



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

Ronald D. Suter, 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

Keith DeVore  
Elected by Miscellaneous Members

Winston Hickox  
Appointed by the Board of Supervisors

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

Steven Soto  
Elected by Safety Members

## MINUTES

### RETIREMENT BOARD MEETING, JULY 20, 2006

The regular 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 July 20, 2006, at 1:04 p.m.

#### OPEN SESSION:

##### ADMINISTRATIVE MATTERS:

1. Board President James A. Diepenbrock requested that Chief Executive Officer Richard Stensrud preside over the election of SCERS Board Officers for the 2006-2007 Fiscal Year. Mr. Stensrud noted that in accordance with SCERS' By-Laws, SCERS Board Officers for the new fiscal year are elected at the July Board Meeting and invited nominations. Motion by Mr. Hickox to elect Mr. Diepenbrock as President, Mr. DeVore as 1<sup>st</sup> Vice-President, and Mr. Kelly as 2<sup>nd</sup> Vice President; Seconded by Mr. Cox. Motion carried (7-0).

##### PUBLIC COMMENT:

2. Mr. Stensrud introduced SCERS' new General Counsel, James G. Line.

##### MINUTES:

3. Motion by Mr. Kelly to approve the Minutes of the June 15, 2006 regular meeting, amended to note that Mr. Irish was not present; Seconded by Mr. Johnson. Motion carried (7-0).

**CLOSED SESSION:**

**DISABILITY MATTERS:**

4. BARWIS, Maria T.: Action was taken on the Application for Disability Retirement as indicated per attached confidential memorandum from the Chief Benefits Officer dated July 31, 2006.
5. HANSON, Teresa: Action was taken on the Application for Disability Retirement as indicated per attached confidential memorandum from the Chief Benefits Officer dated July 27, 2006.
6. HARRIS-SHEPPARD, Wanda: Action was taken on the Application for Disability Retirement as indicated per attached confidential memorandum from the Chief Benefits Officer dated July 27, 2006.

**SIGNIFICANT EXPOSURE TO LITIGATION [Government Code Section 54956.9(a)]:**

7. Matter was considered.

**OPEN SESSION:**

**ADMINISTRATIVE MATTERS:**

8. Chief Executive Officer Richard Stensrud provided a brief report on miscellaneous system and staff activities. No action was requested or taken.
9. Chief Operations Officer Kathryn Regalia presented a request by the County of Sacramento to pre-pay its employer retirement contributions for Fiscal Year 2006-2007 and a request for approval of the year-end reconciliation for Fiscal Year 2005-2006. Ms. Regalia noted that the amount of the proposed pre-payment had been reviewed and approved by SCERS' actuary, The Segal Company. Motion by Mr. Johnson to accept the County's pre-payment of employer retirement contributions for Fiscal Year 2006-2007 and to approve the Fiscal Year 2005-2006 year-end reconciliation; Seconded by Mr. Suter. Motion carried (8-0).
10. Chief Operations Officer Kathryn Regalia presented a request by the Sacramento Metropolitan Fire District (SacMetro) to pre-pay the employer's portion of SacMetro's retirement contribution for Fiscal Year 2006-2007. Ms. Regalia noted that the proposed pre-payment amount had been determined by SCERS' actuary, The Segal Company. Motion by Mr. Kelly to accept the pre-payment; Seconded by Mr. Suter. Motion carried (8-0).

**OPEN SESSION:**

**ADMINISTRATIVE MATTERS: (Continued)**

11. Chief Executive Officer Richard Stensrud reported that The Segal Company had recommended a 3.49% interest crediting rate for SCERS' reserves as of June 30, 2006. Mr. Stensrud noted that the recommended interest crediting rate fell short of the target six month crediting rate of 3.875%, and that the overall 7.10% interest crediting rate for the fiscal year fell short of the annual target crediting rate of 7.75%. Mr. Stensrud explained that the below-target interest crediting was due to the ongoing phase-in of investment losses from previous years through the five-year smoothing technique utilized by SCERS, which had pulled down the otherwise strong investment performance for the year. Mr. Stensrud noted, however, that deferred gains now exceeded deferred losses in the smoothing process, with the result that if investment performance remained stable SCERS should be able to meet its interest crediting goals in the near future.
  
