



Executive Staff:

Richard Stensrud  
Chief Executive Officer

Jeffrey W. States  
Chief Investment Officer

James G. Line  
General Counsel

Kathryn T. Regalia  
Chief Operations Officer

John W. Gobel, Sr.  
Chief Benefits Officer

Members of the Board of Retirement

James A. Diepenbrock, President  
Appointed by the Board of Supervisors

Keith DeVore, 1<sup>st</sup> Vice President  
Elected by Miscellaneous Members

John B. Kelly, 2<sup>nd</sup> Vice President  
Appointed by the Board of Supervisors

Dave Irish, Director of Finance  
Ex-Officio

Winston H. Hickox  
Appointed by the Board of Supervisors

Alice Jarboe  
Elected by Miscellaneous Members

William D. Johnson  
Elected by Safety Members

Nancy Wolford-Landers  
Elected by Retired Members

Robert Woods  
Appointed by the Board of Supervisors

William Cox  
Elected by Retired Members

John Conneally  
Elected by Safety Members

## MINUTES

### RETIREMENT BOARD MEETING, THURSDAY, JANUARY 18, 2007

The special meeting of the Retirement Board was held in the Sacramento County Employees' Retirement System Administrative Office, U.S. Bank Plaza Building, 980 9th Street, 18<sup>th</sup> Floor, Sacramento, California, on Thursday, January 18, 2007, at 10:06 a.m.

#### OPEN SESSION:

##### PUBLIC COMMENT:

1. None heard.

##### EDUCATIONAL MATTER:

2. Tom Lightvoet of Mercer Investment Consulting provided a Commodities Investing Overview describing what commodities are, the ways in which investments can be made in commodities, and the possible benefits as well as challenges of investing in commodities.

Jon Fraade of AIG Financial Products and Dr. Gary Gorton, a professor at Wharton School of Business, made a presentation on investing in commodity futures indices. The presentation included information on: (1) The difference between investing in commodity futures vs. investing in commodities; (2) Why investors should consider investing in commodities futures; (3) What the historic data suggest is the return that can be earned by investing in commodities futures; (4) A comparison of the risk and return characteristics of commodities futures to other asset classes; and (5) Implementation strategies for investing an allocation to commodities futures.

**EDUCATIONAL MATTER (continued):**

Extensive discussion followed, and in the end the Board expressed its desire that commodities be included in the modeling for the upcoming asset/liability study.

Motion by Mr. DeVore to receive and file the presentation materials; Seconded by Mr. Woods. Motion carried (9-0)

**MINUTES:**

3. Consideration of the Minutes of the December 21, 2006, regular meeting was continued.

**CLOSED SESSION:**

**DISABILITY MATTERS:**

4. DAVIDSON, Bennett: Action was taken on the Application for Disability Retirement per confidential memorandum from the Chief Benefits Officer dated January 19, 2007.
5. HANSEN, Duane L.: Action was taken on the Application for Disability Retirement per confidential memorandum from the Chief Benefits Officer dated January 19, 2007.

**LEGAL MATTER:**

6. Confidential attorney/client discussion with counsel on Claim No. 1951196 against Reliance Insurance Company (in Liquidation) by assignment from EMJ Construction Consultants, N.A., Inc., Cause No. 269 MD 200 (Commonwealth Court of Pennsylvania)

**OPEN SESSION:**

**ADMINISTRATIVE MATTERS:**

7. Chief Executive Officer Richard Stensrud presented a report on developments affecting public retirement systems, and recent system and staff activities.

Mr. Stensrud provided a report on the recent Executive Order issued by the Governor creating a commission to review public employee pension plans and retiree health care coverage. Mr. Stensrud noted that the State Association of County Retirement Systems ('SACRS') would be recommending potential candidates to serve on the commission.

Mr. Stensrud reported that per the Board's authorization at the December Board Meeting, Staff had determined that the interest crediting rate for the member contribution accounts, effective December 31, 2006, would be 2.35%. Mr. Stensrud noted that a recommendation regarding the interest crediting rate for the other actuarial reserves would be presented at the February Board Meeting.

