

San Mateo County Employees' Retirement Association
Minutes of the Investment Committee

December 19, 2000 – Investment Committee Agenda

PUBLIC SESSION – The Committee will meet in Public Session at 2:30 p.m.

- 1.0 Call to Order
- 2.0 Roll Call
- 3.0 Approval of the Minutes for the October 23, 2000 Investment Committee Meeting
- 4.0 Oral Communications from the Committee
- 5.0 Oral Communications from the Public
- 6.1 Acceptance of Monthly Portfolio Performance Report
- 6.2 Approve Restitution Plan Regarding BGI's Russell 2000 Growth & Value Weighting on 5/31/2000
- 6.3 Approval of Amendment to Contract with Barclays Global Investors for Tobacco-Free R1000 Index Fund
- 6.4 Approval of Manager(s) Search for Enhanced Index Fund(s)
- 6.5 Approval of Portfolio Rebalancing Policy Amendment to *SamCERA's Investment Plan*
- 7.0 Other Business
- 8.0 Adjournment

MINUTES OF SAMCERA's Investment Committee

- 1.0 Call to Order** Mr. Cottle called the Public Session of the Investment Committee to order at 2:30 p.m., December 19, 2000, in *SamCERA's* Board Room, Suite 280, 702 Marshall Street, Redwood City.
- 2.0 Roll Call** Mr. Bryan, Mr. Buffington, Ms. Colson (2:50), and Mr. Cottle. *Board Members in Attendance:* Mr. McMahon and Ms. Stuart. *Alternate Board Member in Attendance:* None. *Staff:* Mr. Clifton and Mr. McCausland. *Consultant:* Mr. Anderson *Retirees:* Mr. Murphy
- 3.0 Approval of the Minutes**

Motion by Cottle, second by Bryan, to approve the Minutes of October 23, 2000. The motion carried unanimously.
- 4.0 Oral Communications from the Committee** None
- 5.0 Oral Communications from the Public** Mr. John Murphy, speaking for the retirees, reports they are cognizant of the great job the Retirement Board is doing in investments. He distributed two articles from the Wall Street Journal (WSJ). The first entitled *Northrop Warns Of Reduced Income From Pension Funds* was published 12/6/2000. Mr. Murphy characterized the article as describing how returns may affect Plan assets and liabilities. A partial article from the December 12th WSJ warns that future retirees face an insurance crunch. "Without a retiree medical plan, employees wait longer to retire and that may delay career advancement for younger workers according to New York benefits consultant William M. Mercer."

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6.1 Acceptance of Monthly Portfolio Performance Report.

November 30, 2000	One Month	Trailing Three Months	Trailing Six Months	Trailing Twelve Months
Equity Aggregate	-7.94	-13.74	-7.52	-3.83
Equity Composite Benchmark	-8.24	-14.38	-8.00	-4.67
<i>Variance</i>	<i>0.30</i>	<i>0.64</i>	<i>0.48</i>	<i>0.84</i>
Fixed Income Aggregate	1.73	3.17	7.72	8.18
Fixed Income Composite Benchmark	1.64	2.96	7.59	8.00
<i>Variance</i>	<i>0.09</i>	<i>0.21</i>	<i>0.13</i>	<i>0.18</i>
Real Estate Aggregate	0.43	1.92	4.05	9.93
NCREIF (one quarter lag)	N/A	3.40	6.15	12.59
<i>Variance (1)</i>	N/A	N/A	N/A	N/A
Cash Aggregate	0.51	1.55	2.41	5.46
91 Day Treasury Bill	0.55	1.61	3.04	6.06
<i>Variance</i>	<i>0.04</i>	<i>-0.06</i>	<i>-0.63</i>	<i>-0.60</i>
Total Fund Returns	-4.38	-7.71	-2.21	1.19
Total Plan Policy Benchmark	-4.88	-8.52	-2.72	-0.11
<i>Variance</i>	<i>0.50</i>	<i>0.81</i>	<i>0.51</i>	<i>1.30</i>

(1) The aggregate is a current return. A variance against the one-quarter lag in the NCREIF is misleading.

Mr. Clifton provided a handout that details Bank of Ireland Asset Management's historic return calculations versus State Street's calculation (Watson Wyatt prior to 7/1999). It illustrates that Watson Wyatt added 8 basis points to their performance calculation in an attempt to provide a gross of fee return. The BIAM Group Trust reports a net of fee return. It charges a management fee of 75 basis points prior to calculating performance. Besides the 8 basis points representing more than the management fee, Watson Wyatt was inconsistent in applying the adjustment. Mr. Cottle asked Mr. Clifton to have BIAM provide both net and gross of fee returns. The differences will be reviewed at the February Committee meeting.

