SCERS
SACRAMENTO COUNTY EMPLOYEES' RETIREMENT SYSTEM

MINUTES

RETIREMENT BOARD MEETING, WEDNESDAY, JUNE 19, 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, June 19, 2013, and commenced at 10:01 a.m.

OPEN SESSION:

1. Motion by Ms. Wolford-Landers to select Richard Fowler to serve as Chair for the meeting in the absence of the Board President and Vice-President; Seconded by Ms. Gin. Motion carried (6-0).

PUBLIC COMMENT:

2. Walter Schmelter, attorney for Charlotte M. Hegle, addressed the Board. Mr. Schmelter discussed Ms. Hegle's condition and application for disability retirement.

   Sarah Travis addressed the Board, discussing her condition and application for disability retirement.

   Chief Executive Officer Richard Stensrud noted that Item 12 on the agenda, the appeal by Stanley R. Huls of a benefit determination matter, was being deferred to the July Board Meeting at the request of the appellant.

<u>MINUTES:</u>

3. The Minutes of the May 8, 2013 special meeting were approved on Motion by Ms. Valverde; Seconded by Mr. Conneally. Motion carried (6-0).

<u>CONSENT MATTERS:</u>

Items 4-10

The Consent matters were acted upon as one unit upon a Motion by Ms. Wolford-Landers; Seconded by Ms. Valverde. Motion carried (6-0).

4. <u>CAPITELLO, Isabel</u>: Granted a nonservice-connected disability retirement.

5. <u>HEGLE, Charlotte M.</u>: Denied a service-connected disability retirement.

6. <u>JOHNSON, Christine R.</u>: Denied a service-connected disability retirement.

7. <u>TRAVIS, Sarah E.</u>: Denied a service-connected disability retirement.

8. Approved the proposed interest crediting rate for member contribution accounts for the six month period ending June 30, 2013.

9. Approved the proposed extension of the engagement with Nossaman LLP to provide real estate investment-related legal services.

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

<u>OPEN SESSION:</u>

<u>ADMINISTRATIVE MATTERS:</u>

11. 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 employer contribution rates for the 2013-2014 fiscal year had recently been approved on consent and without discussion by the Sacramento County Board of Supervisors. Mr. Stensrud noted that the rates will go into effect in July.

Mr. Stensrud congratulated Richard Fowler on his reappointment to the SCERS Board.

Mr. Stensrud reported that the State Association of County Retirement Systems (SACRS) Spring Conference took place May 13 – 17 and invited comments from Board Members who attended. Ms. O’Neil, Mr. DeBord, and Ms. Gin all stated that it was a good conference.

ADMINISTRATIVE MATTERS (continued):

In response to a question from Mr. DeBord regarding the voting process for Board elections this fall, Mr. Stensrud stated that SCERS would not use the electronic voting platform to conduct the election as had been done with Board election last year. Mr. Stensrud noted that the electronic voting platform had been a 'pilot project' and might be used again in the future, but since the next election features retiree positions, Staff felt that those in that electing body might not be as comfortable with an electronic platform.

Mr. Stensrud reported that the California Association of Public Retirement Systems (CALAPRS) Trustee Roundtable took place on June 14. Mr. Stensrud noted that Mr. Fowler had attended the program and invited him to share any observations. Mr. Fowler stated that the presentations were very valuable and interesting.

Mr. Stensrud 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 could contact Staff for assistance.

Mr. Stensrud reported that he recently provided a presentation to one of SCERS' smaller participating employers, the Mission Oaks Recreation and Parks District. Mr. Stensrud stated that Mission Oaks had requested the presentation in order to acquire a better understanding of their participation in SCERS. Mr. Stensrud reported that the presentation seemed to be well-received.

Discussion followed regarding the importance of educating system stakeholders on the strength of the retirement system and how SCERS operates. Mr. Fowler commented that in attending meetings with representatives from other retirement systems, he was continually impressed with how well SCERS compares to those systems. It was noted that this fact may not be fully appreciated by stakeholders. It was also noted that some stakeholders may not fully understand how and why pension costs are what they are, or that SCERS has done an excellent job – through the performance of the investment program and prudent use of the available actuarial tools – of making those costs as manageable as possible. Mr. Stensrud noted that maintaining this level of success would be SCERS' key challenge going forward. Mr. Stensrud further noted that he anticipated this topic – sustaining and building upon success – would be the focus of a Board strategic planning exercise in the Fall.

12. The appeal of Stanley R. Huls of a benefit determination matter was deferred to the July Board Meeting at the request of the appellant.

