MINUTES

FINANCE AND RISK MANAGEMENT COMMITTEE MEETING
MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION (MCERA)

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

October 4, 2011 – 10:30 A.M.

CALL TO ORDER Chair Bolger called the meeting to order at 10:45 A.M.

ROLL CALL PRESENT: Bolger, Brenk, Given, Gladstern, Webb

ABSENT: Phillips, Richardson

MINUTES

It was M/S Brenk/Gladstern to approve the May 24, 2011, Finance and Risk Management Committee Meeting Minutes as submitted.

AYES: Bolger, Brenk, Gladstern, Webb

NOES: None

ABSTAIN: Given

ABSENT: Phillips, Richardson

A. OPEN TIME FOR PUBLIC EXPRESSION
None.

Chair Bolger directed deliberations to **Agenda Items C.1** and **C.2**.

C. NEW BUSINESS

1. Unaudited Financial Statements for FY 2010/11
Consider and discuss unaudited financial statements.

Mr. Wickman presented the preliminary prior fiscal year financial statements to the Committee.

Chair Bolger expressed satisfaction with the financial statements and her appreciation to Senior Accountant Lisa Jackson for providing visibility into MCERA operations. Trustee

Gladstern discussed payables, such as unpaid death benefits and consulting fees to SF Sentry, for example, with Ms. Jackson.

As a follow up to prior matters, Chair Bolger inquired about the pending fiduciary insurance policy. The Administrator reported that a binding proposal for fiduciary liability insurance has been completed with National Union.

The Chair discussed foreign exchange transactions and suggested that MCERA should execute letters of agreement with the relevant investment managers. Counsel Dunning suggested the idea of establishing guidelines within the Investment Policy Statement under which the investment managers operate. Mr. Wickman will consult with Callan Associates regarding possible options and report back to the Committee.

2. Investment Risk Metrics
Present and discuss different metrics used to assess investment risk.

Trustee Gladstern introduced Kevin Dunne, Callan Associates investment consultant, who provided an educational review on assessing investment risk. Mr. Dunne stated that determining asset allocation drives 93% of portfolio variability of return over the long run, based on published research. For this reason, Callan Associates devotes considerable time to asset allocation.

Risk mitigation includes manager structure oversight by performing due diligence as to consistency of style, process, and positioning. Other risk measures include disciplined diversification and rebalancing, with allowance for holding longer during favorable trends. Also, investments must be managed based on the liquidity needs of the Plan. For example, the relative illiquidity of private equity dictates that no additional allocation to that space beyond the current target is warranted, according to Mr. Dunne.

Recent concerns have arisen with regard to short term cash, which Mr. Dunne has discussed with the Retirement Administrator. In particular, the Short Term Investment Fund (STIF) at State Street is highly exposed to non-secured issues outside the U.S. Therefore, Callan Associates recommends reducing risk and giving up some yield by moving to the U.S. Treasury STIF. For further discussion of this matter, see **Agenda Item B.2.i** below.

Mr. Dunne also discussed the cash management feature of the Clifton futures overlay program, which mitigates cash drag by equitizing portfolio cash on a daily basis. Another program involving risk is the securities lending program, which assumes counter-party risk to gain incremental yield. Based on recent discussions evolving from Callan's recent education presentation on securities lending, the program is under review. Risk associated with leverage, commonly used in absolute return assets, is assessed by considering whether it is prudently applied across market cycles.

Mr. Dunne explained that Callan's annual standard deviation analysis is the same as a value-at-risk (VaR) calculation, and can be built into existing reports for shorter time frames as preferred. He added that all statistical analysis relies on historical data or projections. Based on the current portfolio, he stated that Callan is not recommending adding risk to the portfolio at this time.

On a quarterly basis the asset allocations are analyzed for potential policy risk, for example, in under- or over-weight positions. Attribution of return to the manager or class is reported regularly by Callan. Returns relative to the policy index over the past five years vary by 2%, but have matched the index over longer time frames, showing that asset allocation drives returns, according to Mr. Dunne.

Asset allocation performance is monitored by the quarterly review of rolling three-year standard deviations from Public Fund peers, which shows that MCERA volatility is relatively higher than peers. Trustee Brenk asked if risk could be assessed by analyzing the historical returns, but Mr. Dunne does not recommend this approach. Further portfolio dissection includes style matrices comparing the MCERA equity portfolio to a global benchmark according to equity capitalization and value-growth orientation. Sector allocations and global regional allocations are also compared, showing that the Fund is overweight to U.S. equities (52.2% versus 42.4%) compared to the global benchmark. Further analysis of U.S. equity holdings as to capitalization and value-growth orientation was presented compared to the Russell 3000 Index. A similar analysis was presented for international equity holdings.

In summary, the investment consultant stated that diversification and determination of asset allocation are the keys to risk management. Callan Associates will modify investment reports to include risk measures as the Board prefers.

Based on discussions, Chair Bolger directed deliberations to **Agenda Item B.2.i**.