**ADMINISTRATIVE MATTERS: (Continued)**

Mr. Stensrud reported that the recommended cost-of-living adjustment ('COLA') for SCERS' benefit allowance payments would be presented at the February Board Meeting. Mr. Stensrud noted that the approved COLA would be effective April 1, 2007.

Mr. Stensrud reported that Staff would be reporting to the Board in the near future regarding proposed revisions to the Investment Policy Watch List procedures. Mr. Stensrud reported that similar follow-up would be provided shortly regarding the consideration of climate change on SCERS' investment practices.

Mr. Stensrud reported that implementation of the proposed authorization for County employees to purchase Additional Retirement Credit ('ARC') and the proposed one-time election by Tier 2 members to upgrade to Tier 3 for future service was on hold as the County conducted meet and confer sessions regarding the proposals.

Mr. Stensrud reported that the California Association of Public Retirement Systems ('CALAPRS') would be holding its annual General Assembly on March 11-13, 2007, and that Staff would be circulating information shortly for those Board Members interested in attending.

Mr. Stensrud reported that SACRS would be holding a Special Business Meeting and Educational Symposium on February 5-6, 2007. Mr. Stensrud noted that certain business matters and legislative proposals would be put to a vote of the membership at the Business Meeting and he requested that the SACRS Voting Proxy form authorized by the Board for the November SACRS Conference be utilized for the February votes as well. Mr. Stensrud noted that he was authorized to vote on behalf of SCERS in that proxy, and proposed that absent objection, he would vote on behalf of SCERS at the February meeting and report back on those votes for ratification by the Board. The Board concurred in this approach.

8. Chief Executive Officer Richard Stensrud presented a proposed Memorandum of Understanding ('MOU') between SCERS and the Superior Court of California, County of Sacramento ('Court'), concerning an actuarial analysis of the assets and liabilities attributable to certain proposed populations of Court employees and retirees. Mr. Stensrud noted that the Court had requested the analysis for the purpose of assessing various retirement and other post-employment benefit questions. Mr. Stensrud explained that the project would require both extensive manual data extraction by SCERS Staff and analysis by SCERS' actuary. Mr. Stensrud further noted that because of the varied possible approaches to the defining parameters for the analysis, and the fact that such decisions would also affect the definition of the County employee and retiree population and the assets and liabilities attributable to that population, the County had been included in the discussions determining which defining parameters would be utilized. Finally, Mr. Stensrud noted that the analysis that would be produced under the MOU would not definitively answer all the questions of concern to the Court or the County, but it would provide a non-binding starting point for further analysis.

**ADMINISTRATIVE MATTERS: (Continued)**

Motion by Mr. Cox to authorize execution of the MOU; Seconded by Mr. Kelly. Motion carried (9-0).

9. Chief Executive Officer Richard Stensrud presented a proposed Resolution establishing an interim process and defining parameters for implementation of Section 402(l) of the Internal Revenue Code ('Code'), as authorized by the federal Pension Protection Act ('PPA'), until such time as the Internal Revenue Service ('IRS') provides clarification regarding how certain provisions of Section 402(l) should be interpreted.

Mr. Stensrud explained that under the new law, effective January 1, 2007, certain retired 'public safety officers' ('PSOs') may elect to exclude from taxation up to \$3,000 of retirement income per year if a tax qualified retirement system paid those benefits directly to the provider of a qualified health insurance plan to cover the retiree's insurance premiums for such a plan. Mr. Stensrud explained that because it appears that the retirement system will have to report the amount of such payments in the Form 1099 issued to the retiree each year, the retirement system has initial responsibility for determining whether the retiree is eligible for the tax benefit and whether the payments were made for qualified health insurance premiums. Mr. Stensrud noted, however, that the ability of SCERS and other 1937 Act systems to implement and administer this benefit has been hamstrung by the failure of the IRS to provide clarification and guidance regarding the meaning of certain key terms in Section 402(l).