13. Chief Operations Officer Kathryn Regalia presented the proposed SCERS Administrative Budget for the 2013-2014 Fiscal Year. Ms. Regalia outlined the changes relative to the preceding fiscal year and noted that the administrative expense cap for retirement systems

ADMINISTRATIVE MATTERS (continued):

under the 1937 Act is 0.21% of the actuarial accrued liability, excluding IT costs. Ms. Regalia stated that SCERS' 2013-2014 Fiscal Year Administrative Budget is 0.08% of actuarial accrued liability, excluding IT costs, which is well below the cap.

Motion by Ms. Wolford-Landers to approve the proposed SCERS Administrative Budget for the 2013-2014 Fiscal Year. Seconded by Ms. O'Neil. Motion carried (6-0).

14. Ms. Regalia provided a report on the proposals received in response to the request for proposals for Professional Auditing Services. Ms. Regalia reported that an evaluation committee was formed and met to discuss the two proposals received – from Macias Gini & O'Connell, LLP (MGO) and Brown Armstrong Accountancy Corporation. Ms. Regalia stated that, after discussion, the committee unanimously agreed that MGO submitted the stronger proposal. Ms. Regalia noted that the proposal by MGO showed expertise in the area of investments and actuarial services, a seasoned staff that would be placed on the SCERS' engagement, and the ability to meet SCERS' timelines.

    Motion by Ms. O'Neil to approve the engagement of Macias Gini & O'Connell, LLP as the provider of professional auditing services. Seconded by Ms. Wolford-Landers. Motion carried (6-0).

15. Chief Executive Officer Richard Stensrud reminded the Board that in April 2012, The Segal Company made a presentation to the Board on the considerations and recommended components of an actuarial funding policy. Mr. Stensrud explained that at the current meeting Segal would review the issues and options involved with an actuarial funding policy, including the impact of new accounting statements recently adopted by the Governmental Accounting Standards Board (GASB) and the development of actuarial funding policy guidelines by the California Actuarial Advisory Panel (CAAP). Mr. Stensrud noted that a proposed actuarial funding policy was being presented for the Board's consideration.

    Mr. Stensrud introduced Paul Angelo and Andy Yeung from The Segal Company who provided a presentation on the proposed actuarial funding policy.

    Mr. Angelo explained that the actuarial valuation is built around certain key parameters that impact the determination of the plan's liability and the calculation of the annual contribution rates that will provide funding to address that liability. Specifically, those parameters include:

    - An <u>actuarial cost method</u>, which allocates the ultimate expected costs for active members to each year of past, current and future service to yield the actuarial accrued liability (AAL), and from that number, determines the cost attributable to the current year (the 'Normal Cost'). Theoretically, contributing the Normal Cost for each year of service

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

will be sufficient to fund all plan benefits, assuming all actuarial assumptions are met, including the investment return assumption. If, however, the assets of the plan are greater than the AAL, the plan is overfunded, yielding a 'surplus.' If the assets are less than the AAL, the plan is underfunded, yielding an unfunded actuarial accrued liability or 'UAAL.'

- An <u>asset smoothing method</u>, which reduces the effects of short term market volatility, while still tracking the overall movement of the market value of plan assets.

- An <u>amortization policy</u>, which determines the length of time and the structure of the payments required to pay off the plan's UAAL or surplus.

Mr. Angelo explained that these three parameters represent the core of what is referred to as the pension plan's actuarial funding policy. Mr. Angelo noted that together, these three parameters seek to address the following policy goals:

- Current plan assets and future contributions, together with investment returns, should be sufficient to fund all benefits payable to active, inactive and retired members and beneficiaries.

- The cost of the benefits should be reasonably allocated to the years of service such that the annual contributions should, to the extent possible, bear a consistent relationship to the employer's payroll and maintain a close relationship to the cost of each year of service.

- The volatility of future employer contributions should be managed and controlled to the extent reasonably possible.

- The funding policy should promote accountability and transparency by allowing an assessment of whether, how and when the plan sponsor will meet the plan funding requirements.

Mr. Angelo noted that the second policy goal above promotes 'intergenerational equity,' meaning that each generation of taxpayers incurs the cost of benefits for the employees who provide services to those taxpayers. Mr. Angelo noted that the volatility management focus of the third policy goal above promotes 'period to period equity,' meaning that the cost incurred by taxpayers in any period compares equitably to the cost just before and after.

