

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

October 28, 2003 – Investment Committee Agenda

PUBLIC SESSION – The Committee met in Public Session at 10:00 A.M.

- 1.0 Call to Order
- 2.0 Roll Call
- 3.0 Approval of the Minutes for the Investment Committee Meeting
- 4.0 Oral Communications From the Committee
- 5.0 Oral Communications From the Public
- 6.0 Investment Management Services of the Investment Committee
 - 6.1 Acceptance of Monthly Portfolio Performance Report
 - 6.2 SamCERA's Investment Manager Structure – U.S. Equity Part Two
 - * 6.3 Annual Investment Manager Review – Barclays Global investors
 - 6.4 Approval of Topics for Investment Manager Review – Bank of Ireland Asset Management
 - 6.5 Adoption of Due Diligence Policy & Procedures
 - 6.6 Review, Revision & Reaffirmation of Investment Committee Charter
 - 6.7 Approval of Amendments to SamCERA's Investment Plan – Asset Allocation / Capital Market Assumptions
- 7.0 Other Business
- 8.0 Adjournment

**The Committee will briefly discuss this topic. The Agenda Item in its entirety will be heard at the Board.*

MINUTES OF SAMCERA's Investment Committee

- 1.0 Call to Order:** Mr. Bryan called the Public Session of the Investment Committee of the Board of Retirement to order at 10:00 A.M October 28, 2003, in *SamCERA's* Board Room, Suite 125, 100 Marine Parkway, Redwood Shores, California.
- 2.0 Roll Call:** Mr. Bryan, Ms. Arnott for Mr. Buffington, Ms. Colson, and Mr. Lewis *Board Members in Attendance:* Ms. Salas, and Ms. Stuart *Staff:* Mr. Clifton and Mr. McCausland. *Consultant:* Ms. Jadallah, *Public:* none *Retirees:* One (10:50)
- 3.0 Approval of the Minutes:** The September 23, 2003 Investment Committee Minutes were unanimously approved.

Action: Motion by Mr. Colson, seconded by Mr. Lewis, carried unanimously to accept the Investment Committee Minutes.
- 4.0 Oral Communications From the Committee:** None
- 5.0 Oral Communications From the Public:** None

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- 6.1 Acceptance of Monthly Portfolio Performance.** Mr. Clifton reported that September lived up to its historic billing as a down month for domestic equities. *SamCERA's* domestic equity aggregate lost 1.18%, while international equities gained 1.60% resulting in a total equity aggregate of -0.59%. Diversification in the form of Fixed Income allowed the Association's total portfolio to report a gain of 0.35%.

For the period ended September 30, 2003, *SamCERA's* Total Fund Return underperformed its Policy Benchmark in all periods through the trailing twelve months. The under performance may be largely attributed to poor security selection in the international equity portfolio where the manager trailed the MSCI ACWI Free ex-US by 976 basis points. BIAM's attribution report points toward poor security selection in the Consumer Discretionary, Financials, and Utilities Sectors as the main detractors to performance. The international equity portfolio accounts for approximately 75% of the total plan underperformance.

Mr. Clifton extended an invitation from Bank of Ireland Asset Management to attend an Investment Seminar on November 6th that will feature discussions by Chris Reilly, BIAM's Director & Chief Investment Officer and Leona Nicholson, Senior Equity Manager on the forces currently driving equity markets, how BIAM has performed and the current positioning of BIAM's Portfolio. Ms. Jadallah informed the Committee that BIAM would be in Strategic Investment Solutions' office at 11:00 A.M. that day and Trustees and staff are welcome to attend. Mr. Clifton, Ms. Jadallah & Mr. Thomas attended a similar presentation by BIAM last year and Mr. Clifton & Ms. Jadallah suggested that an office meeting may be more productive.

The table presented below shows the composite returns

September 30, 2003		One Month	Trailing Three Months	Trailing Six Months	Trailing Twelve Months
Equity Aggregate	\$868,093,553	-0.59%	4.24%	22.82%	25.35%
Equity Composite Benchmark		-0.27%	5.24%	24.03%	27.84%
<i>Variance</i>		-0.32%	-1.00%	-1.21%	-2.49%
Fixed Income Aggregate	\$377,767,918	2.65%	-0.15%	2.58%	5.27%
Fixed Income Composite Benchmark		2.65%	-0.15%	2.35%	5.41%
<i>Variance</i>		0.00%	0.00%	0.23%	-0.14%
Real Estate Aggregate (1)	\$58,197,962	-0.03%	1.21%	4.32%	13.65%
NCREIF (one quarter lag)		2.09%	2.09%	4.22%	7.96%
<i>Variance</i>		-2.12%	-0.88%	0.10%	5.69%
Cash Aggregate	\$8,814,547	0.24%	0.64%	1.25%	2.18%
91 Day Treasury Bill		0.10%	0.25%	0.58%	1.32%
<i>Variance</i>		0.14%	0.39%	0.67%	0.86%
Total Fund Returns	\$1,312,873,980	0.35%	2.79%	15.18%	18.06%
Total Plan Policy Benchmark		0.72%	3.51%	16.26%	20.05%
<i>Variance</i>		-0.37%	-0.72%	-1.08%	-1.99%

The table below shows portfolio market values and target weightings versus actual allocations.

