

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

August 23, 2012 – 9 A.M.

CALL TO ORDER Chair Bolger called the meeting to order at 9:00 A.M.

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

ABSENT: Cooper

MINUTES

It was M/S Richardson/Brenk to approve the May 17, 2012, Finance and Risk Management Committee Meeting Minutes as submitted. The motion was approved by unanimous vote.

In response to the Chair's inquiry, Retirement Administrator Wickman stated that side letter agreements regarding fiduciary acknowledgements may be preferable for mutual funds due to the potential for increased fees associated with moving to separate accounts. The matter will be addressed at a future Investment Committee meeting.

A. OPEN TIME FOR PUBLIC EXPRESSION

No public comment.

B. OLD BUSINESS

1. Administrative Budget FY 2011/12 Quarterly Review

Consider and review budget for quarter ending June 30, 2012

Mr. Wickman presented the administrative budget through June 30, 2012, and addressed items of note. He discussed the Interdepartmental charges noting that he will continue to monitor the charges although he is hopeful that they will level out on an annual basis. In response to Trustee Webb's inquiry, Mr. Wickman indicated that depending on the size and significance of the pension reform initiatives from the legislative process, MCERA could have additional expenses in the fiscal year to implement the changes into the new benefit management system.

Mr. Wickman addressed non-administrative budget items such as retiree payroll that increased from last quarter as a result of the April 1st COLA. In response to Trustee

Brenk's inquiry, Mr. Wickman said that the pace of retirements has not dramatically increased as workers remain in the work force due to the weak economy.

Other non-administrative items reviewed by Mr. Wickman included refunds of contributions (which include corrections for overpayments by employees with over 30 years of service), a one-time final payment to Linea upon the successful implementation of the new benefit system, payment to SF Sentry for system risk analysis, and foreign taxes. Manatt, Phelps, & Phillips provided interim support for investment matters and legal expertise on proposed pension legislation that supports informed debate.

Chair Bolger directed deliberations to **Agenda Item C.1.**

C. NEW BUSINESS

1. Corporate Governance Presentation – William McGrew, CalPERS
Education session on corporate governance issues

Mr. Wickman introduced Bill McGrew, a Portfolio Manager who manages corporate governance matters for CalPERS. Mr. McGrew traced the growing influence and scope of the corporate governance sphere at CalPERS as it evolved from a legal focus to an operating unit under the Chief Investment Officer in November of 2011. Early activities on proxy voting and reacting to anti-takeover actions expanded to shareholder rights, engaging underperforming companies, and building investor coalitions. Current issues include financial market reform, environmental-social-governance (ESG) matters, board diversity, and corporate engagement.

Trustee Given joined the meeting at 9:43 a.m.

Mr. McGrew reviewed the CalPERS proxy voting process which is managed with a web-based proxy voting platform. Items that are inconsistent with the organization's "global principles" are flagged for review by the proxy team and/or the Board. Quarterly proxy reports are part of the compliance process.

As a result of MCERA's size, Mr. McGrew recommended initiating a corporate governance process by using CII guidelines to assess annual proxy voting reports. Inquiring about investment managers' proxy voting guidelines communicates the importance of the matter. Additional steps may include developing global principles for managers to follow. In response to Trustee Gladstern's inquiry, he recommended the use of a clause that gives the right to ask for an explanation of how proxies are voted and why.

Mr. McGrew addressed five work streams of principles and proxy voting, corporate engagement, financial market reform, ESG integration, and institutional relations. Approaches include engagement with legislators to achieve reasonable financial market reforms and encouraging a cohesive corporate governance message to enhance institutional relations.

Chair Bolger recessed the meeting for a break at 10:23 A.M., reconvening at 10:27 A.M.

2. System Risk Quarterly Review – SF Sentry

a. Presentation and discussion of preliminary system risk analysis

SF Sentry representative David Hansen presented the preliminary system risk studies for the quarter ending June 30, 2012. Market conditions at that time, he stated, included a relatively low VIX level following an end-of-quarter market rally. Mr. Hansen introduced Tim Holmes who reported that cash positions on a month-to-month basis are stable. He attributed the relatively high cash level in the Wellington portfolio to duration management. Trustee Bolger observed that RCM's cash position is relatively high.

The private equity portfolio capital commitment is \$100 million for each of two managers, of which approximately one-third is deployed. As the portfolios mature, a sector analysis will become more meaningful. According to Mr. Hansen, the lower-than-expected pace of capital calls is a worldwide phenomenon.

Mr. Hansen presented an overview of the VIX. He stated that the VIX is a forward-looking view of future price activity that is driven largely by purchases of puts by "portfolio insurers." Mr. Hansen views the rate of change of the VIX as a useful indicator. In response to Trustee Given's inquiry, Scott White explained that the VIX serves as a point of reference for the purpose of hedging downside risk.

Mr. White of SF Sentry reported that the Value at Risk (VaR) remains lower than end-of-2011 levels, although it increased from March to June due to May market volatility. By manager, the S&P 500 Index Fund was the single largest contributor to risk in the overall portfolio due mainly to its relatively large allocation.

Mr. Hansen stated that equities are within reasonable limits with no material change from the prior quarter. Top ten holdings include Merck as a new addition and Apple which represents the largest position.

Mr. Holmes reported on fixed income allocations and interest rate sensitivity. Yields remain relatively low due in part to the run in corporate securities, he said. Trustee Richardson commented on the potential impact on corporate credit of trimmed mortgage activity for Fannie Mae and Freddie Mac.