12. Chief Executive Officer Richard Stensrud facilitated a discussion by the Board regarding possible components of an interest crediting and excess earnings policy. Mr. Stensrud explained that an interest crediting and excess earnings policy was, in essence, a statement of the Board's goals and priorities with respect to funding the retirement system. Mr. Stensrud noted that the Board had previously heard an educational presentation and had discussions regarding issues related to an interest crediting and excess earnings policy. Mr. Stensrud explained that the purpose of the present discussion was to identify the concepts the Board would like to see incorporated in such a policy, and then to bring a proposed policy to the Board in August or September for formal consideration.

The first area of discussion was whether all the SCERS reserves should have interest credited at the same rate or whether there were reasons why a particular reserve or reserves should have a different interest crediting rate. Mr. Stensrud noted that this question had become relevant given the recent period of poor investment performance that had resulted in an inability of retirement systems, including SCERS, to meet target interest crediting goals. Mr. Stensrud noted that unlike the other reserves, funds in the employee contribution reserve can be withdrawn from the system if the employee terminates employment. Mr. Stensrud noted that retirement systems were asking themselves whether, given that there might be insufficient earnings to keep the system on track with its funding goals, it should be a higher priority to credit more interest to the reserves that will fund the bulk of the ultimate retirement benefit rather than giving interest to reserves that can leave the system. Mr. Stensrud further suggested that the Board should consider whether adopting a different crediting rate for employee contributions would make a sufficient difference in the system's funding to offset a claim that the differential treatment was unfair.

Extensive discussion followed including: (1) It was noted that the purpose of the system is to fund a retirement benefit, not to serve as a savings account, but given that the employee's contributions can be withdrawn (much like a savings account), perhaps the interest crediting

**OPEN SESSION:**

**ADMINISTRATIVE MATTERS: (Continued)**

on the employee contribution reserve should be more aligned with savings deposit rates; (2) A decision to credit any valuation reserve at less than the assumed earnings rate means that the system falls behind its funding schedule unless the funds not applied to that reserve are applied to some other reserve or reserves; (3) Although the ultimate retirement benefit is not affected if a lower interest rate is used for employee contribution reserves, the balance in the employee's contribution account also represents the amount that may be paid as a lump sum in the event of an active employee's death (e.g., to a non-spouse beneficiary) and thus a lower interest crediting rate for employee contributions would result in a smaller payment in such cases; and (4) Such payments are made about five to ten times a year, but if SCERS were to credit interest to employee contributions at one-half of the assumed earnings rate rather than the full earnings rate, the plan would pay out approximately \$150,000 less per year in withdrawals. In addition, discussion took place regarding the practice in other systems, including the alternative benchmarks used by other systems for crediting interest to employee contributions.

After considering the various factors, it was the consensus of the Board that a lower crediting rate for the employee contribution reserve, with the difference being applied to the other reserves, would result in a meaningful improvement in the plan's funded status, and that this outweighed the lower payout to former employees who withdraw their funds. Accordingly, the Board requested that this concept be incorporated in the proposed interest crediting and excess earnings policy brought to them for consideration.

The second area of discussion was the relative priority of funding the core, vested retirement benefits versus funding supplemental, non-vested benefits such as subsidies for retiree health care. Mr. Stensrud noted that reserves for supplemental, non-vested benefits are not included in the asset base utilized for determining the funded status of the system and thus not included when calculating the contribution rates necessary to maintain a solid funded status. Mr. Stensrud noted that in an environment where it can be difficult to meet the target crediting rate, and where the cost of the core, vested retirement benefits had increased substantially, the Board should consider whether available earnings should be applied to non-vested benefits if it resulted in higher costs for the employer with respect to the vested benefits. Mr. Stensrud further suggested that in considering the question the Board should also bear in mind that supplemental benefits are often the only vehicle retirees have for addressing needs not covered through cost-of-living adjustments.