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Asset Allocation As of 9/30/2003	Market Value	Allocation		Percentage Off Target	Rebalance Range
		Current	Target		
BGI Russell 1000	\$533,007,282	40.60%	40.00%	0.60%	±5%
BGI Russell 2000	\$145,862,658	11.11%	10.00%	1.11%	±5%
BIAM	\$189,223,612	14.41%	15.00%	-0.59%	±5%
Total Equity	\$868,093,553	66.12%	65.00%	1.12%	
BGI US Debt	\$209,546,721	15.96%	16.00%	-0.04%	±3%
DAMI	\$168,221,196	12.81%	13.00%	-0.19%	±3%
Total Fixed Income	\$377,767,918	28.77%	29.00%	-0.23%	
Real Estate	\$58,197,962	4.43%	6.00%	-1.57%	±2%
Cash	\$8,814,547	0.67%	0.00%	0.67%	
Total	\$1,312,873,980	100.00%	100.00%		

Action: The Committee unanimously accepted the Monthly Performance Report. The Committee will recommend to the Board of Retirement that it accept the report.

6.2 SamCERA's Investment Manager Structure – U.S. Equity Part Two. Strategic Investment Solutions' representative, Margaret Jadallah, presented Investment Manager Structure – U.S. Equity, Part II. This presentation flows from the Board's decision on 7/22/2003 to maintain the current asset allocation of 65% Equities (40% Domestic Large Capitalization, 10% Domestic Small Capitalization, and 15% International), 29% Fixed Income and 6% Real Estate and to review the current manager structure.

At the September 23, 2003 Investment Committee and Board, SIS presented an introduction to *SamCERA's* domestic equity manager structure. They informed the Committee that if *SamCERA* wants its US Equity Composite to rank in the top 40%-33% of the Composite Universe, it should target .75% to 1.30% of Alpha. SIS provided ten alternative equity structures ranging from Alternative One (Passive Large Cap with ½ Passive Small Cap and ½ Active Small Cap, which was projected to have 0.70% Active Risk with an Information Ratio of 0.30 and contributing 0.21% Alpha) to Alternative Ten (Active Large and Small Cap, which was projected to have 3.67% Active Risk with an Information Ratio of 0.54 and contributing 2.00% Alpha). The Recommendation from SIS would be somewhere in the middle. They believe all of *SamCERA's* Small Cap Assets and a portion of its Large Cap Assets should be managed actively.

The Board asked SIS to provide an additional five alternatives for its review. Today's presentation contains the five alternatives found below. SIS assumes an above average Investment Manager would have an information ratio of 0.30, which is a common assumption. Most of SIS' clients choose a tracking error between 2.00% to 2.50%. The alternatives below demonstrate a lower risk tolerance with tracking error of 0.75% to 1.50%.

- 1) ½ Passive and ½ Enhanced Large Cap with Passive Small Cap. (Active Risk 0.80%, Information Ratio 0.30, Alpha 0.24%)
- 2) ½ Passive and ½ Enhanced Large Cap with ½ Passive Small Cap, ¼ Active Small Value, and ¼ Active Small Growth. (Active Risk 1.02%, Information Ratio 0.48, Alpha 0.50%)
- 3) ½ Passive and ½ Enhanced Large Cap with ½ Passive and ½ Enhanced Small Cap Core. (Active Risk 0.96%, Information Ratio 0.39, Alpha 0.38%)
- 4) ½ Passive and ½ Enhanced Large Cap with ½ enhanced and ½ Active Small Cap split between Value and Growth. (Active Risk 1.19%, Information Ratio 0.53, Alpha 0.63%)

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- 5) $\frac{1}{2}$ Passive and $\frac{1}{2}$ Enhanced Large Cap with Active Small Cap split between Growth and Value. (Active Risk 1.48%, Information Ratio 0.50, Alpha 0.75%)

Of the five alternatives presented SIS recommends alternative five. They have identified a good stable of large cap enhanced index managers that can provide approximately 0.50% Alpha on a fairly consistent basis. They believe in active small cap management. The alternative still has a moderate benchmark risk.

In response to a question from Mr. Bryan, Ms. Jadallah confirmed that BGI's enhanced small cap product technically is not closed, but there is an extremely long queue. Regarding enhanced small cap products SIS believes they are so inefficient that a Plan should employ active management. They also believe there is an implementation problem with enhanced products. SIS has identified ten to fifteen products of which only half are institutional and half of those are closed.