Trustee Brenk posed the option of annual rather than quarterly risk studies. In response, Mr. Hansen stated that quarterly reviews help to avoid surprises and Mr. White spoke to the value of more data points.

b. Review of collateral investments in securities lending program

Mr. Holmes reviewed the securities lending collateral pools, which he said are diversified with relatively low risk and reasonable yields. The longer duration pool is

composed of asset-backed securities that do not trade over exchanges but are attractive in a tradable market and are usually held to maturity.

Chair Bolger expressed concern about the longer duration pool and the fact that subsequent to large investors pulling out in 2008 it has been closed. Trustee Richardson, adding that one maturity in that pool was extended to 30 years, recommended exiting from the pool. Trustee Given agreed as he believes the situation is unlikely to improve. In response, Mr. Holmes pointed out that liquidity has improved since 2008 and the weighted average life is only 4 years.

Based on discussions, Trustee Bolger appointed Trustees Richardson, Brenk, and herself to an ad hoc committee to consider the matter.

3. **SF Sentry Contract Renewal (Action)**

Consider and possibly recommend to Board renewal of contract with SF Sentry

Mr. Wickman presented a memo outlining the one-year contract with SF Sentry for system risk studies that expires October 12, 2012. He discussed the items to be addressed in the event the agreement is extended. Chair Bolger spoke favorably about the program and she encouraged discussion on whether it should be continued.

Trustee Gladstern indicated that she sees value in the system risk presentations after having initial doubts. Trustee Brenk stated that the risk studies aid in understanding the portfolio, although related action is unclear. Trustees Given and Stevens expressed concern about the expense. Trustee Richardson spoke to the value of an independent analysis of the Fund and recommended continuing the system risk studies under the purview of the Investment Committee. In response to Trustee Webb's question on whether the analysis would lead to action for a market-changing event, Trustee Richardson remarked that being able to act on an outlier event is valuable to the fund.

Chair Bolger stated that the system risk analysis offers value and points of discussion during investment manager portfolio reviews, and she recommended continuing the program.

Results of a sentiment vote called for by the Chair regarding renewing the SF Sentry contract follow:

- AYES: Bolger, Brenk, Richardson, Webb
- NOES: Given, Gladstern, Stevens

Consideration of the matter continued, with Trustee Stevens posing the option of hiring a Chief Investment Officer (CIO) as a better use of funds. In response, Mr. Wickman discussed the challenges to establishing and recruiting an executive CIO. He recommended continuing with the system risk studies, recalling that their purpose is to be able to evaluate how investment managers are managing the portfolios.

Trustee Brenk questioned whether a loss to the Fund due to a market disturbance could be prevented by the system risk studies, and he recommended semi-annual or annual reviews instead of quarterly. Trustee Given recommended a cost analysis based on other service providers as well as a presentation by SF Sentry to the Investment Committee prior to taking action on a new contract.

It was M/S Given/Gladstern to recommend that the Investment Committee at its September 20 meeting consider, subsequent to a presentation by SF Sentry of today's system risk analysis, whether to renew the SF Sentry contract. The motion was approved by unanimous vote.

4. Fiduciary Liability Insurance Renewal (Action)

Consider and review options regarding renewal of fiduciary liability insurance

Mr. Wickman presented a memo outlining provisions of the current fiduciary liability insurance policy with Chartis which expires in October 2012. He stated that current terms are favorable to MCERA and therefore repeating last year's process of comparing multiple bids was not needed. Trustee Brenk commented that he is comfortable with renewing the current policy based on the review and analysis accomplished last year.

Counsel Dunning provided a review of key elements of fiduciary liability insurance, one of which is to identify pending claims against the system. Items excluded from coverage were also reviewed. Ms. Dunning referred to the insurance as one component of the Board's risk management.

It was M/S Richardson/Webb to recommend to the Board approval of a renewal of the fiduciary liability insurance policy with Chartis. The motion was approved by unanimous vote.

Chair Bolger directed deliberations to **Agenda Item B.2.**

2. Quarterly Checklist

Consider, review and updates on the following:

a. MCERA travel and event related expenses

Mr. Wickman reviewed travel and educational expenses for items such as CalAPRS, CII and SACRS conferences.

b. Other expenses per Checklist guidelines

Credit card transactions that included the new mobile microphone for recording Committee meetings were reviewed.

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

See Agenda Item B.1 above.

d. Reconciliation of MCERA administrative accounts

Director of Finance Given and Mr. Wickman met to plan a systematic process to review the past six years of administrative accounts to resolve outstanding issues.

e. Vendor services provided to MCERA

New vendor Milliman was hired to conduct the actuarial audit.

f. MCERA staffing status

No discussion.

g. Internal controls, compliance activities and capital calls

Mr. Wickman stated that internal controls for check processing are being addressed in response to the auditor's inquiry.

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

The actuarial audit is underway. The Notes to Financial Statements will be reviewed by the ad hoc Financial Statement Notes Committee based on comments from the actuary, investment consultant, and attorney.

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

The ad hoc IRS Compliance Committee will meet to discuss information received from Ice Miller.

There being no further business, Chair Bolger adjourned the meeting at 1:02 P.M.

Bernadette Bolger, Chair

Attest: Jeff Wickman, Retirement Administrator