# VENTURA COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

# BOARD OF RETIREMENT

# BUSINESS MEETING

# JANUARY 26, 2009

## MINUTES

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| **DIRECTORS <u>PRESENT</u>:** | Tracy Towner, Chair, Safety Employee Member<br>William W. Wilson, Vice Chair, Public Member<br>Lawrence L. Matheney, Treasurer, Ex-officio Member<br>Albert G. Harris, Public Member<br>Joseph Henderson, Public Member<br>Karen Becker, General Employee Member<br>Robert Hansen, General Employee Member<br>Arthur E. Goulet, Retiree Member<br>Will Hoag, Alternate Retiree Member<br>Chris Johnston, Alternate Employee Member |
| **DIRECTORS <u>ABSENT</u>:** | Peter C. Foy, Public Member |
| **STAFF <u>PRESENT</u>:** | Tim Thonis, Retirement Administrator<br>Lori Nemiroff, Assistant County Counsel |
| **<u>PLACE</u>:** | Ventura County Employees' Retirement Association<br>Second Floor Boardroom<br>1190 South Victoria Avenue<br>Ventura, CA 93003 |
| **<u>TIME</u>:** | 9:00 a.m. |

**<u>ITEM</u>:**

**I. <u>INTRODUCTION OF MEETING</u>**

Chairman Towner called the Business Meeting of January 26, 2009 to order at 9:00 a.m.

## II. APPROVAL OF AGENDA

Mr. Matheney moved, seconded by Mr. Harris, to approve the agenda with a modification to hear Item VI.A. Old Business after Items VII.A. and VII.B. New Business.

Motion passed.

## III. APPROVAL OF MINUTES

A. Disability Meeting of January 5, 2009.

Mr. Henderson moved, seconded by Mr. Harris, to approve the Minutes for the Disability Meeting of January 5, 2009.

Motion passed. Mr. Matheney abstained.

## IV. CONSENT AGENDA

A. Regular and Deferred Retirements and Survivors Continuances for the Month of December 2008.

B. Statement of Plan Assets, Statement of Changes in Plan Net Assets, and Summary of Investments and Cash Equivalents for the Month Ended November 30, 2008.

C. Report of Checks Disbursed in December 2008.

D. Budget Summary for the Month Ended December 31, 2008, Fiscal-Year 2008-09.

E. Barclays Global Investors Report for the U.S. Equity Index Fund, Extended Equity Market Fund, U.S. Debt Index Fund, ACWI EX-US Fund for the Month Ended December 31, 2008.

Mr. Goulet moved, seconded by Mr. Matheney, to approve the Consent Agenda.

Motion passed.

## V. INVESTMENT INFORMATION

A. EnnisKnupp & Associates, Kevin Vandolder and Muzammil Waheed.

1. Monthly Investment Performance Update, December 2008.

2. Monthly Manager Updates/Summary, December 2008.

   a. Sprucegrove
   b. Capital Guardian
   c. GMO
   d. Acadian
   e. Western
   f. Reams
   g. Loomis Sayles

Kevin Vandolder, CFA, and Muzammil Waheed were present from Ennis Knupp & Associates.

Mr. Vandolder introduced Mr. Waheed who was assisting with the Asset/Liability presentation.

Mr. Vandolder began by reviewing VCERA's performance for the month of December. Mr. Vandolder noted the fund's positive performance during December on both an absolute and relative basis. For the month, VCERA's portfolio returned 3.3% relative to the policy portfolio's return of 3.0%. At month end, VCERA's portfolio was valued at $2.2 billion and was underweight in U.S. equity and overweight in fixed income and real estate when compared to policy allocations. Mr. Vandolder noted that later in the agenda the Board would be considering a proposal from The Clifton Group to rebalance the portfolio using futures contracts.

During the month the Western Index Plus portfolio, Capital Guardian and Acadian Asset Management outperformed their respective indices while Sprucegrove underperformed.

Mr. Vandolder discussed GMO's outperformance during the month of December and his attendance at a recent presentation made by GMO's CEO Jeremy Grantham. GMO is anticipating real returns in the S&P 500 over the next seven years to be approximately 7% which is a very bullish outlook. EnnisKnupp's recommendation is for clients to maintain their equity disciplines in order to take advantage of these types of opportunities.

