



Board of Retirement Regular Meeting

Sacramento County Employees' Retirement System

Agenda Item 16

MEETING DATE: April 16, 2025

SUBJECT: Education: Governance Protocols

SUBMITTED FOR: ☐ Action ☒ Information

RECOMMENDATION

Receive and file presentation on governance protocols regarding staff delegation.

PURPOSE

This item supports the SCERS Strategic Management Plan objectives to promote a strong Board-Staff partnership and ensure effective implementation and oversight of the investment program.

BACKGROUND

Under the current implementation protocols established in 2011, the Board delegates the most time-intensive elements of the process of selecting investment managers to Staff and SCERS' investment consultants, while preserving the Board's oversight of the overall investment program and its underlying asset classes.

The move toward greater delegation corresponded with the evolution of SCERS' investment portfolio. This included increasing exposure to alternative asset classes as well as moving to a direct investment approach within alternative assets, and away from fund of funds. Given the number of investments that would be made, and have since been made, the need to make such investments in a timely manner, and the relatively small size of any one investment within the alternative asset classes, the Board determined that it was advisable to establish protocols for making investments to effectively and efficiently address those considerations, while allowing for sufficient oversight by the Board.

The current implementation protocols differentiate between traditional assets/public market investments (Public Equity, Fixed Income, Public Credit, and Liquid Real Return) and alternative assets/private market investments (Absolute Return, Private Equity, Private Credit, Real Assets, and Real Estate). For alternative assets, targeted investments generally fall below \$100 million but have in the past ranged up to and beyond \$100 million for open-end commingled funds and SCERS-specific fund of one mandates. Public market asset classes generally involve larger investment commitments, exceeding \$100 million and upwards of \$500 million.

When managing SCERS' assets, Board members must act as prudent fiduciaries. In carrying out these fiduciary duties, the Board can delegate various responsibilities to other parties, but

such a delegation must be reasonable, prudent, and properly monitored and controlled. When the current implementation protocols were put into place, the Board determined that because of the knowledge and expertise required to properly identify, screen, and select investment managers and strategies, these tasks were suitable for a prudent fiduciary delegation of responsibilities. The manager selection process across the asset classes reflects the Board's recognition that Staff and the consultants possess the requisite knowledge and expertise to help assure prudent decisions in selecting investment managers across the portfolio.

CURRENT IMPLEMENTATION PROTOCOLS

The current implementation protocols are described within SCERS' Master Investment Policy Statement (IPS). To summarize, the current protocols authorize Staff and consultants to identify qualified investment manager and fund candidates for investment within the various asset classes based on the long-term asset allocation structure approved by the Board for a particular asset class, and the approved annual investment plan for that asset class.

Traditional Assets/Public Markets

For traditional assets/public markets, the implementation protocol delegates the most time-sensitive elements of the process to Staff and consultant, including the screening and evaluation leading to the recommendation to engage or terminate a particular investment manager. For traditional assets/public market asset classes, the Board makes the final decision regarding engagement or termination of investment managers. Staff and the consultant identify the most qualified candidates for a mandate and pursues extensive due diligence on the manager candidates. Staff and consultant provide reporting to the Board along the way, culminated by a final recommendation report. At any point in the process, questions or concerns by any trustee regarding a proposed investment or proposed manager is communicated to SCERS' CEO. The manager being recommended for the engagement makes a presentation to the Board at an upcoming Board meeting. Legal review of documentation and negotiation of deal terms also takes place during the process.

Alternative Assets/Private Markets

For alternative assets/private markets, the execution of the long-term asset allocation structure and annual investment plan, including the selection of investment managers is delegated to Staff, subject to the Board's ability to review, discuss, and object to the recommendations of Staff and consultant during the investment protocol process. Staff and consultant identify the most qualified candidates for a prospective investment commitment based on the asset allocation structure for the underlying asset class approved by the Board, and the approved annual investment plan for the underlying asset classes. When a particular manager candidate is identified, Staff and consultant pursues extensive due diligence on the manager candidate, including conducting extended interviews with the portfolio managers and other key members of the investment team. Legal review of fund documentation and negotiation of deal terms also takes place. Staff and consultants provide detailed reporting to the Board during the process, including a final recommendation report. At any point in the process, questions or concerns by any trustee regarding a proposed investment or proposed manager is communicated to SCERS' CEO. Absent questions or concerns by the Board, the proposed investment is finalized and the necessary documentation executed.

