MINUTES

REGULAR BOARD MEETING
MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

One McInnis Parkway, 1st Floor
Retirement Board Chambers
San Rafael, CA

February 9, 2011 - 9 A.M.

EVENT CALENDER	9 A.M.	Regular Board Meeting
CALL TO ORDER	Chair Gladstern called the meeting to order at 9:02 A.M.	
ROLL CALL	PRESENT:	Bolger, Brenk, Given (non-voting), Gladstern, Haim, McFarland, Phillips, Richardson, Walsh, Webb (non-voting), Wofford
	ABSENT:	None

MINUTES
It was M/S Richardson/Walsh to approve the January 12, 2011, Regular Board Meeting Minutes as submitted. The motion was approved by unanimous vote.

A. OPEN TIME FOR PUBLIC EXPRESSION

Chair Gladstern said that in response to comments it has received, MCERA is reviewing its own formal processes for taking public comment during Board meetings. The Chair noted that public comments may be made following each agenda item's presentation and before the Board deliberates on the item.

Michael Smith greeted Board members and commended them for their work.

B. BOARD OF RETIREMENT MATTERS

1. Administrator's Report (Oral)

a. Administrator's update

Retirement Administrator Jeff Wickman reported that the IRS Plan Determination filing was successfully completed. Mr. Wickman commended staff and counsel for their work on the project.

Mr. Wickman announced that a new Welcome Guide for New Members is now available on the website, and he commended Assistant Retirement Administrator Helen Moody and Communications Associate Syd Fowler for its development. The

Member Handbook is scheduled next for revision, and the Pre-Retirement Seminar on MCERA's Web site has recently been updated.

The current fiscal year administrative budget is on target, and the Finance and Risk Management Committee will address the level of variances that should be shown in staff's budget reports. The Administrator and the Senior Accountant have completed a draft Fiscal Year 2011-12 budget, to be reviewed by the Finance and Risk Management Committee.

The new tenant is scheduled to occupy the remaining space at One McInnis Parkway on February 28, 2011.

MCERA is reviewing information on the forty-five applicants who opted for Marin County's Voluntary Separation Incentive Program (VSIP) to assist them with the retirement process.

A Public Records Act request for payments of benefits from "excess earnings" from 2006 to the present will be completed this week. The requestor was notified that only the Ad Hoc COLA that is provided under the Government Code has been paid from "excess earnings".

b. Staffing update

A staffing plan will be addressed in the draft budget for the upcoming fiscal year.

c. Facility Use Report

The Marin County Association of Retired Employees (MCARE) held a meeting at the facility. Trustee Haim asked if we could assist the retiree group with mailing its newsletter, and Mr. Wickman offered to discuss the matter with the group.

The Retirement Administrator attended the Marin County Council of Mayors and Council members Ad Hoc Pension and OPEB Reform meeting on January 31. The Administrator has offered to assist the Chair of the Committee with any data needed for the group's research.

d. Future meetings
- February 22 Finance and Risk Management Committee
- March 9 Regular Board

2. Committee Reports

a. Governance Committee

1. Interest Crediting Policy (Action)

Consider and take possible action to adopt Governance Committee recommendation to amend Policy

Governance Committee Chair Brenk reviewed the revisions to the Interest Crediting Policy recommended by the Committee, and Chair Gladstern invited comment.

Based on the recommendation of the Governance Committee, Committee Chair Brenk moved that the Board adopt the Interest Crediting Policy as amended. The motion was approved by unanimous vote.

2. Unrestricted Earnings Policy (Action)
Consider and take possible action to adopt Governance Committee recommendation to amend Policy

Committee Chair Brenk reviewed the Governance Committee's recommended changes to the Unrestricted Earnings Policy, which included a provision that the funded status of the Plan "should be 100%" before excess earnings may be considered for use in granting an Ad Hoc Cost of Living Adjustment (Ad Hoc COLA) as provided in the Government Code. Mr. Brenk reported that the Committee's deliberations included considerable discussion about the relative merits of either an 80% or 100% funding threshold. Trustee Brenk also noted that the change to 100% was something that occurred during the Governance Committee meeting.