Mr. Angelo noted that SCERS has in place an actuarial cost method, an asset smoothing method, and an amortization policy, however, the three parameters are not currently framed in the form of a formal, consolidated actuarial funding policy. Mr. Angelo explained

ADMINISTRATIVE MATTERS (continued):

that the goal was to establish a formal policy that will not only serve as the foundation for ongoing actuarial funding decisions, but will also meet the GASB requirement that actuarially determined employer contributions be based on a funding policy adopted by the governing body of the retirement system.

Mr. Angelo explained that for SCERS' actuarial funding policy, The Segal Company was recommending: (1) Modification of the current Normal Cost methodology so that it can be used for both funding and financial reporting purposes under both the new GASB accounting and financial reporting standards; (2) Maintaining the current asset smoothing methodology; (3) Continued amortization of the UAAL as of June 30, 2012 as a single layer over a declining amortization period (22 years as of June 30, 2013); (4) Going forward, separate amortization layers each year for each different source of UAAL or surplus; (5) Continued amortization over a closed, declining period for each different source of UAAL or surplus; and (6) Continued use of level percent of pay for amortization payments.

Mr. Angelo explained that with respect to the amortization periods for the respective sources of UAAL or surplus, Segal was recommending: (1) A shorter period (15-20 years) for actuarial gains or losses; (2) A longer period (20-25 years) for gains or losses attributable to assumption changes or changes in actuarial methodology; (3) A short period (0-15 years, with a default of 5 years) for plan changes such as retirement incentives; (4) A long period (30 years) for amortizing surplus; and (5) When to 're-start' an amortization period or combine amortization layers.

Mr. Angelo discussed the concept of negative amortization. Mr. Angelo explained that this happens if the early payments toward retiring the UAAL are less than the interest accruing on the outstanding balance. Mr. Angelo noted that for SCERS, negative amortization results if the amortization period is greater than 20 years. Mr. Angelo explained that there is nothing inherently wrong with negative amortization, but that it should be considered in setting the length of the amortization period for each layer.

Mr. Angelo noted that Segal was suggesting three alternative approaches to combining the recommended amortization periods for the various sources of UAAL and explained the differences between the alternatives.

Mr. Stensrud noted that one of the alternative approaches uses the same amortization period (20 years) for both UAAL due to actuarial gains and losses and UAAL due to assumption or actuarial methodology changes. Mr. Stensrud noted that under that alternative, the amortization period for actuarial gains and losses is at the longer end of the recommended range, while the amortization period for assumption/methodology changes is at the shorter end of the recommended range. Mr. Stensrud suggested that this alternative appeared to offer a good balance between amortization periods. Mr. Stensrud further noted that it also provides amortization periods that avoid negative amortization. Mr. Stensrud explained that for those reasons, Staff was recommending that the Board utilize the amortization periods under that alternative in SCERS' actuarial funding policy.

ADMINISTRATIVE MATTERS (continued):

Mr. Angelo noted that the recommended change in the method for calculating Normal Cost would increase the employer contribution rate by approximately 0.4% of payroll, but explained that this would be offset over time by a decrease in the UAAL rate, as a small amount of UAAL is generated under the current methodology. Mr. Angelo noted that it was not possible to quantify in advance the future cost impact associated with adopting any of the recommended amortization periods because the future changes in UAAL are not known.

Mr. Stensrud noted that the components of the recommended actuarial funding policy were virtually identical to what had been discussed in April 2012. Mr. Stensrud further noted that the information concerning the proposed actuarial funding policy had been shared with the County, other participating employers, and the bargaining units in April 2012 and prior to the current meeting.

Discussion followed.

Motion by Ms. Wolford-Landers to approve the actuarial funding policy as recommended by The Segal Company and Staff; Seconded by Mr. Conneally. Motion carried (6-0).

INVESTMENT MATTERS:

16. Jamie Feidler of Cliffwater, LLC presented the Alternative Assets Investment Performance Report for periods ending December 31, 2012 and March 31, 2013, including information regarding the hedge fund, private equity, real assets, and opportunities portfolios.

Mr. Feidler reported that SCERS' hedge fund portfolio was up 4.7% in the first quarter of 2013, outperforming the absolute policy benchmark (3 Month T-Bills + 5%) which was up 1.3% in the first quarter of 2013. Mr. Feidler noted that SCERS' hedge funds outperformed the HFRI Equity Hedge Index in the first quarter of 2013, which was up 3.5%.