- Mr. Clifton highlighted a line item under Cash Equivalents called Transitional Fund Aggregate. He explained that this account contains dividends receivable and tax reclaims from the portfolios closed out in May and June. These amounts will be on the books until they are collected and the tax reclaim amounts are subject to foreign exchange fluctuations. Responding to a question on when the tax reclaims will be collected, Mr. Clifton reminded the Committee that there are ~\$17,000 in reclaims still outstanding from BONY. Mr. Waring informed the Committee that collection of reclaims require much patience, especially those from France. Mr. Clifton reported that at some point the Board may be asked to write off stale reclaims, which have little hope of being collected. It is not unusual for Plans with international portfolios to write off tax reclaims.
- Mr. Cottle pointed out that the performance report now has equity and fixed income aggregates. When those aggregates are compared to the benchmark we are doing okay. *SamCERA's* returns are hurt by Real Estate, but even so, the portfolio is outperforming the Policy Benchmark by 1.3% for the trailing twelve months with an absolute return of 1.19%. The Bonds and Real Estate are not strong enough to offset the losses in Equities

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6.2 Approve Restitution Plan Regarding BGI's Russell 2000 Growth & Value Weighting on 5/31/2000. Mr. O'Donnell briefly reviewed the transition to the Russell 2000 Index Fund, which occurred on 5/31/2000. He and Mr. Waring reminded the Board that BGI, State Street and *SamCERA* had been working on a one-day reconciliation item from 5/31 to 6/1/2000. The cause for the difference was traced back to a transaction originated by BGI's transition team. This transaction placed monies at an incorrect weight in the value and growth components of the Russell 2000 Index Fund. The inaccurate weighting resulted in an underperformance of ~22 basis points.

BGI's Funds are modularized, which means when you buy the Russell 2000 Index Fund you are actually buying the R2000 value and growth components. One conceptually assumes that you purchase the components in equal weights, or 50/50. However, the Russell Indices may be at 50/50 only on July 1st when the Index reconstitutes. After that date the components are likely to move out of balance, which they did by the transition date. The correct weights appear on a handout provided by BGI. The R2 Value was 42.27% and R2 growth was 57.73%. BGI's transition team essentially purchased the Fund with a 50/50 weighting. The calculated return for the day with the 50/50 weighting was 3.20%. A correct weight of 42.27% & 57.73% provided a return of 3.42%. *SamCERA* missed out on 22 basis points of return because of this problem. BGI reports that they have risk control measures in place, which require dual review of each portfolio order. In this case it is one of those rare exceptions where both reviews overlooked the incorrect weightings. BGI is reviewing their procedures and will report to the Board on the result of the review. BGI offers as restitution \$233,918.10, the difference between returns. The offer is an attempt to, as equitably as possible, put *SamCERA* in a position that it would have been if the transaction occurred, as it should.

Mr. Buffington reminded the Committee that had the monies been in the account, which is down 5.77% since 5/31 *SamCERA* would have lost money. On the other hand BGI had *SamCERA's* cash and cash has been king. However, he felt that since we are able to determine where the money would have been, which was in the Fund, this is a very equitable solution.

• Mr. Bryan agreed that it is a fair settlement. • The Trustees in attendance unanimously agreed. Three options were discussed regarding receipt of the settlement. *SamCERA* could use the monies to purchase units in the Russell 2000, offset the manage fee or receive a cash settlement. The Committee determined that receiving payment via wire would be the most appropriate method of settlement. Staff was directed to work with BGI to arrange receipt.

Motion by Buffington, second by Bryan to instructed staff to accept and deposit a wire in the amount of \$233,918.10 as restitution for BGI's mis-weighting of the Russell 2000 Growth & Value components on 5/31/2000. The motion carried unanimously.

6.3 Approval of Amendment to Contract with Barclays Global Investors for Tobacco-Free R1000 Index Fund. The Board worked for several months to formulate a policy regarding Tobacco Investments. As a result, the Board adopted a Russell 1000 Ex-Tobacco Benchmark. Staff was instructed to solicit a proposal from Barclays Global Investors to manage a Russell 1000 Ex-Tobacco Index Fund. BGI reports that *SamCERA* would be their only client with that mandate. It necessitates opening a commingled account with *SamCERA* as the only client initially. They propose to manage that Fund for an additional basis point over the Russell 1000 mandate. Based on *SamCERA's* Russell 1000 portfolio of ~\$550 million the management fee would increase by ~\$55,000. There would be a modest transition fee in changing mandates. BGI's transition analysis reveals

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that all but four securities can be transitioned in-kind. The liquidation and reinvestment of the proceeds from the four tobacco securities may cost \$5,000. Staff presented a Resolution adopting amendments to Exhibit B Collective Investment Fund Guidelines, and Exhibit D, Investment Management Fees of the *SamCERA/BGI* Investment Agreement.