## V. INVESTMENT INFORMATION (continued)

A. EnnisKnupp & Associates. (continued)

Mr. Vandolder informed the Board that at the February business meeting he would be discussing several "dislocation strategies" that would be designed to take advantage of current market valuations in specific asset classes. For example, AIG fixed income securities, which have the backing of the US government, and are yielding 12%.

Mr. Vandolder noted that the presented December results do not include real estate returns and to expect negative performance in this asset class. Mr. Vandolder also discussed the commentaries of Western, Reams and Artio.

3. VCERA Asset Liabilities Study – January 2009.

Mr. Waheed stated the Strategic Asset Liability Study was long term in nature, not tactical, and modeled VCERA's assets and liabilities over the next 15 years. The models used in completing the study were stochastic in nature and included "Monte Carlo" simulations. Mr. Waheed described the key takeaways from the study to include that VCERA's existing allocation of 73% to non-fixed income assets is reasonable. Mr. Waheed noted the recent downturn within the equity markets supported a higher allocation to equities; however, a substantial increase to the allocation was not warranted.

Mr. Matheney questioned the selection of a 15 year time horizon given the longer term nature of VCERA's liabilities.

Mr. Waheed responded that timeframes less than 15 years would be considered "tactical" in nature, while longer periods are difficult to model and there would be less confidence in the results.

Mr. Angelo stated that there was not a "bright line" for the appropriate time horizon in terms of these studies.

Mr. Waheed reviewed VCERA's current funding status as of the June 30, 2008 actuarial valuation and informed the Board that the study's starting point incorporates the current fiscal year actual asset return of -26% through November 30, 2008.

## V. INVESTMENT INFORMATION (continued)

A. EnnisKnupp & Associates. (continued)

Mr. Waheed described VCERA's liabilities to include the benefits already earned by members, future service with future pay, and future hires.

The investment results from the current asset liability study were more positive than the previous studies based upon higher nominal/arithmetic returns within the various equity allocations. The best estimate of VCERA's future return was 7.2%, with the expected actuarial assumption return of 8% being achieved 38% of the time. The returns described above included an estimate of inflation of 2.3%.

Mr. Waheed reviewed the forecasted range for employer contributions through 2022 under the various scenarios as well as the represented funding ratio for each year.

In summary, Mr. Waheed noted that the analysis continued to support a high level of equity exposure. Mr. Vandolder offered Treasury Inflation Protection Securities (TIPS) as inflationary protection for a portfolio with 73% of its assets deployed in "risky assets".

Mr. Wilson moved, seconded by Mr. Hansen, to continue allocating 73% of VCERA's total assets to assets exhibiting equity-like return characteristics.

Mr. Johnston stated in his view VCERA needed a better mixture of assets with more diversification within the 73% allocation.

Motion passed.

4. Securities Lending Discussion – January 2009.

5. Memorandum - Impact on Securities Lending Cash Collateral Pools.

Mr. Vandolder described the securities lending process noting the acceptance of the borrowers' collateral for the loaned security, the investment of the collateral and the goal to earn more on the invested collateral than returned to the borrower in the form of a rebate.

Mr. Vandolder noted the sizeable activity in 2008 within securities lending programs and the additional revenue earned by VCERA by participating in securities lending programs. VCERA participates in securities lending programs with State Street, BGI, and Sprucegrove.

## V. INVESTMENT INFORMATION (continued)

A. EnnisKnupp & Associates. (continued)

The current environment is very challenging according to Mr. Vandolder as several securities lending programs have suffered losses. Sprucegrove's program is one that has suffered losses.

Mr. Vandolder noted that State Street's program is emphasizing risk minimization rather than income maximization. EnnisKnupp supports this focus. Specifically the State Street security lending fund pool has been marked down on a marked to market basis but there have been no impairments within the pool. EnnisKnupp continues to support clients maintaining their securities lending programs.

Mr. Johnston questioned whether VCERA was hurting itself by loaning securities because of the contribution of securities lending programs to the increase in market volatility.

Mr. Matheney moved, seconded by Mr. Hansen, to receive and file the Securities Lending Discussion and Memorandum.

Motion passed.