Mr. Stensrud explained that delaying implementation of the tax benefit was an option, but one that could result in detrimental impact to eligible retirees. Accordingly, Mr. Stensrud proposed an interim process and set of defining parameters that (a) Staff and tax counsel believe are reasonable and which appear to be within the range of options the IRS would deem permissible; (b) provides a process for determining eligibility which is both defensible and administratively efficient; (c) will provide information to a retiree deemed ineligible by SCERS so that the retiree can make his or her case directly to the IRS (the ultimate arbiter of eligibility); and (d) will 'give way' if and when the IRS provides guidance.

Mr. Stensrud explained how the proposed interim process would address the following key issues: (1) What jobs held at retirement will qualify the retiree as a PSO? (2) What constitutes a qualified health insurance plan? (3) What is 'normal retirement age' ('NRA') under the SCERS pension plan?

Mr. Stensrud explained that determining NRA was the most uncertain of the three issues due to the fact that NRA is not a concept that has been incorporated into the 1937 Act and that the IRS has provided little guidance on how it should be defined in a public plan context. Mr. Stensrud identified the three primary ways in which retirement systems were considering defining NRA: (a) the 'formula name' approach; (b) the age determined by the actuary as reasonably representative of the actual retirement age of the covered workforce; and

**ADMINISTRATIVE MATTERS: (Continued)**

(c) the age when the retirement formula ‘topped out.’ Mr. Stensrud outlined the relative strengths and weaknesses of the three possible approaches from an administrative and tax law perspective. Mr. Stensrud noted, however, that it should be kept in mind that the IRS has historically sought to maximize tax revenue rather than minimize tax revenue, and thus there would be greater risk in establishing a NRA that was too expansive in terms of granting eligibility for the tax exclusion.

Mr. Stensrud noted that preliminary reports indicated that 1937 Act systems were primarily considering the three described options, and that he expected that any legislation sponsored by the State Association of County Retirement Systems (‘SACRS’) would include these options as potential ‘safe harbors.’ Mr. Stensrud also noted that CalPERS had elected to utilize the ‘formula name’ method for establishing NRA.

Mr. Stensrud reported that he was recommending that the proposed interim process used by SCERS utilize the ‘formula name’ method for determining NRA since it represented the best combination of being reasonable and permissible from a tax law perspective and administratively efficient.

Mr. Stensrud noted that there was no assurance that the IRS would ultimately agree with the eligibility determinations made under the proposed interim definitions, and this would be clearly communicated to retirees who would have to acknowledge and accept this risk as part of their authorization that SCERS track and report on the payments made on their behalf to health care providers.

Substantial discussion followed, including: (1) Whether implementation of Section 402(l) should be delayed until the IRS had provided guidance; (2) The most defensible approach for defining NRA; (3) The potential risk to SCERS if the IRS subsequently adopted eligibility parameters different from those in the interim process; and (4) The difficulty in getting definitive tax law guidance. In the end, the Board concluded that delaying implementation of the benefit was not a viable option and that the proposed interim process and definitions provided a reasonable and defensible method for implementing the new tax benefit in an uncertain environment.

Motion by Mr. Johnson to adopt the proposed Resolution establishing an interim process and set of definitions for implementing the new PPA tax exclusion; Seconded by Mr. Cox. Motion carried (9-0).

10. Chief Executive Officer Richard Stensrud presented proposals by two potential facilitators for the Board’s upcoming strategic planning session. Mr. Stensrud noted that he felt either of the two candidates – Nancy Williams with the firm of Ennis Knupp and Tom Iannucci with the firm of Cortex Applied Research, Inc. – would do an excellent job, in that they both had extensive knowledge and experience in working with public retirement systems in the areas of strategic planning, governance best practices, and education. Mr. Stensrud stated that he believed that such in-depth familiarity with SCERS’ business model and business environment would maximize the effectiveness of the strategic planning process.