Extensive discussion followed, including: (1) The relative priority of funding vested versus non-vested benefits; (2) The relative priority of establishing adequate contingency reserves; (3) Whether there should be threshold requirements regarding the plan's funded status before funding is provided for non-vested benefits; (4) The extent to which the SCERS Board should be 'adopting' benefits as opposed to administering benefits adopted by the plan

**OPEN SESSION:**

**ADMINISTRATIVE MATTERS: (Continued)**

sponsor; and (5) The uncertain nature of non-vested benefits and the impact on retirees if such benefits have to be suspended because of insufficient funding.

After considering the various factors, it was the consensus of the Board that funding the vested benefits and appropriate contingency reserves were higher priorities than funding non-vested benefits. It was the further consensus of the Board that its primary duty was to responsibly administer the benefits adopted by the plan sponsor and that funding of non-vested benefits should only be considered if the retirement system was more than fully funded and had established substantial contingency reserves. The Board requested that these concepts be incorporated in the proposed interest crediting and excess earnings policy brought to them for consideration.

The next area of discussion was the appropriate level of contingency reserves and the relative priority of establishing such reserves versus addressing earnings deficiencies from previous years. Mr. Stensrud noted that the 1937 Act recognizes the importance of maintaining contingency reserves in order to offset future earnings deficiencies and unexpected increases in cost. Mr. Stensrud noted that SCERS had utilized annual excess earnings during periods of strong investment performance to establish substantial contingency reserves, and that such reserves had a meaningful impact on mitigating subsequent earnings shortfalls and unexpected costs. Accordingly, Mr. Stensrud suggested that the Board may want to consider establishing a goal of building the contingency reserves to 3% or more of plan assets. Mr. Stensrud further noted, however, that one difficulty in establishing substantial contingency reserves was that such reserves are outside of the actuarial asset base and thus not counted by the actuary in determining the plan's funded status and setting the contribution rates. Mr. Stensrud suggested that the Board should consider the priority and manner of funding the contingency reserves relative to the goal of immediately applying such funds to address earnings deficiencies from past years.

Substantial discussion followed, including: (1) The relative priority of establishing substantial contingency reserves versus addressing earnings deficiencies from past years; (2) Whether one goal should be fully achieved before funding is applied toward the second goal, or whether available funding should be applied to pursue both goals simultaneously; and (3) Consideration of various models for allocating available funds in pursuit of the two goals.

Mr. Stensrud was asked if he had any information regarding the County's views on the subject. Mr. Stensrud reported that he had consulted with County Chief Financial Officer Geoff Davey, and that Mr. Davey had advised him that the County would encourage the Board to consider the two goals as co-equal priorities.

**OPEN SESSION:**

**INVESTMENT MATTERS:**

Further discussion followed, and after consideration of the various factors, it was the consensus of the Board that establishing substantial contingency reserves and remedying past earnings deficiencies were co-equal goals. The Board requested that this concept be incorporated in the proposed interest crediting and excess earnings policy brought to them for consideration.

No formal action was requested or taken.

13. Tom Lightvoet of Mercer Investment Consulting and Chief Investment Officer Jeffrey States provided an overview of the U.S. Equity Large Cap Growth manager search process and the three firms that had been selected to make presentations at the meeting.

Following the remarks, presentations were made by the following firms: (1) INTECH represented by Betsy Flavin, Vice President and Russell Bjorkman, Vice President, Portfolio Management Group; (2) T. Rowe Price represented by L. Kenneth Brooks, Institutional Sales Executive and Robert W. Smith, Portfolio Manager; and (3) Wells Capital Management represented by Thomas Harrison, Managing Director and Thomas Pence, Managing Director and Senior Portfolio Manager.