Trustee McFarland said that he is strongly reconsidering his Governance Committee vote as he is concerned that 100% funding is an unnecessarily high threshold to provide the Ad Hoc COLA.

Trustee Walsh stated that, while he favored the 100% funding threshold, because there was a thorough discussion at Committee he was open to discussing a lower funding threshold. He supported having that discussion at the Board meeting instead of referring the item back to Committee or delaying it to another time. Trustee Wofford agreed as she prefers the Board to have discretion to provide an Ad Hoc COLA at less than 100% funded level.

Trustee Brenk offered a proposed revision to Section IV of the Policy, and he read and explained the following revised text to the Board (**revisions in bold**):

IV. Step 2: If Available Earnings remain after completing Step 1, then the Board may, in its sound discretion, consider:

A. If at least one percent (1%) of MCERA's total retirement system assets are collectively maintained in the Employee Group Statutory Contingency Reserves, ***and the overall funded status of the Plan is 80% or greater****, the Board may consider a transfer to a non-valuation reserve or designation to pay an ad hoc supplemental COLA as permitted by law.* ***Ideally****, before transferring any assets to such non-valuation reserve, the overall funded status of the plan should be* ***approximately*** *100%.*

It was M/S Brenk/Richardson to revise Section IV of the Governance Committee's amended Unrestricted Earnings Policy as stated by Trustee Brenk above.

In response to Trustee Haim's question about City of San Rafael funding, Administrator Wickman explained that as required in the Board's policy, a 1% statutory contingency reserve as to all employer valuation groups must be established before "excess earnings" can be used for an Ad Hoc COLA. The inability to establish this reserve for the City of San Rafael is the reason why the Board had not considered granting the Ad Hoc COLA this year. Trustee Bolger said that there is an inter-generational issue and that the Board's fiduciary responsibility is to all members including younger members and retirees and beneficiaries. Trustee Wofford also advocated a balance between younger members and older retirees.

Trustee Phillips said that one of the reasons for the Governance Committee's amendment to the Unrestricted Earnings Policy was to address concerns about MCERA's funded level. He said that communication on that point is important and that all members of the system are our obligation. All policies should uphold that responsibility, he stated. Mr. Phillips voiced approval of Trustee Brenk's amended wording, and he recommended that further discussion take place at March Strategic Workshop.

Trustee Walsh reviewed the funding process from a financial perspective, noting that first, the state-mandated statutory reserve has to be filled up. Then the actuary's advice must be considered to make sure that funds are available to pay current retirees. Based on that calculation, funding for sponsor and employee contributions is provided for. Then, the question is funding the accrued liability; after that, the leftovers are defined by the law. Under the County Employees Retirement Law (CERL), it discusses 'excess earnings'; however, Mr. Walsh questioned the validity of the term because of the potential, and recent history, of investment losses. Mr. Walsh stressed the importance of protecting the future of the system going forward, and he questioned whether 80% is sufficient to provide for future obligations. Mr. Walsh concluded by stating that since our system of laws provide for the Board to grant the Ad Hoc COLA under certain conditions, and since the plan sponsors do not control that decision, then he believes the funding level threshold should have to be 100%.

Trustee Haim spoke on behalf of having a lower funding threshold for the discretion to provide Ad Hoc COLAs to retirees, observing that the '37 Act was a depression-era policy, written to assure the retirees do not suffer. He said that the amount of money involved in granting an Ad Hoc COLA is small compared to benefits granted to other members. Trustee Gladstern pointed out that only 105 people were involved last year and the Ad Hoc COLA would have brought them up to only 80% purchasing power based on the benefit that the plan sponsor originally granted to them. Trustee Brenk offered his amendment as a balance between the two positions.