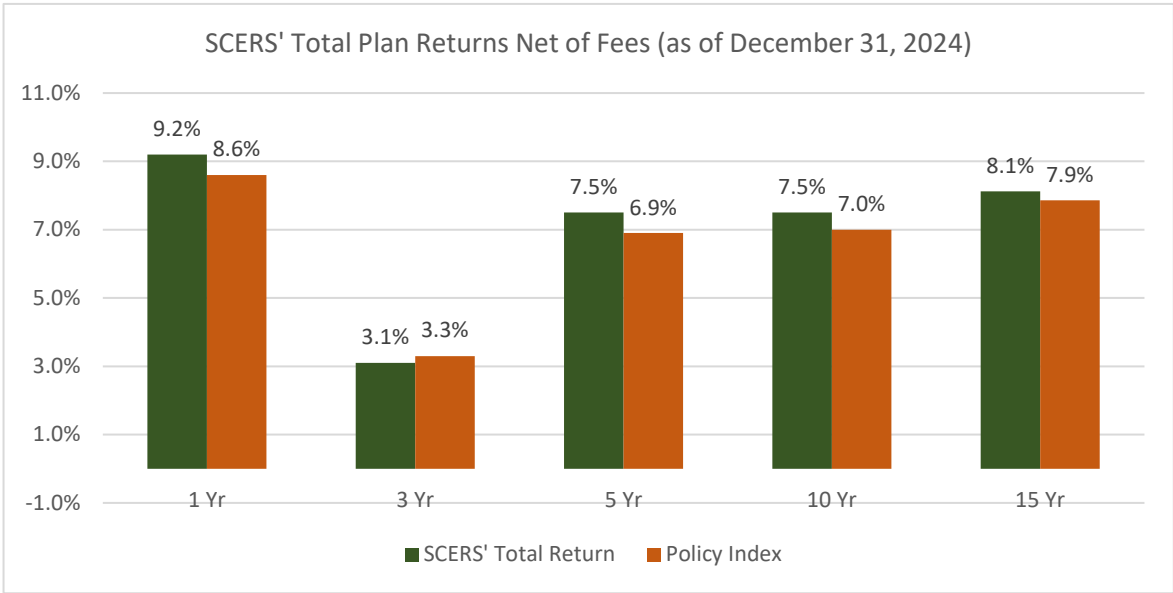
The primary difference between the traditional assets/public markets and alternative assets/private markets implementation process is that for alternative assets/private market investments, absent an objection from the Board, Staff and the consultant will make the final

decision regarding a specific commitment, whereas for traditional assets/public market investments, the Board makes the final decision at a Board meeting after a presentation by the candidate recommended by Staff and the consultant.

DISCUSSION

Over the past decade, Staff believes that the current implementation protocols have worked efficiently and effectively and have added value to SCERS’ portfolio implementation. The investment program has grown from approximately \$6 billion in 2011, to the current value of approximately \$14 billion today, which equates to 2.3 times growth. This compares to the growth in the overall manager count from 40 in 2011 to 110 today, with equates to 2.8 times growth. The strategy/fund count has grown at a greater rate, from 50 in 2011 to 200 today; however, that growth is a function of SCERS emphasizing investing in multiple mandates with existing managers where possible. The overall growth in mangers and funds is also attributed to SCERS moving from a fund of fund approach to a direct approach within the alternative asset classes to improve risk adjusted returns and lower fees. Increasing exposure to alternative assets and implementing through a direct approach does lead to greater portfolio complexity and would have been challenging to implement without the current implementation protocols.

The evolution of SCERS’ portfolio has translated to strong returns. As shown below, SCERS’ portfolio has generated consistent returns above SCERS’ actuarial rate over long time periods, and has generated excess returns, net of fees, over the policy index benchmark over most measurement periods. This strong performance is a result of a well-designed strategic asset allocation, and a thoughtful approach to implementation of the portfolio by the Board, Staff, and SCERS’ investment consultants.



