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TO: Participants in the Sacramento County Employees' Retirement System

FROM: Richard Stensrud
SCERS Chief Executive Officer

DATE: February 25, 2009

**RE: Important Information Regarding SCERS' Investment in
Westridge Capital Management and WG Trading Company**

Late in the evening of February 12th SCERS was informed that the National Futures Association (NFA), an agency responsible for regulating certain aspects of the futures markets, had taken action against certain individuals and certain investment entities, associated with a firm in which SCERS had invested retirement system assets – Westridge Capital Management (Westridge). The NFA action was prompted by the refusal of two of the principals in Westridge (Stephen Walsh and Paul Greenwood) to cooperate with the NFA's efforts to obtain information regarding the financial status of various entities under their control. This news was of particular concern to SCERS because one of those entities – WG Trading Company (WG Trading) – was managing some of the funds which SCERS had invested with Westridge.

Upon learning about these developments, SCERS took immediate action to protect the interests of the retirement system, including termination of the investment engagement with Westridge and WG Trading and the initiation of efforts to recover SCERS' funds. Through these efforts, SCERS has successfully recovered approximately \$5 million of its investment from the Westridge side of the investment strategy. However, since that time, SCERS and the numerous other investors in WG Trading – including several large public retirement systems – have had difficulty in determining the status of and gaining access to the funds held by WG Trading. In SCERS' case, this investment totals approximately \$52 million. Based on preliminary information, it appears that there may be a substantial amount of assets available in the WG Trading fund to re-pay investors, but without further information it has been impossible to determine if that is in fact the case.

Important Information Regarding SCERS' Investment in
Westridge Capital Management and WG Trading Company
February 25, 2009
Page 2

Today, February 25th, it was announced that Federal authorities have filed criminal securities fraud charges against Walsh and Greenwood and frozen their personal assets and the assets of any entities or funds they control. In addition, the Commodities Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) have launched investigations to determine the status of the various funds managed by Walsh and Greenwood, including WG Trading, and have taken control of those funds for the purpose of gathering the available assets and ultimately repaying the investors.

SCERS is pleased that the Federal authorities have taken strong action in this matter. We believe this will increase the likelihood that funds will be recovered and that SCERS and other affected investors will be repaid some or all of the funds we invested. SCERS will be working closely with the Federal authorities and other investors to achieve this result. At the same time, SCERS will continue to actively and aggressively pursue recovery of our funds from all possible sources and will initiate our own litigation if necessary.

While the allegations against Walsh and Greenwood are very serious and the evidence appears damning, it is important to remember that it has not been proven that they have done anything illegal or improper. As noted above, based on the information SCERS has been able to obtain regarding the status of the WG Trading fund, it appears that there are substantial assets in the fund. It may also turn out that there are other assets that can be marshaled to pay investors. Accordingly, at this juncture, SCERS remains cautiously optimistic that we will be able to recover a meaningful amount of our investment.

That being said, SCERS takes this matter very seriously and understands the concerns that SCERS participants may have about the situation. With that in mind, I want to take a few moments to emphasize several key points with respect to this very unfortunate development. I also want to correct and clarify some information that has been reported about the situation.

The possible investment loss will have no impact on SCERS' benefit payments:

- Benefits will be paid when promised and in the amounts promised. SCERS continues to have substantial assets and a strong, positive cash flow. Your SCERS benefits remain secure.

The possible investment loss will not have a material impact on SCERS' investment portfolio:

- A possible negative investment result is never good news, and this is no exception. However, the potential loss in this case is relatively small, and not uncommon, when placed in the context of the day-to-day market experience associated with investing SCERS' \$4.5 billion portfolio, particularly given the investment market volatility of the last eighteen months. SCERS is deeply disturbed that this possible investment loss may be due to fraud, but in the end, a worst case scenario investment loss of 1% of the total portfolio will not have a significant impact on the overall soundness of SCERS' investment program.