Chair Gladstern invited public comment. Alexis McBride, President of MCARE, expressed her concern that the motion as presented would cause the same issues to arise, and she requested compassion in favor of affected retirees. She said that 100% funding "slams the door" on the 105 retirees, and is not fiscally prudent, but conservative. MCERA retiree Ed Henry said that affected retirees worry about getting medicine and food, and he reiterated Ms. McBride's call for compassion and a careful reconsideration of Policy amendments.

Trustee Haim Called for the Question. The Call for the Question was approved by a vote of 7-2, with Trustee Walsh and Phillips opposed.

The Chair called for a vote on Trustee Brenk's motion.

AYES:	Bolger, Brenk, Gladstern, McFarland, Phillips, Richardson, Walsh, Wofford
NOES:	Haim
ABSTAIN:	None
ABSENT:	None

Chair Gladstern recessed the meeting at 10:09 A.M. and directed deliberations to **Agenda Item C, Legal Matters,** and **Agenda Item D**, **Disabilities**, in Closed Session, reconvening in Open Session at 11:26 A.M.

C. <u>LEGAL MATTERS</u>

1. <u>Conference with legal counsel – anticipated litigation (CLOSED SESSION)</u>
   Exposure to litigation pursuant to subdivision (b) of Section 54956.9: one potential case

   No reportable action.

2. <u>Conference with real property negotiators (CLOSED SESSION)</u>
   <u>Property</u>: 1851 Heritage Lane Sacramento, CA
   <u>Agency negotiators</u>: Ron Granville, Bob Rouse and Scott Pritchett, Woodmont Real Estate Services
   <u>Under negotiation</u>: Price for sale of property

   No reportable action.

D. DISABILITIES - (TIME CERTAIN: 10 A.M.)

All disability applications are considered in Closed Session unless applicant specifically waives confidentiality and requests that his or her application be considered in Open Session. **(Action)**

Applications to be Heard	Service/Non-Service Connected	Date of Application	Employer
1. William Steach	Service	8/27/09	San Rafael Fire Dept

Initial consideration of an application for service-connected disability retirement filed by a Safety member.

2. Monte Payne	Service	11/21/07	San Rafael Fire Dept

Consider and take possible action re Administrative Law Judge's Findings of Facts and Recommended Decision.

It was M/S Phillips/Richardson to grant William Steach's application for service-connected disability retirement. The motion was approved by unanimous vote.

It was M/S Wofford/McFarland to adopt the Administrative Law Judge's Findings of Facts and Proposed Decision to grant service-connected disability retirement to Monte Payne. The motion was approved by a vote of 8-1, with Trustee Brenk dissenting.

Chair Gladstern redirected deliberations to **Agenda Item B.2.a.3**.

3. Placement Agent Payment Disclosure Policy (**Action**)
   Consider and take possible action to adopt Governance Committee recommendation to amend Policy

   Governance Committee Chair Brenk reviewed the Governance Committee's recommended amendments to the Placement Agent Payment Disclosure Policy.

Based on the recommendation of the Governance Committee, Committee Chair Brenk moved that the Board adopt the Placement Agent Payment Disclosure Policy as amended. The motion was approved by unanimous vote.

4. Economic Assumptions Policy (**Action**)
   Consider and take possible action to adopt Governance Committee recommendation to amend Policy including discussion of SB 867

   Mr. Brenk reviewed the Economic Assumptions Policy history and summarized its provisions and the Governance Committee's recommended amendments to clarify the process. Trustee Walsh requested clarification of the term "service-based rates", and Actuary Graham Schmidt reviewed the rates included in the term.

Based on the recommendation of the Governance Committee, Committee Chair Brenk moved that the Board adopt the Economic Assumptions Policy as amended. The motion was approved by unanimous vote.

Chair Gladstern noted that an ad hoc committee will work with the actuary and the Retirement Administrator to consider the effects of provisions of SB 867.

5. Budget Policy (**Action**)
Consider and take possible action to adopt Governance Committee recommendation to amend Policy pursuant to AB 609

Trustee Brenk reviewed the revisions to the Budget Policy, in accord with Assembly Bill 609, which was effective on January 1, 2011, including the provision to base the administrative budget on liabilities instead of assets.