During past Enterprise Risk Tolerance (ERT) assessments performed by SCERS’ general investment consultant, Verus, the Board was surveyed regarding SCERS’ governance structure. The aggregate sentiment from the Board has been that there is broad trustee comfort with both the current governance structure and delegation. There was also acknowledgement by some Board members that they were open to considering changes to the governance/delegation structure if a specific adjustment was brought forward articulating the rationale.

Staff believes it is prudent for the Board to refresh the governance discussion to ensure the most appropriate implementation protocol is being utilized today and the Board's time is being used most efficiently at Board meetings. Across peer public pension plans that utilize some form of delegation, there are three common approaches, which are highlighted below:

Approach 1: Asset type delegation – delegation protocols vary depending on the asset type.

- SCERS utilizes this approach with separate implementation protocols and varying amounts of delegation between traditional assets/public markets and alternative assets/private markets.
- There is greater delegation within alternative assets/private markets than traditional asset/public markets, where the former are characterized by smaller mandates and quicker timelines that don't generally align with a scheduled Board meeting. Final Board approval occurs with the latter, which are characterized by larger traditional assets/public market mandates.

Approach 2: Threshold delegation – the amount of delegation is determined by a threshold, such as a percentage or a dollar threshold of the portfolio threshold (i.e., 1.5% or \$200 million of the total portfolio).

- This approach is similar to SCERS' current approach in that greater delegation would still occur with smaller mandates (mostly within the alternative asset classes) that have quicker timelines that don't generally align with a scheduled Board meeting, though it extends into traditional, public market assets under a certain size threshold. Final Board approval would still occur with larger mandates for either private or public markets if there is sensitivity to the dollar size of the investment.
- This approach is potentially a good fit within SCERS' revised strategic asset allocation structure, where there is some blurring between public market assets and alternative assets within the newly form Credit asset class, and to a limited extent within the Global/Unconstrained segment of the Global Equity asset class, which could create some ambiguity as it relates to implementing Approach 1 above.

Approach 3: Standardized delegation – delegation is the same across all investments, with no differential by asset class or threshold level.

- Under this approach, the current alternative assets/private markets implementation protocols would be utilized across all asset classes, including traditional assets/public markets.
- This approach would entail Staff finalizing investment commitments without requiring recommended managers to present to the Board for approval by the Board at a Board meeting.
- This approach is the most administratively efficient and would utilize less of the Board's time for manager selection during Board meetings.

NEXT STEPS

While the current implementation protocols have been beneficial toward implementing SCERS' investment portfolio to its current state, they have not been evaluated by the Board since they were adopted in 2011. Staff is not recommending a change in approach at this time; however, Staff believes it is prudent for the Board to refresh the governance discussion to ensure best practices with business process and administrative efficiency, and best use of the Board's time.

If the Board were interested in considering a revised approach that includes broader delegation across the traditional asset/public markets, an option is to consider expanding the delegation for the next public equity search as a trial. Staff expects that SCERS will be engaging in an investment manager search for a global equity mandate within the Global Equity asset class in 2025.

Any formal changes to SCERS' governance protocols would be presented to the Board through IPS changes at a later date.

ATTACHMENTS

- Board Order
- Governance Protocols Presentation

Prepared by:

/S/

Steve Davis
Chief Investment Officer

Reviewed by:

/S/

Eric Stern
Chief Executive Officer



Retirement Board Order

Sacramento County Employees' Retirement System

Before the Board of Retirement
April 16, 2025

AGENDA ITEM:

Education: Governance Protocols

THE BOARD OF RETIREMENT hereby approves Staff's recommendation to receive and file presentation on governance protocols regarding staff delegation.

I HEREBY CERTIFY that the above order was passed and adopted on April 16, 2025 by the following vote of the Board of Retirement, to wit:

AYES:

NOES:

ABSENT:

ABSTAIN:

ALTERNATES:

(Present but not voting)

James Diepenbrock
Board President

Eric Stern
Chief Executive Officer and
Board Secretary



Governance Protocols

April 16, 2025

Introduction

- Background on investment governance protocols
- Review implementation protocols to identify if any revisions should be considered

