic) REIT Index.

Ms. Young reported that the remaining real estate portfolio generated a return of 2.5% for the fourth quarter, the benchmark for which, a hybrid of the NCREIF/Townsend Value Added Funds Index and the NCREIF/Townsend Opportunity Fund Index, returned 3.9%.

Motion by Ms. Gin to receive and file the quarterly performance report; Seconded by Ms. Wolford-Landers. Motion carried (8-0).

18. Deputy Chief Investment Officer Steve Davis introduced the annual report on the private equity asset class by Cliffwater LLC and SCERS Investment Staff.

Jamie Feidler of Cliffwater, LLC presented the annual report on the private equity asset class and the proposed private equity annual investment plan for 2013.

**INVESTMENT MATTERS (continued):**

Mr. Feidler stated that the investment objective of SCERS' private equity program was to enhance the total fund performance with an expectation to outperform public equities (Russell 1000 Index) by 3% annually over the long-term. Mr. Feidler noted that the private equity target allocation was increased from 5% to 10% in the fourth quarter of 2011. Mr. Feidler further noted that this represents a long-term target as the private equity program will take many years to prudently implement, with the 10% target allocation expected to be reached in 2019.

Mr. Feidler stated that SCERS' existing portfolio is reasonably well-diversified, but that the amount of money invested is relatively small (2.0% of SCERS' total portfolio). Mr. Feidler noted that new commitments are intended to complement the existing investments and maintain long-term diversification.

Mr. Feidler reviewed SCERS' current fund of funds, including HarbourVest Partners VIII, Abbott Capital Private Equity Fund VI, Goldman Sachs Private Equity Partners X, and HarbourVest International Private Equity Partners VI.

Mr. Feidler reported that SCERS' private equity commitment activity since April 2012 has been both tactical and strategic, with commitments to NEA 14; H.I.G. Bayside Loan Opp Fund III Europe; Trinity Ventures XI; Wayzata Opportunities Fund III; and H.I.G. Capital Partners V. Mr. Feidler noted that SCERS' continues to target hard-to-access, top-tier GPs to complement its existing private equity investments, noting that many of these new funds were significantly oversubscribed and/or only offered to select investors.

Mr. Feidler reviewed the recommended 2013 private equity annual investment plan, which targets a $220 million commitment level over 8 funds. Mr. Feidler noted that this target is generated from a proposed commitment range of $200-$240 million between 7-10 funds. Mr. Feidler stated that the recommended area of focus for the remainder of 2013 would include turnaround buyout funds and non-U.S. opportunities, which are intended to complement the existing portfolio and take advantage of the best opportunities in the market. Mr. Feidler also reviewed SCERS' private equity selection process.

Motion by Ms. O'Neil to receive and file the annual report on the private equity asset class and approve the proposed private equity investment plan for 2013; Seconded by Mr. Fowler. Motion carried (8-0).

19. Chief Investment Officer Scott Chan introduced the proposal to modify the hedge fund asset class structure to include a hedge fund strategy-based replication component and to engage AQR Capital for the assignment.

Mr. Chan reviewed the goals of a hedge fund replication strategy. Mr. Chan stated that strategy-based hedge fund replicators try to capture the return that can be attributed to

**INVESTMENT MATTERS (continued):**

hedge fund risk factors, return that would earlier have been attributed to alpha or manager skill. Mr. Chan noted that strategy-based replication is a rapidly evolving area and one that could mark the future of hedge fund investments. Mr. Chan further noted that strategy-based replication, though significantly more complex, will hold a similar place in the hedge fund area as index funds do in traditionally long-only asset management.

Investment Officer Bharat Indurkar stated that Staff is recommending that the Board modify the hedge fund structure to allow an investment of up to 10% of the hedge fund portfolio or 1% of the overall SCERS portfolio in the leading product in the strategy-based replication space, the AQR Delta Fund. Mr. Indurkar noted that the AQR Delta Fund allocates capital across nine underlying hedge fund strategies, which fall into three broad categories: arbitrage, equity oriented, and macro. Mr. Indurkar stated that the AQR Delta Fund has produced strong absolute and risk-adjusted returns on a standalone basis and relative to other multi-strategy funds. Mr. Indurkar further stated that, since inception in October 2008 through February 2012, the moderate volatility version of the fund generated an annualized return of 10.7%. Mr. Indurkar noted that Staff is recommending a fee structure of a 1% management fee and a 10% incentive fee.