Mr. Feidler noted that, in December, 2011, SCERS funded the SC Absolute Return Fund, LLC ("SCARF") with $200 million, which is invested in a portfolio of hedge funds diversified by strategy and across geographies. Mr. Feidler stated that SCARF was up 5.0% in the first quarter, and outperformed the HFRI Fund of Funds Composite Index and the 3 Month T-Bills + 5%, which were up 3.5% and 1.3% respectively. SCARF outperformed relative to SCERS' prior investment in Grosvenor Institutional US Hedged Fund, LP, ('GISH'), a long/short equity fund, by 2.1% during the first quarter.

Mr. Feidler reported that the net investment rate of return ("IRR") of SCERS' private equity portfolio was up 4.0% since inception compared to the Venture Economics Private Equity Index up 6.9% and the multiple of total value to paid in capital ("TVPI") is 1.07x 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.

INVESTMENT MATTERS (continued):

Mr. Feidler reported that, through December 31, 2012, SCERS' real assets portfolio IRR was 7.1% compared to SCERS' real assets portfolio benchmark (CPI + 5%) IRR of 7.4% and SCERS' TVPI was 1.2x.

Mr. Feidler reported that SCERS' opportunistic portfolio generated a net IRR of 8.1% as of December 31, 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 8.7%.

Motion by Ms. Wolford-Landers to receive and file the quarterly performance report; Seconded by Ms. Gin. Motion carried (6-0).

17. Jennifer Young of The Townsend Group presented the quarterly performance report on real estate investments for the quarter ended March 31, 2013.

Ms. Young reported that SCERS' total real estate portfolio returned 3.2% during the first quarter of 2013, outperforming the benchmark (NFI-ODCE) by 2.4%. Ms. Young stated that for the year ended March 31, 2013, SCERS' real estate portfolio return was 14.4% and that in the same period, the benchmark returned 9.7%.

Ms. Young reported that SCERS' core real estate portfolio returned 1.5% during the first quarter, underperforming the benchmark by 0.9%. Ms. Young noted that this underperformance is partly due to a lag in the valuations of the properties in the core separate accounts, which underperformed for the quarter but have outperformed in every other measurable time period.

Ms. Young reported that, within core real estate, SCERS' separate account portfolio underperformed the commingled fund investments for the quarter, but outperformed the commingled fund investments for all other periods. Ms. Young stated that the separate accounts returned 1.4% for the quarter and 12.3% for the year, compared to 1.8% and 9.4%, respectively for the commingled funds.

Ms. Young reported that SCERS' domestic public REIT portfolio returned 7.1%, compared to a first quarter return of 8.2% for the FTSE NAREIT (domestic) REIT Index. Ms. Young stated that SCERS' international REIT portfolio outperformed the FTSE EPRA/NAREIT Global ex-US REIT Index by 0.6% with a return of 5.5% in the first quarter.

Ms. Young reported that SCERS' non-core real estate portfolio returned 3.3% for the quarter and 15.6% for the one year period, above Townsend's benchmark of the NCREIF / Townsend Value Added Funds benchmark, which returned 2.1% and 10.4% respectively.

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

INVESTMENT MATTERS (continued):

18. Chief Executive Officer Richard Stensrud introduced Jamie Feidler who provided an educational presentation on the investment vehicles referred to as ‘derivatives.’

    Mr. Feidler provided a description of what constitutes derivatives, why derivates are used, and who uses derivatives. Mr. Feidler noted that derivatives are generally categorized across five primary types: (1) options, (2) forwards, (3) futures, (4) swaps, and (5) structured products. Mr. Feidler went into a more detailed description of each of these five types of derivates.

    Motion by Ms. Gin to receive and file the educational presentation on the investment vehicles referred to as ‘derivatives;’ Seconded by Ms. Valverde. Motion carried (6-0).

The meeting was adjourned at 2:30 p.m.

MEMBERS PRESENT: Richard B. Fowler II, Diana Gin, Kathy O’Neil, Julie Valverde, Nancy Wolford-Landers, John Conneally, and Michael DeBord.

MEMBERS ABSENT: James A. Diepenbrock, John B. Kelly, Keith DeVore, and Chris A. Pittman.

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; John Lindley, IT Administrator; Lance Kjeldgaard, Outside Counsel; Jamie Feidler, Cliffwater, LLC; Jennifer Young, The Townsend Group; Paul Angelo and Andy Yeung, The Segal Company; Eunice C. Majam-Simpson, Nossaman LLP; Diana Ruiz, Deputy County Counsel; Walter Schmelter; Jack Vetter; and Sarah Travis.

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.