Based on the recommendation of the Governance Committee, Committee Chair Brenk moved that the Board adopt the Budget Policy as amended. The motion was approved by unanimous vote.

b. Ad Hoc CPAS Committee Report

1. Project Status Update
CPAS Ad Hoc Committee Chair Phillips reported that the most recent CPAS build had deficiencies in two key areas that were to be delivered: employer web and system permissions. CPAS has agreed to provide MCERA with a patch for these problems on February 9th. General Ledger functionality was not included in the build per a prior agreement between MCERA and CPAS.

While the majority of the core functionality is nearly achieved, challenges remain in getting the final pieces in place so MCERA can complete User Acceptance Testing and begin parallel processing. Based upon analysis of the patch received later today, the Committee recommends having a CPAS developer on site.

Due to these issues, the Committee determined to delay the April 1 go-live date, and will revise the schedule once more information is received. Both Mr. Phillips and Board Chair Gladstern emphasized that the top priority is to achieve the correct functionality. Trustee Bolger asked if the delay would impact cost. Mr. Wickman said that MCERA is working under the provisions of our original fixed price contract with CPAS.

c. Ad Hoc System Risk Committee Report

Ad Hoc System Risk Committee Chair Richardson reported that the Committee has met with three potential candidates and will address the matter at the March Strategic Workshop.

3. Trustee Comments

Trustee Phillips reported on meeting with Artisan's large-cap international growth investment team with Administrator Wickman.

Trustee Phillips recommended consideration of having a Disability Committee to minimize disruptions to other Board meeting matters. Recommendations for improving the disability process will be addressed at the March Strategic Workshop.

Trustees Brenk and Webb reported on an educational visit with private equity manager Pathway Capital Management. The Trustees learned about the private equity process, and agreed that the firm has a sound methodology and track record.

Trustee Bolger inquired about the status of AXA Rosenberg. Mr. Wickman reported that AXA Rosenberg had set aside approximately $217 million for settlement with investors such as MCERA and AXA Rosenberg paid a $25 million fine to the SEC without admitting fault. Settlement will be determined on a case-by-case basis, and Investment Consultant Kevin Dunne said that follow-up discussions continue.

Chair Gladstern attended the CalAPRS Trustees Roundtable, where she found informative sessions on fiduciary insurance and securities litigation. Ms. Gladstern spoke at a recent MCARE lunch and she invited the MCARE members to attend MCERA Board and committee meetings.

E. OLD BUSINESS

None.

F. NEW BUSINESS

1. Annual Cost of Living Adjustment as of April 1, 2011 **(Action)**

Mr. Wickman presented the actuary's recommendation for a Cost of Living Adjustment (COLA) as of April 1, 2011. He stated that the Board's responsibility is to review the actuary's calculations and determine whether there has been a cost of living increase or decrease. Trustee Bolger observed that the employers set the basic COLA thresholds for their employees, which are then paid by MCERA when the employees retire.

It was M/S Haim/McFarland to adopt the actuarial calculation for an annual cost of living adjustment as of April 1, 2011. The motion was approved by unanimous vote.

2. Economic Assumption Building Block Presentation – Graham Schmidt, EFI Actuaries

Mr. Wickman introduced the presentation is a follow-up to prior discussions of economic assumptions. Chair Gladstern invited public comment following the actuary's presentation.

Actuary Graham Schmidt, Vice President of EFI Actuaries, provided a detailed review of each economic assumption, emphasizing the necessity of a consistent framework. Mr. Schmidt said that the discount rate, currently 7.75%, is the most visible assumption but he noted that inflation is the foundation for all economic assumptions. The current CPI and wage inflation assumption is 3.5%.

Trustee Walsh inquired whether the CPI included wages, and Mr. Schmidt replied affirmatively. Mr. Walsh asked whether, when using inflation to calculate the liability, wage inflation and cash-outs are factors, and Mr. Schmidt affirmed that they are factors. Mr. Schmidt reviewed four sources of pay increases: wage inflation, productivity, longevity and promotion.