Important Information Regarding SCERS' Investment in
Westridge Capital Management and WG Trading Company

February 25, 2009

Page 3

The possible investment loss will not have a material impact on the County's retirement costs:

- SCERS' investment performance plays an important role in the amount that SCERS' participating employers must contribute to the retirement system each year, but SCERS utilizes two widely-recognized actuarial practices to help control the impact of the financial markets on employer costs. First, rather than recognize investment experience all at once, SCERS phases-in investment experience – both good and bad – over a five-year period. This 'smoothing' helps reduce the impact of investment market volatility. Second, if investment performance falls short of expectations, the shortfall is paid off over time, much like a mortgage. This means that the impact of a bad period in the market can be paid off at a manageable rate.
- Together, the actuarial practices described above mean that the negative investment experience over the last eighteen months, including the possible losses in the current situation, will not cause an immediate increase in the employer's contribution costs. In fact, the employer costs for the 2009-2010 fiscal year will only increase by 0.5% (approximately \$1 million) over the costs for the 2008-2009 fiscal year. Please note this is well below the inaccurate \$5-15 million increase cited in some reports.
- This does not mean that there will be no cost impact from the extended period of substantial negative investment market experience. To the contrary, it will have to be dealt with. It does mean, however, that for SCERS, this impact will not begin to be felt until the 2010-2011 fiscal year. A potential positive development from this delay in the cost impact is that it could provide an opportunity for the current negative investment experience to be offset, at least in part, by the economic recovery that historically follows a substantial market downturn. As a committed long-term investor, SCERS' investment performance has always rebounded strongly during such periods.
- SCERS remains confident that over time our investment performance will continue to exceed the actuarial investment earnings assumption, adding value to the pension fund and thereby limiting, rather than adding to costs. In the end, this means that the possible losses associated with the current situation will be paid off by SCERS' investment program and not by the taxpayers.

SCERS' decision to make the investment in question was reasonable and prudent given the information available at the time:

- Westridge and WG Trading had been providing the investment product in the case at hand to institutional investors like SCERS since 1996. By all reports, the firms had a long track record of successfully meeting their investment objectives. The firms had a number of investors like SCERS, including other public retirement systems, who were happy with the performance of the firms.

Important Information Regarding SCERS' Investment in
Westridge Capital Management and WG Trading Company
February 25, 2009
Page 4

- SCERS' outside investment consultant performed a thorough review of Westridge and WG Trading and rated them highly.
- The investment strategy employed by Westridge and WG Trading offered diversification benefits relative to the other investment managers selected by SCERS to invest in the same segment of the market.
- Westridge and WG Trading had been subject to SEC and CFTC audits, review and oversight since 1996 with no indication of any problems.
- A nationally-recognized accounting firm had conducted annual audits of WG Trading and had noted no problems.

Prior to the announcement SCERS received from the futures industry regulatory entity, there was no evidence of any problems with WG Trading:

- From the inception of the investment in June 2008, SCERS received monthly statements from Westridge reporting on the holdings of both Westridge and WG Trading. Those statements indicated portfolio holdings and the value of those holdings consistent with the investment strategy of the firms and the overall market experience.
- Westridge raised no questions regarding the information provided to them by WG Trading. The principal in charge of the Westridge part of the investment strategy claims to have no knowledge that anything improper was being done on the WG Trading side and professes that he is as shocked by the allegations as the investors.
- No clients of the firm had reported any problems, including clients who had withdrawn funds.

In closing, I want to reiterate our profound disappointment and frustration regarding this situation. SCERS has taken pride in the fact that we have not been involved in any of the investment market fraud scandals up to this point, and we consider that to be indicative of the thoroughness of our commitment to the prudent oversight and management of the SCERS trust. The current situation illustrates, however, the difficulty that even the most careful investor has in identifying potential fraud if the perpetrators are committed to their task.

Contrary to the characterization in the media, SCERS' funds are not 'missing.' As previously noted, the preliminary information suggests that the fund holding our investment has assets and that at least some portion of our investment might be recovered. We will continue to vigorously work toward that end.

Respectfully,

Richard Stensrud
Chief Executive Officer