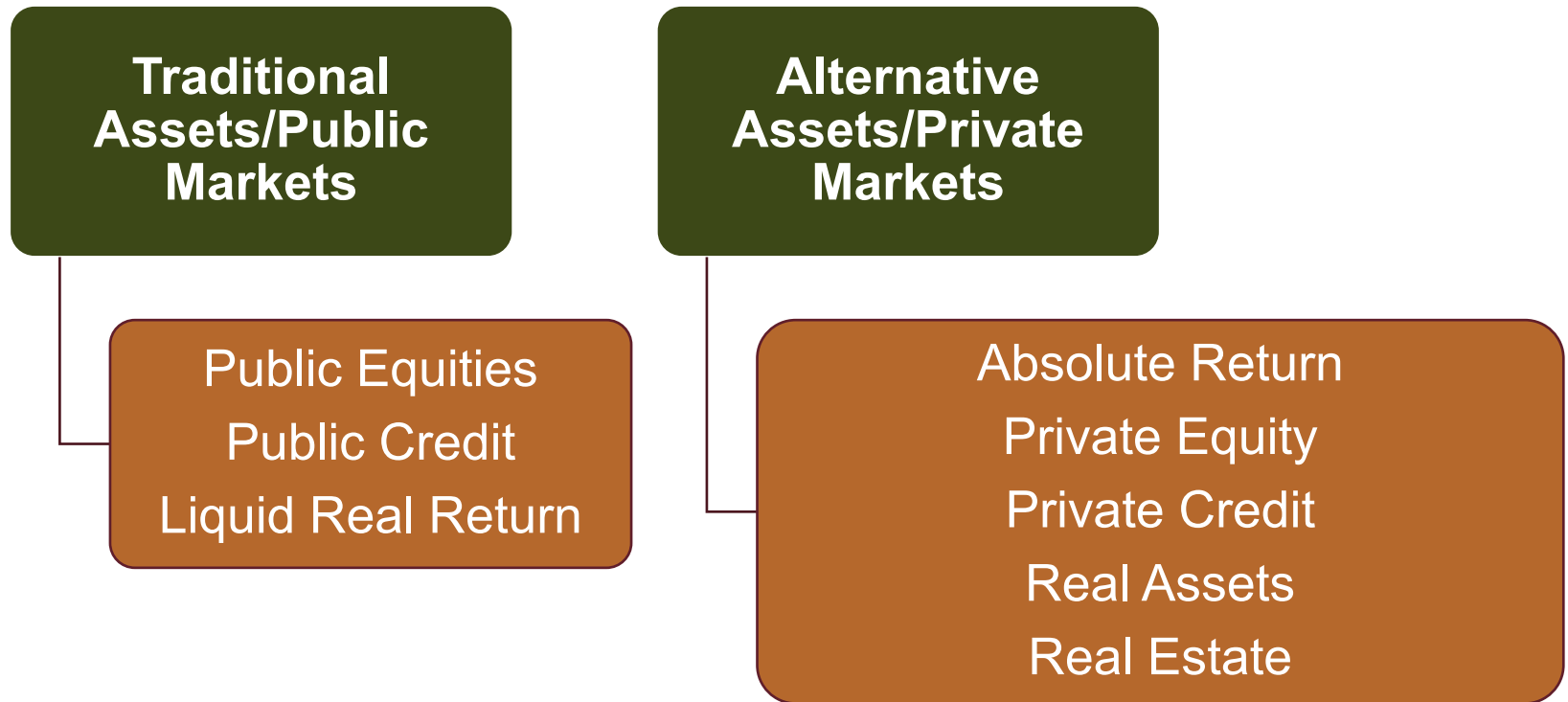
Implementation Protocols

- Current protocols in place since 2011
- Board delegation of most time intensive elements of process to Staff and investment consultants
- Increased delegation corresponded with evolution of SCERS' investment portfolio
 - Increasing exposure to alternative assets and move from fund of funds to direct investments
 - Sizing, timing, and complexity of alternative asset investments