6. Capital Markets Assumptions – January 2009 Update.

7. Article - EnnisKnupp Capital Markets Modeling Assumptions – Update January 2009.

Mr. Vandolder described the development of the return for US Stocks noting an inflation component of 2.3%, a dividend income component of 2.8% and a real growth in corporate earnings of 4.0% in support of a total expected return of 9.1%.

Mr. Matheney questioned EnnisKnupp's confidence in modeling the inflation factor of 2.3%. Mr. Vandolder responded that the model was developed in a similar manner as the variables in the asset liability study and EnnisKnupp would provide more information on the subject at the Board's February business meeting.

Mr. Harris moved, seconded by Mr. Hansen, to receive and file items V.1., 2., 6. and 7.

Motion passed.

## V. INVESTMENT INFORMATION (continued)

A. EnnisKnupp & Associates. (continued)

8. Proposal from The Clifton Group dated January 20, 2009, "Using Existing Overlay Program to Rebalance the Portfolio".

Mr. Vandolder noted that VCERA would need $60 million in additional equity exposure in order to return to target allocations. Given the challenges currently in the fixed income markets, EnnisKnupp and staff requested The Clifton Group to offer a proposal on how VCERA could rebalance its portfolio using futures contracts.

The Clifton proposal describes how VCERA could achieve the rebalancing trade by raising $20 million to provide initial and variation margin in order to overlay a 3% increase in domestic equity futures contracts and removing a similar percentage in fixed income contracts. Clifton estimates total incremental costs to achieve a six-month rebalance to be $95,000 including $50,000 in transaction costs.

Staff described its frustration in the market not permitting portfolio rebalancing in the traditional manner and supported The Clifton Group's proposal.

Mr. Hansen moved, seconded by Mr. Goulet, to approve the proposal submitted by The Clifton Group to use the existing overlay program to rebalance the portfolio.

Motion passed.

## VI. OLD BUSINESS

A. Recommendation on Available Board Options Under Step #7 of the Interest Crediting Policy.

1. Letter from Staff dated January 26, 2008.

2. Statement of Reserves dated June 30, 2008.

3. Letter from CEO dated September 15, 2008.

4. $27.50 "Notice" dated January 28, 2008.

## VI. <u>OLD BUSINESS</u> (continued)

A. Recommendation on Available Board Options Under Step #7 of the Interest Crediting Policy. (continued)

5. Letter from Staff dated January 7, 2008.

6. Letter from CEO to Board of Supervisors dated December 18, 2007.

(*Matter heard after New Business Items VII.A. and VII.B.*)

Staff summarized and reviewed the issues surrounding the Board's options under Step 7 of the interest crediting policy and the existence of approximately $96 million in undistributed excess earnings. Staff noted the potential use of excess earnings previously discussed by the Board regarding the replenishment of the $4.7 million transferred from the $27.50 supplemental benefit reserve in order to maintain the STAR COLA benefit and reviewed the Board's actions over the past 16 months. Specifically, staff identified the fiduciary and legal risk associated with the transfer and recommended the Board consider transferring $4.7 million to the $27.50 supplemental benefit reserve from undistributed excess earnings in order to mitigate the legal risks. Additionally, staff provided the impact of such transfer on the employer contribution rate.

Ramon Rubalcava was present from SEIU Local 721 and addressed the Board in support of the transfer.

Paul Derse was present from the County Executive Office and noted that the Board of Supervisors' position opposed the approval of certain non-vested retirement benefits including STAR COLA. Specifically, the County does not support increasing the amount excluded from "assets available for benefits" in order to provide non-vested supplemental benefits. Mr. Derse further noted the significant budget issues currently being faced by the Board of Supervisors and the State of California and requested the Board of Retirement not transfer any funds from undistributed earnings.

Mr. Goulet noted that the County CEO originally recommended the $25 million transfer in the settlement of a previous excess earnings lawsuit in order to offset future retiree health care costs. The CEO's recommendation was that all VCERA members be considered. Mr. Goulet felt that the County was "switching horses" and that some retirees may soon be included on future County welfare rolls.

## VI. OLD BUSINESS (continued)

A. Recommendation on Available Board Options Under Step #7 of the Interest Crediting Policy. (continued)

Mr. Goulet moved, seconded by Mr. Hansen, to transfer $4.7 million from undistributed excess earnings to the $27.50 supplemental benefit reserve.