**ADMINISTRATIVE MATTERS: (Continued)**

Mr. Stensrud noted that establishing a good strategic plan at this juncture was critical for several reasons, including (a) it had been several years since SCERS had undertaken a strategic planning exercise; (b) the environment in which SCERS would be operating had changed substantially; (c) it was an opportune time for SCERS to determine its direction and focus in the new environment; (d) the current composition of the Board would provide a good combination of institutional experience and fresh perspectives; and (e) changes in the senior staff had brought new perspectives and new skills to the organization.

Discussion followed regarding the proposals from the two firms. Motion by Ms. Jarboe to authorize the Chief Executive Officer to engage Nancy Williams of Ennis Knupp to facilitate the strategic planning exercise; Seconded by Mr. Woods. Motion carried (9-0).

11. Chief Operations Officer Kathryn Regalia presented the Semi-Annual Administrative Expense Report for the Six Months Ended December 31, 2006. Ms. Regalia reported that administrative expenses were running well under the mid-year projected expense levels. Motion by Mr. Kelly to receive and file the report; Seconded by Mr. Johnson. Motion carried (9-0).

**INVESTMENT MATTERS:**

12. Russ Kuhns, Chairman, and Jim Voytko, President, Director of Research and Senior Consultant, with R.V. Kuhns & Associates presented the results of a special report comparing SCERS' investment program and investment performance to that of top performing California pension funds included in R.V. Kuhns' semi-annual public fund survey. They discussed with the Board differences in SCERS' asset allocation and investment manager structure relative to other California public funds in an effort to identify reasons why those funds had been able to achieve higher risk adjusted returns than SCERS over the past three and five year periods. Their analysis lead them to conclude that the most significant factors contributing to SCERS' solid but median level performance were: (1) Most of the top performing funds have a more actively managed domestic equity portfolio; (2) Most of the top performing funds have a more actively managed domestic fixed income portfolio; and (3) SCERS does not have an allocation to private equity or real return strategies. Extensive discussion followed. Motion by Mr. Kelly to receive and file the R.V. Kuhns report; Seconded by Mr. Woods. Motion carried (9-0).
13. Chief Investment Officer, Jeffrey States and General Counsel James Line presented a proposed Resolution establishing a policy governing participation on investment fund advisory committees. Mr. States and Mr. Line discussed the circumstances in which it might be appropriate for SCERS to consider having someone serve in this type of advisory role, but also noted the potential risks in doing so. Substantial discussion followed, and in the end it was the Board's view that the proposed policy provided good controls on the potential problems while allowing SCERS to benefit by having a representative on an advisory board in appropriate cases. Motion by Mr. DeVore to adopt Resolution 2007-02; Seconded by Mr. Woods. Motion carried (9-0).

**INVESTMENT MATTERS: (Continued)**

14. The Quarterly Asset Allocation and Portfolio Rebalancing Report for the Quarter Ended December 31, 2006 was received and filed on a Motion by Mr. Hickox; Seconded by Mr. Kelly. Motion carried (9-0).
15. The Monthly Investment Management Compliance and Activity Report for December, 2006 was received and filed on a Motion by Mr. Woods; Seconded by Mr. Irish. Motion carried (9-0).

The meeting was adjourned at 3:10 p.m.

**MEMBERS PRESENT:** James A. Diepenbrock; Keith DeVore, John B. Kelly, Dave Irish, Winston Hickox; Alice Jarboe; William D. Johnson; Robert Woods; John Conneally and William Cox.

**MEMBERS ABSENT:** Nancy Wolford-Landers.

**OTHERS PRESENT:** Richard Stensrud, Chief Executive Officer; Jeffrey States, Chief Investment Officer; James G. Line, General Counsel; Kathryn Regalia, Chief Operations Officer; John Gobel, Chief Benefits Officer; Suzanne Likarich, Retirement Services Manager; Russ Kuhns and Jim Voytko of RV Kuhns; Jon Fraade of AIG Financial; Dr. Gary Gorton, Professor, Wharton School of Business; Tom Lightvoet of Mercer Investment Consulting; and Teresa Kennedy, Office Specialist.

Respectfully submitted,

SACRAMENTO COUNTY EMPLOYEES'  
RETIREMENT SYSTEM

Richard Stensrud  
Chief Executive Officer

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.