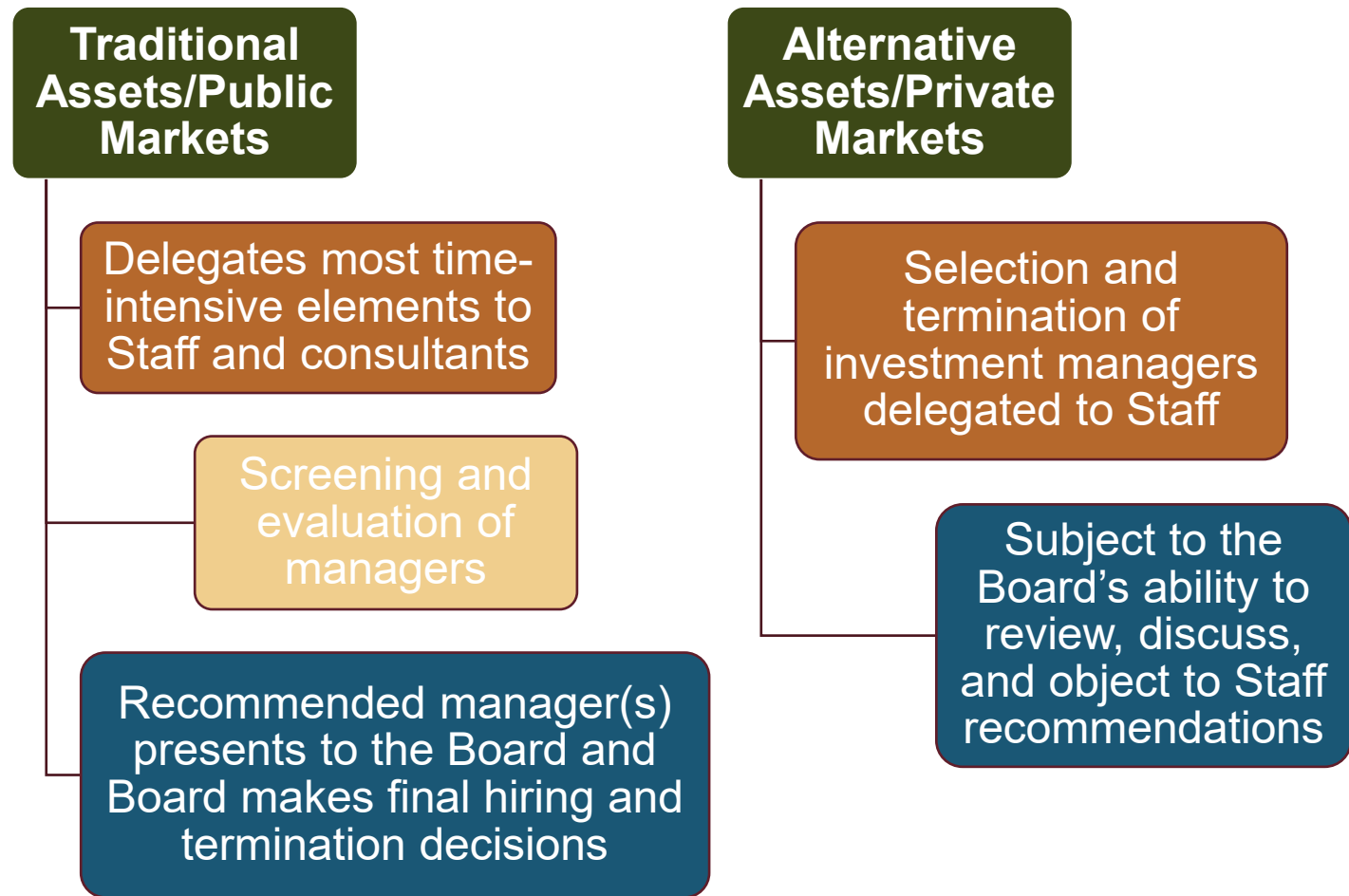
Delegation

- Board can delegate certain responsibilities to other parties while carrying out fiduciary duties
 - Delegation must be reasonable, prudent, and properly monitored and controlled
- Board still has oversight of investment portfolio
- ERT surveys show that there is broad Board comfort with SCERS' governance structure and delegation
 - There is some openness to discussing changes to the structure