Mr. Matheney stated he could not support the motion because of the future losses faced by the system, but could support the transfer of a smaller amount.

Mr. Harris stated the importance of vesting the $27.50 monthly supplemental benefit.

Mr. Hansen, Mr. Goulet, Mr. Towner and Ms. Becker for the motion. Mr. Henderson, Mr. Matheney, Mr. Harris and Mr. Wilson opposed.

Motion failed.

Mr. Goulet moved, seconded by Mr. Harris, to have the $95.8 million in the undistributed earnings reserve, as of June 30, 2008, remain as a reserve against future deficiencies in interest earnings for future periods.

Motion passed.

## VII. NEW BUSINESS

A. Review and Approval of Annual Actuarial Report as of June 30, 2008; The Segal Company; Paul Angelo and John Monroe.

Paul Angelo and John Monroe were present from The Segal Company to review VCERA's Actuarial Report as of June 30, 2008.

Mr. Angelo emphasized in his preliminary remarks that the June 30, 2008 valuation included the June 2008 market downturn, but did not include the downturns in September and October 2008.

In terms of the valuation, Mr. Angelo noted the improvement of the plan's funding status from 87.9% to 91.3%, the decrease in the employer contribution rate from 17.48% to 16.03%, and the minimal change in the average member rate to 8.04% from 8.10%.

VII. **NEW BUSINESS (continued)**

A. Review and Approval of Annual Actuarial Report as of June 30, 2008; The Segal Company. (continued)

Further, Mr. Angelo referenced the $96 million in undistributed excess earnings that was available for allocation under VCERA's interest crediting policy as of June 30, 2008.

The actuarial gains, according to Mr. Angelo, could be attributed to the asset smoothing method; however, one needed to be cautious due to the fact that the $288 million in deferred gains that were present as of June 30, 2007 were now assimilated into the actuarial value of assets fully and there were now $230 million in deferred losses to be recognized in future years.

Mr. Angelo stated that it would be important to emphasize to the plan sponsors that this $230 million loss would result in a 3.4% increase in contribution rates.

Mr. Matheney questioned the impact of the future losses on the actuarial soundness of the plan.

Mr. Angelo responded that the concept of "actuarial soundness" is context-based and the issue of whether a 3-4% contribution increase will render a sponsor insolvent cannot be determined within the discussion of an annual actuarial valuation.

Mr. Matheney questioned the impact of not changing the rate and, if there was reduced soundness, would VCERA need new sets of assumptions.

Mr. Angelo answered that from an actuarial perspective, The Segal Company has not seen a reason to change the actuarial assumptions and that the adoption of the recommended rates would maintain the plan's actuarial soundness.

Mr. Goulet stated that the known losses for this year would provide a strong argument for not reducing the contribution rates today.

Mr. Angelo questioned whether it would be prudent to override VCERA's current funding policy by not reducing the rates and questioned the basis upon which VCERA would recommend maintaining the current contribution rate.

VII. **NEW BUSINESS (continued)**

A. Review and Approval of Annual Actuarial Report as of June 30, 2008; The Segal Company. (continued)

Mr. Wilson stated his reluctance to change VCERA's current funding policy and felt it prudent to inform the County regarding future rate increases.

Mr. Goulet supported Mr. Wilson's position and would recommend an emphasis be made to the County regarding the likelihood of higher future contribution rates.

Mr. Matheney moved, seconded by Mr. Wilson, to adopt the June 30, 2008 actuarial valuation.

Mr. Johnston questioned the impact on contribution rates should VCERA double or triple its contingency reserve.

Mr. Angelo responded that such a move would increase employer contribution rates by approximately 1.40% of covered payroll.

Motion passed. Mr. Goulet opposed.

After consideration of item VII.B., Mr. Goulet provided an explanation as to why he voted against the motion. It would be Mr. Goulet's preference to provide the Board of Supervisors with a letter recommending the County set aside additional funding for future retirement contributions.

Mr. Goulet moved, seconded by Mr. Matheney, to request staff write a letter to the Board of Supervisors emphasizing the projected increases in employer contribution rates and recommend the County set aside additional funding for future employer contributions.

Motion passed.