Discussion followed.

Motion by Mr. Fowler to approve the proposal to modify the hedge fund asset class structure to include a hedge fund strategy-based replication component and to engage AQR Capital for the assignment; Seconded by Mr. DeVore. Motion carried (8-0).

20. Chief Investment Officer Scott Chan introduced the educational presentation by The Townsend Group and SCERS Investment Staff regarding international real estate investment strategies.

Mr. Chan stated that SCERS' current real estate portfolio has very limited international exposure. Mr. Chan noted, however, that non-US institutional real estate represents approximately 60% of the investable real estate universe. Mr. Chan stated that by expanding SCERS' private real estate structure to include a component for global real estate, SCERS will benefit from a broader set of opportunities and further diversification.

Jennifer Young of The Townsend Group provided an overview of global real estate. Ms. Young stated that relative to other asset classes, private core real estate offers the highest return for the lowest amount of risk. Ms. Young noted that on a global basis, Australia and the UK have provided higher core returns relative to the US albeit with higher (but comparable) levels of risk. Ms. Young covered some of the risks in the global real estate market as well as corresponding mitigating factors and examples.

**INVESTMENT MATTERS (continued):**

Ms. Young stated that private core ex-US investments would be limited to open-end commingled fund structures (“OECFs”). Ms. Young also stated that private non-core ex-US investments would be limited to closed-end commingled funds or special situations. Ms. Young noted that returns vary vastly by strategy and location. Ms. Young stated that each region faces a different set of challenges and opportunities, and that careful selection will be required.

Ms. Young reviewed Townsend’s outlook on the markets in the Americas, Europe, and Asia.

Mr. Chan stated that Staff and Townsend believe there are very compelling opportunities to consider the allocation of between 0%-30% of the total real estate allocation to global real estate. Mr. Chan noted that some of the benefits of investing in global real estate include an expanded opportunity set to take advantage of distress; better relative value opportunities abroad at different points in the cycle; and increased diversification. Mr. Chan noted that the flexibility to invest (but not be required to invest) when risk adjusted returns are favorable compared to US options provides a structure that enables SCERS to benefit from enhanced opportunities and mitigate risks. Mr. Chan noted that international core investments would compete for space versus domestic core investments, and international non-core opportunities would compete across all of SCERS’ assets for space in the opportunities portfolio. Mr. Chan stated that an additional benefit comes from Townsend having an existing global footprint to provide analysis and due diligence. Mr. Chan noted that SCERS would be limiting the opportunity set to very high quality investment managers in open-end and closed-end comingled funds globally.

Motion by Ms. O’Neil to receive and file the educational presentation by The Townsend Group and SCERS Investment Staff regarding international real estate investment strategies; Seconded by Ms. Wolford-Landers. Motion carried (8-0).

The meeting was adjourned at 1:39 p.m.

MEMBERS PRESENT: James A. Diepenbrock, Keith DeVore, Richard B. Fowler II, Diana Gin (arrived at 10:51 a.m.), Kathy O’Neil, Chris A. Pittman, Julie Valverde, Nancy Wolford-Landers (arrived at 10:06 a.m.), John Conneally, and Michael DeBord.

MEMBERS ABSENT: John B. Kelly

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; Thuyet Dang, Accounting Manager; Bharat Indurkar, Investment Officer, John Lindley, IT Administrator; Lance Kjeldgaard, Outside Counsel; Pete Keliuotis and Steve Masarik, Strategic Investment Solutions, Inc; Jamie Feidler, Cliffwater, LLC; Jennifer Young, The Townsend Group;

John Kennedy and Eunice C. Majam-Simpson, Nossaman LLP; Diana Ruiz, Deputy County Counsel; and Mark Sabin.

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.