B. OLD BUSINESS

2. Quarterly Checklist

   Consider, review and updates on the following:

   i. Other items from the Retirement Administrator related to risk and finance

      In line with Mr. Dunne's comments about MCERA's Short-Term Investment Fund (STIF), Mr. Wickman reiterated the risk in the current STIF holdings. Because the risk is significant and outweighs the return, and because of the time-sensitivity of the issue, the Retirement Administrator, based on the advice of the investment consultant, Callan Associates, recommended that the Committee take action to direct him to transfer the STIF account to the lower-yielding but safer U.S. Government STIF fund immediately. Mr. Dunne stated that Callan Associates supports the Administrator's recommendation based on the high risk of holding sovereign debt. Chair Bolger supported the proposed Committee action on the matter, and noted that any such action would need to be ratified by the Board at its October meeting.

It was M/S Webb/Brenk to direct the Retirement Administrator to move the STIF fund from the regular fund to the U.S. Government Short-Term Investment Fund as soon as practicable. The motion was approved by unanimous vote.

Chair Bolger directed discussions to **Agenda Item B.1**.

1. Administrative Budget FY 2010/11 Review
   Consider and review final prior fiscal year's budget.

   At the request of Chair Bolger, Senior Accountant Lisa Jackson reviewed and explained reasons for variations in the budget from budgeted amounts.

   Conference and training expenses include fees charged for attendance, according to Ms. Jackson. Ms. Gladstern discussed these expenses, and inquired about the variance from the budget for depreciation expense. Ms. Jackson explained that the variation arose due to the delayed CPAS implementation, since CPAS expenses cannot be depreciated until the project goes live.

   Staffing expenses were examined, with Mr. Wickman stating that the extra hire expenditures will be reduced due to the transition of most positions, including that of the Assistant Retirement Administrator, to permanent positions. A small amount of extra hire will remain in the budget to allow for flexibility, he said. Trustee Brenk inquired about the increase in overhead for benefits. This area was under-budgeted, according to Mr. Wickman, because the factor used to calculate benefit costs had not been adjusted to reflect increased costs.

   The Chair discussed County overhead with Trustee Given, who said that the County is working to update cost-applied values. Trustee Gladstern expects reduction in overhead for the County when MCERA assumes the retiree payroll.

   Mr. Given commended the accountant for the structure of the budget, and requested that future changes to the budget be separate going forward.

   Based on discussions, the Committee accepted the Fiscal Year 2010/11 budget.

Agenda Item B.2, **Quarterly Checklist**, continued.

a. MCERA travel and event related expenses

   Upon a review of travel expenses, Chair Bolger and Trustee Gladstern found trustee and staff expenses to be reasonable, observing that the conferences are worthwhile and educational. For consultants, however, the Chair indicated a concern about expenditures for hotel reservations at SACRS conferences. A discussion followed about the extent to which consultants to MCERA participate and should be paid to attend conferences, followed by Trustee Given's suggestion to clarify the Travel

Expense Policy on this point. Administrator Wickman will review the individual consultant contracts to ensure appropriate contract language regarding the reimbursement of expenses. The Administrator will seek reimbursement from the consultants for the SACRS hotel reservations that were charged to MCERA.

b. Other expenses per Checklist guidelines

Upon review, the Committee found credit card statements to be reasonable. Chair Bolger received assurance from Mr. Wickman that dinner expenses did not include alcoholic beverages.

c. Variances in the MCERA administrative budget in excess of 10%

The Chair determined to consider the item at the next Committee meeting.

d. Reconciliation of MCERA administrative accounts

Trustee Given stated that there are assignments to clear certain administrative accounts of stale-dated checks, for example, and he will develop a detailed reconciliation over the course of the next several months. Counsel Dunning advised that Trustee Given may provide the information to the Committee based on his status as Director of Finance for the County.

e. Vendor services provided to MCERA

Mr. Wickman reported that, in addition to normal consulting services, SF Sentry and Alliance Resources were engaged, by action of the Board, for system risk studies and recruiting services, respectively.

Chair Bolger provided for Committee members a review of the nature of directed brokerage, which takes place when an investment manager directs a stock transaction to a particular broker, who may then rebate a portion of the fee back to the manager. The question, she said, becomes whether the manager receives best execution.

Mr. Wickman reported that MCERA has an agreement with Knight Capital to provide commission recapture services for MCERA. Mr. Wickman stated that his review shows that MCERA has a historical practice of engaging in commission recapture. The Chair asked counsel to determine if directed brokerage activity is appropriate. Trustees Brenk, Given, and Gladstern advised that a prudent course of action is to review the history of the program to determine whether it was authorized by the Board. Chair Bolger agreed that Mr. Wickman would review the subject with Counsel Dunning and bring it before the Committee to initiate the process of either ratifying or discontinuing the program.

f. MCERA staffing status

Mr. Wickman stated that progress is being made on the position changes approved in the Fiscal Year 2011/2012 budget.

g. Internal controls, compliance activities and capital calls

Chair Bolger reviewed capital calls to the Committee's satisfaction.

h. Audits, examinations, investigations or inquiries from governmental agencies

The external auditors are reviewing the recent audit.

i. See above.

j. Form 700 summary submittal

Counsel Dunning presented an annual summary of Form 700 reporting for the Committee's review. She noted that consultants who serve MCERA over a long period of time in the role of a staff member who would be required to file the Form 700 also are required to file the Form. Chair Bolger discussed the resolution of conflicts, if they are found, with counsel, and she emphasized the importance of timely reporting of the Forms.

There being no further business, Chair Bolger adjourned the meeting at 1:24 P.M.

______________________________ ____________________________________

Bernadette Bolger, Chair Attest: Jeff Wickman, Retirement Administrator