Mr. Clifton advised the Committee that it has been the Boards practice when considering new products to review multiple providers. In prior searches a consistent criterion was a manager's ability to provide an acceptable performance record spanning a minimum of five years. Although Barclays Global Investors is renowned as a manager of Indexed Funds, the Russell 1000 Ex-Tobacco Index is a new product. Not only is it a new product for BGI, but a new product in the marketplace. It is very plausible that a search will fail to find a provider with a proven Russell1000 Ex-Tobacco track record. However, it is the opinion of staff that the Board with the assistance of a consultant establish a process of due diligence and initiate a search for an Investment Manager to manage a Russell 1000 Tobacco-Free Index Fund.

Mr. Cottle asked Mr. Anderson if he knew of anyone who managed a Russell 1000 Ex-Tobacco Index. Mr. Anderson is only aware of products with an S&P 500 Ex-Tobacco mandate. He then asked BGI if they were aware of any other providers of the product. Mr. O'Donnell was not aware of any products. Their proposal is to open a commingled product on behalf of *SamCERA* and hope that they get the economies of scale. Mr. Waring reported that they have not seen much interest in the product. • In response to a question from Mr. Cottle Mr. O'Donnell stated that their enhanced portfolios are not ex-tobacco. However, *SamCERA's* dollars are large enough that BGI would entertain the possibility of opening commingled enhanced tobacco free product managed by the same team that manages the Russell 1000 Tilt Funds. • Mr. Buffington suggested postponing the decision to move to a Russell 1000 Ex-Tobacco Index. He reasons that the Committee is interested in enhanced strategies so why do two transitions. • Mr. Bryan is interested in enhanced portfolios, but wishes to have a tobacco free mandate as soon as possible.

Motion by Buffington, second by Colson to postpone amendments to exhibits B & D of the *SamCERA/BGI* Investment Agreement. The motion carried with Buffington, Colson and Cottle voting yes and Bryan voting against.

- 6.4 Approval of Manager(s) Search for Enhanced Index Fund(s).** The Board discussed an enhanced structure for the Large Cap Equity Portfolio. The nature of a core portfolio and two satellite portfolios needs to be addressed. Last Spring the Committee conceptualized about putting 40% into a large cap core and at sometime carving out value and growth pieces of perhaps 5%. The management styles and benchmark for these pieces were not determined. • Ms. Colson suggests it would be efficient to consider the enhanced core, growth and value portfolios at the same time. • Mr. Buffington concurred that the Committee should concentrate on and execute one road map. He does not see value in tinkering sporadically with little pieces. His vision is to have the 5% to 10% pieces, with a little more aggressive mandate, complement the core and enhance the overall return
- Mr. Bryan prefers a single tobacco free enhanced core.

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Mr. Waring offered to do a project to help pull together the factors of how one would mix and match the percentages of the different manager types in a consistent way in order to maximize their structure. BGI's *PortfolioWorks* software does just that. The process would match how your managers work together to make a portfolio and contribute to Alpha with the Board's acceptable risk budget. BGI does many of these studies and feels it falls within the strategic relationship. The analysis would allow the Committee to conceptualize and then present it to the Board for implementation.

Motion by Colson, second by Buffington to instruct Mr. Cottle, Mr. Anderson and Mr. Clifton to arrange a working meeting with BGI to develop a framework for enhanced indexing and manager structure. The motion carried unanimously.

6.5 Approval of Portfolio Rebalancing Policy Amendment to *SamCERA's Investment Plan*.

Mr. Cottle recommended that this item be postponed pending the results of the optimization workshop. Mr. Clifton stated that Mr. McCalla recognizes that the process takes time. Mr. McCalla is aware of where the Committee is in the process and does not expect a quick reply.

Action: The Committee unanimously decided to postpone discussions on portfolio rebalancing until the manager structure could be reviewed.

7.0 Other Business: Mr. Cottle distributed a letter from Deutsche Asset Management (DeAM) and a Due Diligence Meeting Summary. • The letter defines DeAM's mission, values and strategic objectives. It details recent steps taken to meet those objectives, including the appointment of key personnel. • The due diligence shares some observations from Dave Baldt the chief strategist of the Philadelphia office. He expressed concerns that the parent company requested Philadelphia to bear 20% of the firms marketing and client servicing overhead costs. The parent company also asked the Philadelphia team to manage significantly higher asset levels. There is some likelihood that the Philadelphia office will consider a partial ownership affiliation with another firm. • Mr. Clifton distributed a letter announcing that Bank of Ireland Asset Management is opening an office in Chicago. It is BIAM's fourth office in North America.

8.0 Adjournment: There being no further business Mr. Cottle adjourned the Committee at 4:00.