Two Separate Implementation Protocols

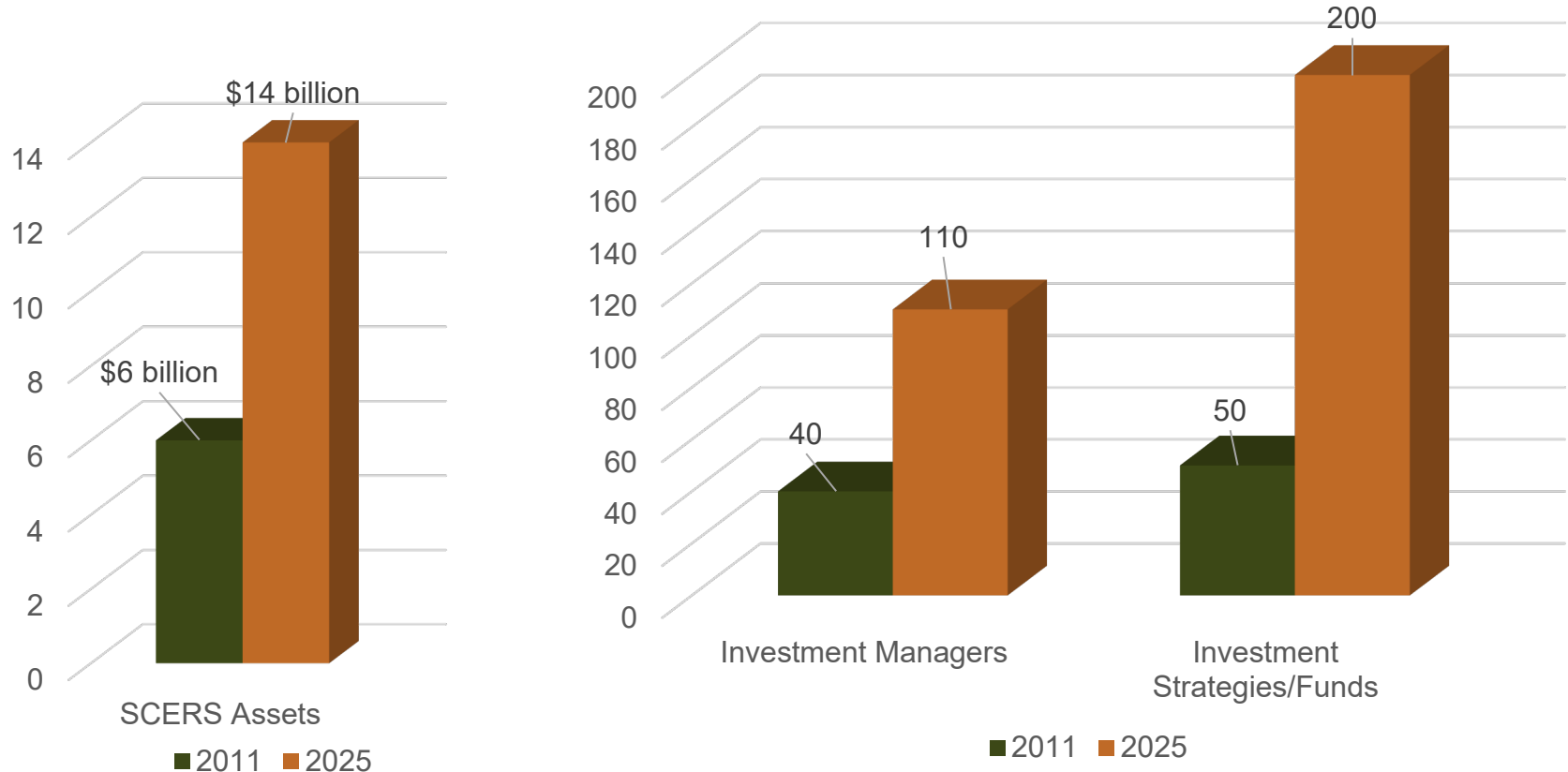


Two Separate Implementation Protocols



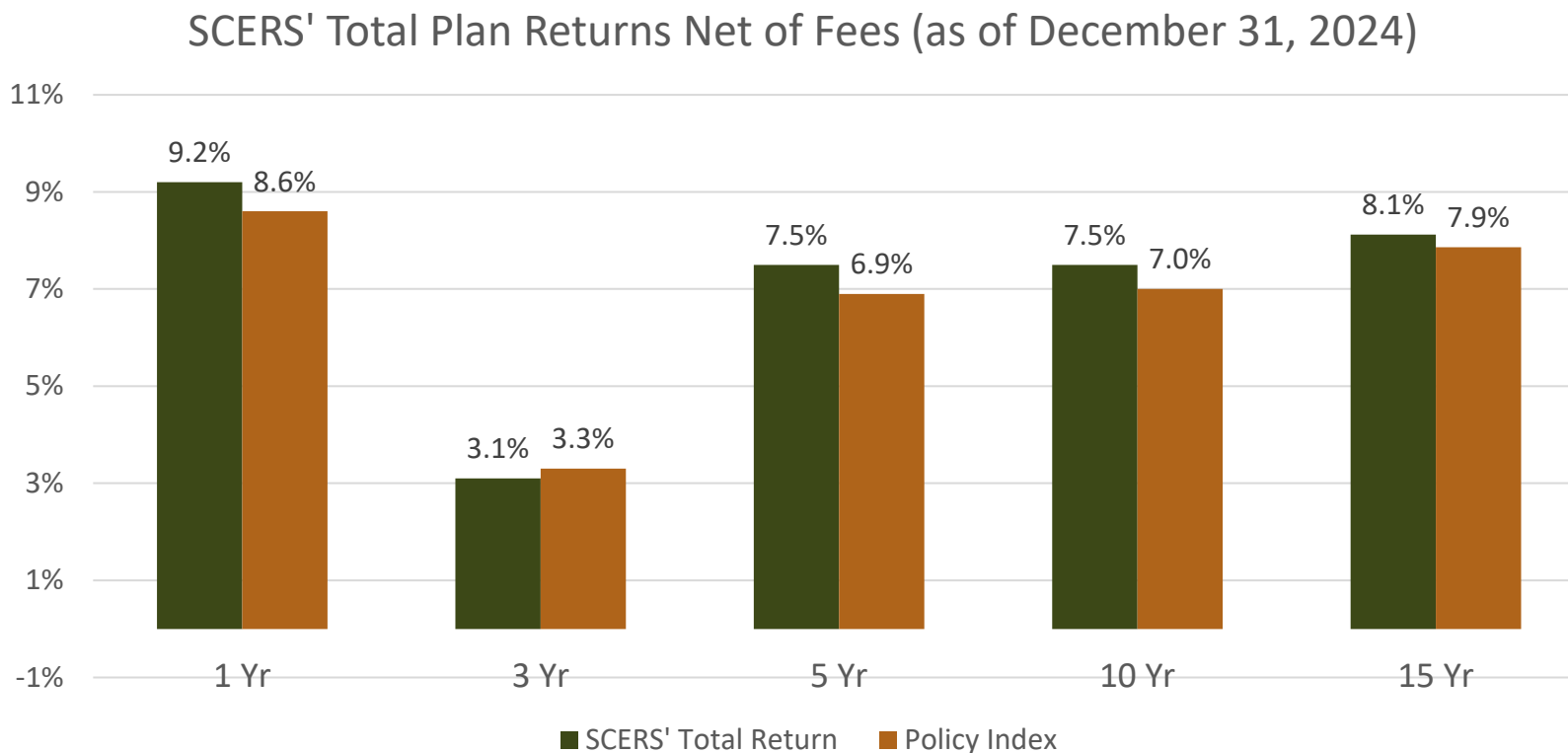
- Detailed reporting provided by Staff and consultants
- Board can express questions or concerns during either process

Growth in SCERS Assets and Managers



- Assets have grown 2.3 times / investment managers 2.8 times
- Manager count fueled by alternative assets and move to direct investments
- Implementation protocols facilitated implementation

SCERS Performance



- Consistent returns across long time periods
 - Mostly above SCERS' actuarial rate and policy index benchmark
- Attributed to thoughtful approach toward implementation

Delegation Approaches

Asset Type Delegation

- Amount of delegation varies by asset type
- i.e., greater delegation within alternative assets/private markets vs. traditional assets/public markets

Threshold Delegation

- Amount of delegation is determined by a threshold (% or dollar based)
- i.e., delegation on anything up to 1.5% of the total portfolio or a \$200 million investment

Standardized Delegation

- Delegation is the same across all investments
- No differentiation by asset class or threshold level

Conclusion/Next Steps

- Current implementation protocols are effective, but they haven't been evaluated since adopted in 2011
- Board discussion on implementation protocols, best use of Board's time at Board meetings, and if any adjustments should be considered
- Any revised approach under consideration could be used on a trial basis for the next public markets manager search
- Any formal changes would be presented to the Board through IPS changes at a later date