B. Review and Approval of Annual Financial Report From Brown Armstrong; Steven R. Starbuck, CPA.

1. VCERA Comprehensive Annual Financial Report Dated June 30, 2008.

2. Presentation of the June 30, 2008 Audit Results.

3. Independent Auditor's Report Dated December 18, 2008.

## VII. NEW BUSINESS (continued)

B. Review and Approval of Annual Financial Report From Brown Armstrong. (continued)

4. Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards* Dated December 18, 2008.

5. Required Communication to the Board of Retirement in Accordance with Professional Standards.

Steven Starbuck, CPA and Amanda Dickerson, CPA were present from Brown Armstrong.

Mr. Starbuck described Brown Armstrong's audit process that begins in the Spring and includes the review of financial information accumulated by VCERA management throughout the year and the review of VCERA's internal control system. Specifically the audit areas include VCERA's investment program, actuarial data, contributions and benefit payments. In accordance with Brown Armstrong's June 30, 2008 audit, Mr. Starbuck was pleased to state that VCERA achieved an unqualified opinion which is the highest level of opinion given.

Mr. Starbuck also reviewed the other required reports including the report on internal control and required communication in accordance with professional standards. Mr. Starbuck noted no material weaknesses were identified with VCERA's internal controls. Also, Mr. Starbuck noted the implementation of new GASB Statement #50 in terms of note disclosures and there were no disagreements with management on accounting issues.

Mr. Goulet questioned whether Brown Armstrong would recommend VCERA create an audit committee.

Mr. Henderson moved, seconded by Mr. Harris, to receive and file items 1.-5.

Motion passed.

## VII. NEW BUSINESS (continued)

C. Proposed 2009 Due Diligence Site Visit Schedule.

Staff reviewed the Board's Due Diligence Policy and proposed a schedule for visiting up to twelve service providers in 2009.

Mr. Hansen indicated he would be in the Boston area in late September and could visit GMO, Acadian and Loomis Sayles.

Mr. Matheney and Mr. Hoag noted their availability to attend the Ennis Knupp Client Conference in May.

Ms. Becker stated her availability to visit Sprucegrove in July and Boston in the Fall.

Mr. Hansen also indicated his availability to visit Sprucegrove.

Mr. Hoag also indicated his availability to travel to Boston.

Mr. Wilson moved, seconded by Mr. Henderson, to accept the proposed schedule with staff returning at a future date with recommendations.

Motion passed.

D. Appointment of Personnel Review Committee.

Mr. Hoag, Mr. Hansen and Ms. Becker indicated their interest in serving on the committee in 2009. Mr. Harris indicated a preference not to serve.

Mr. Wilson moved, seconded by Mr. Matheney, to appoint Mr. Hoag, Mr. Hansen and Ms. Becker to the 2009 Personnel Review Committee, with Ms. Becker serving as Chair.

Motion passed.

E. Approval of Membership for Elected Official Pursuant to G.C. Section 31553 – John Zaragoza.

Mr. Matheney moved, seconded by Mr. Harris, to approve VCERA membership for John Zaragoza.

Motion passed.

## VIII. INFORMATIONAL

A. Publications (Available in Retirement Office)
   1. Institutional Investor
   2. Pensions and Investments

B. *Who's Under the TARP* – Forbes Magazine Article dated December 19, 2008.

C. *Financial Advice Without Spin* – Forbes Magazine Article dated January 12, 2009.

D. Los Angeles Pension Trustees Network Corporate Governance Roundup, February 23, 2009, in Los Angeles, CA.

E. RREEF Alternative Investments 2009 Educational Client Seminar, February 24-25, 2009, in Newport Beach, CA.

F. 2009 CALAPRS General Assembly, March 1-3, 2009, in Monterey, CA.

G. CALAPRS Principles of Pension Management For Trustees, March 24-27, 2009, at Stanford University Law School.

## IX. PUBLIC COMMENT

Staff provided an update on VCERA's office space search, real estate returns, new travel and general claim forms, and noted several agenda items scheduled for January 26, 2009 had been moved to the February 2, 2009 meeting.

## X. BOARD MEMBER COMMENT

None.

## XI. ADJOURNMENT

There being no further items of business before the Board, Chairman Towner adjourned the meeting at 12:30 p.m. upon the motion of Mr. Harris, seconded by Mr. Henderson.

Respectfully submitted,

TIM THONIS, Administrator

Approved,

TRACY TOWNER, Chairman