Mr. Schmidt continued by discussing real return, stating that historically, the real return on equities has been 6 to 8%, and on fixed income, 4%. The real rate of return is the difference between the discount rate and the inflation assumption. Based on portfolio allocation, the real return assumption was calculated at 4.8%, which coincides with the investment consultant's calculation of 5% based on the 2009 asset allocation study. Based on the actuary's recommendation, the Board reduced that assumption in 2009 to 4.25%.

Mr. Wickman presented data from other '37 Act systems showing the discount rate, inflation rate and real rate of return. He commented that many systems were looking at their rate of return assumption with their next experience study. This will allow them to consider changes in concert with new capital market projections.

Mr. Schmidt reviewed alternative funding ratios based on different projected assumed real rates of return from 2.75% to 5.75%. He said that the results reveal the importance of the determination of the assumption rate. Trustee Walsh observed that while most systems are at a similar assumption rate to MCERA, their inflation assumptions vary widely and many are higher. Mr. Schmidt explained that the long-term view is for lower inflation levels, and Trustee Phillips affirmed that view.

Mr. Schmidt noted that the field of financial economics calls for using a "risk free" discount rate for projecting liabilities. In this approach the discount rate would mirror the risk of cash flows. Since pension payments are assumed to have low risk, the theory says to use the yield of assets with similar term structure and risk-profile. Generally, the Treasury bonds are identified as a representative asset. He observed, however, that some studies based on this approach have used the discount rate without adjusting for inflation. Adjusting for inflation creates a significantly lower rate than that used for MCERA's assumptions calculations. When Mr. Schmidt recalculated costs using a 4%

discount rate, with a 2.25% inflation assumption, the result was a large increase in the unfunded liability.

Trustee Walsh supported the Government Accounting Standards Board (GASB) provision to use the risk-free rate for the unfunded liability for disclosure purposes. Mr. Schmidt acknowledged that for those systems which are not making contributions (in contrast to MCERA's plan sponsors and active members), that approach has validity.

Mr. Schmidt explained that the difference in the projections of present value of future benefits is the reward for taking risk by investing in a diversified portfolio. Were all investments in US Treasury bonds, then that certainty brings a guaranteed lower return over the long term. Therefore, according to the actuary, the "risk-free" approach foregoes the opportunity to spread risk and reward across all generations over the long term.

Public comment was invited by Chair Gladstern. Larry Kay, retiree with the County, expressed concern about the components of the Bay Area CPI index. Trustee Phillips observed that that index is used only for purposes of the CPI. Mr. Schmidt said that the base CPI includes everything, but that the Bay area index is used only to determine COLA levels.

Chair Gladstern recessed the meeting for lunch at 12:48 P.M., reconvening at 1:17 P.M.

Trustee Phillips was excused from the meeting at 1:00 P.M.

3. <u>Notification of SACRS Board of Director Elections 2011-2012</u>
Consider and discuss election process and deadlines

Chair Gladstern presented notice of SACRS Board of Director elections to be held in May 2011, along with the time table for submission of nominees.

4. <u>Discuss and consider termination of Market Neutral program and transition of assets to separate asset classes **(Action)**</u>
Administrator Wickman reviewed the Board's deliberations and due diligence visits over the last six months about the market neutral program and its consideration over whether the program should be terminated. In January, the Investment Committee discussed the matter.

It was M/S Richardson/Wofford to terminate the market neutral program. Trustee Brenk observed that the program's returns did not meet expectations. Callan Associates Investment Consultant Kevin Dunne said the program returned the same as cash over time, as well as the S&P 500. The motion was approved by unanimous vote.

Mr. Dunne reviewed three options of reinvesting the funds among the two current large-cap managers and the State Street Global Advisors S&P 500 index. Trustee Bolger discussed different types of S&P 500 index funds, such as equal-weighted instead of capitalization-weighted, and also a return-based index. These would be alternatives to the standard S&P 500 index, according to Mr. Dunne, who reviewed several different index funds, and said that each has a different focus.