The investment firms presented information regarding the respective history of their organizations; the background and experience of their investment staff; their investment process and why it would add value over the benchmark Russell 1000 Value Growth Index; and performance. Questions were asked of the presenters about various aspects of their presentations.

The presentation materials were received and filed on a motion by Mr. Woods; Seconded by Mr. Irish. Motion carried (8-0).

14. Extensive discussion followed regarding the three large cap growth manager candidates, including consideration of: (1) The key differences between the three firms; (2) Quantitative vs. fundamental investment processes; (3) The size of the investment organizations; (4) Research capabilities; (5) Methods for trading the stocks to execute the strategy; (6) Their performance over extended periods; and (7) The risk/return characteristics of each firm.

A motion was made by Mr. Woods to engage INTECH; Seconded by Mr. Hickox. Motion carried (8-0). A motion was then made by Mr. Woods to authorize the Chief Investment Officer to engage a transitions manager to transfer the assets to the new manager; Seconded by Mr. Hickox. Motion carried (8-0).

**INVESTMENT MATTERS: (Continued)**

15. Chief Investment Officer Jeffrey States presented the Quarterly Asset Allocation and Portfolio Rebalancing Report for the Quarter Ended June 30, 2006. The Report was received and filed on a motion by Mr. Irish; Seconded by Mr. Kelly. Motion carried (8-0).
16. Chief Investment Officer Jeffrey States presented the R.V. Kuhns Customized Public Funds Universe Report for the period ended December 31, 2005. Mr. States outlined key elements in the report, including how SCERS' investment performance compared to its peers. The report was received and filed on a Motion by Mr. Woods; Seconded by Mr. Kelly. Motion carried (8-0).
17. Chief Investment Officer Jeffrey States presented a draft of proposed changes to SCERS' Investment Policy and Objectives. Mr. States noted that the Investment Policy needed to be reviewed and updated to address various changes in investment strategy; permissible investments; investment benchmarks; new Governmental Accounting Standards Board (GASB) requirements; modifications to the investment management agreement; investment manager reporting requirements; and the authority to take action in emergency situations. Discussion followed regarding various aspects of the proposed changes. Mr. States reported that he would incorporate the Board's comments into the proposed changes and would return with formal amendments for the Board to consider.

No action was requested or taken.

18. Chief Investment Officer Jeffrey States presented the Monthly Investment Management Compliance and Activity Report for June 2006. The Report was received and files on a Motion by Mr. Woods; Seconded by Mr. Kelly. Motion carried (7-0).

The meeting was adjourned at 4:45 p.m.

**MEMBERS PRESENT:** James A. Diepenbrock; William Cox; Keith DeVore; Winston Hickox; Dave Irish; William D. Johnson; John B. Kelly; Ronald Suter (arrived at 1:20 p.m.); and Robert Woods (arrived at 1:12 p.m.).

**MEMBERS ABSENT:** Steven Soto and 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; Diana Ruiz, Deputy County Counsel; Tom Lightvoet and Allison Yager of Mercer Investment Consulting; Russell Bjorkman and Betsy Flavin of INTECH; L. Kenneth Brooks and Robert W. Smith of T. Rowe Price; Thomas J. Pence and Thomas A. Harrison of Wells Capital Management; Thuyet Ziyalan, Investment Accountant; and Michele Raymond, Senior Office Assistant.

Respectfully submitted,

SACRAMENTO COUNTY EMPLOYEES'  
RETIREMENT SYSTEM

Richard Stensrud  
Chief Executive Officer

APPROVED: \_\_\_\_\_  
James A. Diepenbrock, President

DATE: \_\_\_\_\_

cc: Retirement Board (11); Clerk, Board of Supervisors (6); County Counsel (2); County Executive (2); County Employment Records & Training; County Employment Services & Risk Management (2); County Labor Relations; Employee Organizations (21); Sacramento County Retired Employees' Association; SCERS Member Districts (11); Amervest Company, Inc. (2); Dickstein & Merin; and The Sacramento Bee.