In addressing Trustee Brenk's query as to whether active or passive management is expected to outperform over the next few years, Investment Consultant Jim Callahan said that performance of investment styles goes in cycles and is difficult to predict. However, he observed that the large-cap managers have added value over time over their benchmarks, and so he supports continued large-cap active management, though with a blend to include passive management.

Trustee Bolger observed that downside protection by large-cap managers was absent during the 2008 market downturn. Mr. Callahan pointed to a select few financial stocks as factors; however, in other downturns the managers performed admirably, he said.

Trustee Haim made a motion to invest the market neutral program funds equally among the Dodge & Cox, RCM, and S&P 500 index in order to retain alpha opportunity. There was no second. Trustees discussed the costs and complexities of such a transition, and the relative merits of the three different investment options presented by the investment consultant. Trustee Walsh advocated investing all of the funds in the S&P 500 index to provide for downside risk, and Trustees Bolger and Brenk concurred.

It was M/S Brenk/Wofford to invest the proceeds of the terminated market neutral program into the State Street Global Advisors S&P 500 Index.

AYES:	Bolger, Brenk, Gladstern, McFarland, Richardson, Walsh, Wofford
NOES:	None
ABSTAIN:	Haim
ABSENT:	Phillips

Chair Gladstern recessed the meeting to Closed Session for **Agenda Item F.5** at 2:02 P.M.

5. Public Employee Performance Evaluation (CLOSED SESSION)
   Title: Retirement Administrator
   In accordance with MCERA's Retirement Administrator Annual Performance Evaluation Policy Section 3(b), conduct mid-year informal performance review

Trustee Phillips rejoined the meeting in Closed Session at 2:45 P.M.

No reportable action.

6. Future Meetings
Consider and discuss agenda items for future meetings

No discussion.

G. INVESTMENT INFORMATION

"X" indicates report distributed; * indicates report distributed electronically

PERIODIC REPORTS

1. Equities and Fixed Income

		Abbott Capital	-Private Equities Fund	
		Analytic Investors	-Equitized US Market Neutral Portfolio	
*	X	Artisan Funds, Inc.	-International Equities Fund	
*	X	The Clifton Group	-Futures Overlay Program	
		Columbus Circle Investors	-Small Cap Growth Portfolio	
*	X	Dimensional Fund Advisors	-Small Cap Value Fund	
*	X	Dodge & Cox	-Large Cap Value Portfolio	
		Eaton Vance	-Emerging Markets	
*	X	Morgan Stanley	-International Equities Fund	
*	X	Numeric Investors	-Equitized US Market Neutral Portfolio	
		Pathway Capital	-Private Equities Fund	
*	X	Pyramis Global Advisors	-Equitized US Market Neutral Fund	
*	X	Pyramis Global Advisors	-International Small Cap Equity Fund	
		RCM	-Large Cap Growth Equities Portfolio	
	X	Wellington Management	-Core Domestic Fixed Income Portfolio	
	X	Western Asset Management	-Core Plus Domestic Fixed Income Portfolio	

2. Real Estate

		Woodmont Realty Advisors	-Direct ownership – Monthly report	
		AEW Capital Management	-Value Added Portfolio	Quarter
*	X	ING Clarion	-Core Portfolio	Quarter
*	X	RREEF	-Value Added Portfolio	Quarter
		Woodmont Realty Advisors	-Direct Ownership	Quarter

3. Market Neutral

	X	Monthly Performance Report	-For period ending January 31, 2011	

4. Other

H. OTHER INFORMATION

1. Approved Trustee Training Calendar
2. *Keeping in Touch* – February Issue, Retired Employees Association newsletter
3. Notification regarding possible revisions to Interest Crediting and Unrestricted Earnings Policies

I. **CONSENT CALENDAR (Action)**

It was M/S Haim/Wofford to approve the Consent Calendar as submitted. The motion was approved by unanimous vote.

There being no further business, Chair Gladstern adjourned the meeting at 3:45 P.M.

Maya Gladstern, Chair	Bernadette Bolger, Secretary