In the Committee's discussion of the alternatives presented, they agreed that regarding the large cap structure they prefer $\frac{1}{2}$ Passive and $\frac{1}{2}$ Enhanced. The discussion then focused on the small cap structure. ♦ Mr. Bryan recommended alternative four. However, in light of implementation difficulties with small cap enhanced, he would not object to beginning with alternative two and moving to alternative four when a suitable small cap enhanced product is located. ♦ Mr. Lewis concurred with that approach. ♦ The consensus of the committee is that by beginning with alternative two, which is $\frac{1}{2}$ Passive and $\frac{1}{2}$ Enhanced Large Cap with $\frac{1}{2}$ Passive Small Cap, $\frac{1}{4}$ Active Small Value, and $\frac{1}{4}$ Active Small Growth and moving to alternative four, which replaces the small cap passive with small cap enhanced, the Association will have more options regarding the small cap enhanced implementation problems. ♦ The committee discussed getting into the queue for BGI's enhanced small cap product and researching other providers. Staff is to report back on the length of BGI's queue relative to when the Association could become invested.

Ms. Jadallah reported that next month SIS would present manager structure for international equity and fixed income. She asked the Committee to comment on the current managers. ♦ The Committee gave direction for SIS to provide international equity alternatives that include and exclude the current international equity manager. ♦ The Committee wishes to include Deutsche Asset Management in the fixed income alternatives. Those alternatives should include core-plus mandates, including high-yield and foreign debt, but no emerging market. The Committee will entertain an alternative, which includes all active management. However, some members would be hesitant to adopt an all-active mandate.

Action: Motion by Ms. Colson, second by Ms. Arnott, to recommend to the Board of Retirement that it adopt alternative four, which is $\frac{1}{2}$ Passive Index and $\frac{1}{2}$ Enhanced Index in Large Cap and Small Cap $\frac{1}{2}$ Enhanced Index and 1/2 Active Management split equally between Growth and Value. (Active Risk 1.19%, Information Ratio 0.53, Alpha 0.63%), as its manager structure for domestic equity.

- 6.3 Annual Investment Manager Review – Barclays Global Investors** Mr. Clifton asked if the committee had any questions or concerns regarding the materials submitted by BGI for their annual review with the Board. ♦ Ms. Colson & Mr. Lewis noted that the US Debt Index Fund is constructed of seven component funds. They wish to know more regarding the component funds. ♦ Mr. Lewis commented on the questions regarding the firm's top individuals who are key to the firm and portfolio's success. He would like to have noted any change in those individuals over the past twelve to eighteen months. ♦ In addition, Mr. Lewis wants BGI to discuss their trading cost and why they do not use soft dollars for market research. Will this change as BGI increases active strategy management? ♦ Mr. Bryan would like BGI to address the Russell Reconstitution. The Russell 2000 Index Fund has a significant Tracking error that is attributed at least in part to BGI's reconstitution strategy this year. He also wants to understand if other index providers had similar difficulties.

Mr. Clifton reminded the Committee that the Investment Management Agreement with BGI expires in

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January. He recommended that the Agreement be presented to the Board for renewal in November. Should the Board make changes in BGI's manager mandate at the conclusion of the manager structure, it will be easy to amend the Collective Investment Fund Guidelines. ♦ The Committee agrees with staff's recommendation to present the Agreement in November

Action: No action is required.

- 6.4 Approval of Topics for Investment Manager Review – Bank of Ireland Asset Management.** Mr. Lewis asked that the questions referring to the key individuals at the firm include a request to acknowledge recent departures or additions to that list. ♦ He wishes to understand why BIAM is underperforming in all time periods. Is the cause of underperformance the same in all periods? Mr. Clifton noted that BIAM's sell discipline has been problematic. Also, stock selection and county diversification, underweight Japan and overweight Great Britain and somewhat overweight Euroland is the common thread for the underperformance. ♦ Ms. Jadallah would like BIAM to explain in which market situations do they do well and which present problems.

Action: No action is required. The review will be held at the Board Meeting.

- 6.5 Adoption of Due Diligence Policy & Procedures.** The Committee discussed the final draft of the Due Diligence Policy & Procedures making minor amendments. The changes appear in F.04 – Official Due Diligence Trip and F.06 – Coordination of Due Diligence. A lined out and amended version of the Policy & Procedures follows:

Due Diligence Policy & Procedures

AUTHORITY

The San Mateo County Employees' Retirement Association (*SamCERA*) Board of Retirement (Board) is responsible for the management of the Association's assets under authority granted by Article XVI, Section 17 of the California Constitution.

Article XVI, Section 17(c) of the California Constitution provides that "the members of the retirement board of a public pension or retirement system shall discharge their duties with respect to the system with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aim."

POLICY

SamCERA's due diligence process requires (i) staff to perform regular due diligence monitoring and report on same, (ii) investment consultants and managers to make regularly scheduled due diligence presentations to the Board and staff in *SamCERA's* offices, and (iii) the Board, staff, and Investment Consultant to make on-site visitations to service provider's offices when determined appropriate by the Board.

PURPOSE

To discharge the fiduciary responsibilities of the Board of Retirement and staff, regular due diligence

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with the San Mateo County Employees' Retirement Association investment managers and real estate properties are essential to the Board of Retirement's ability to effectively monitor the performance of its investment professionals and to the prudent discharge of the Board's fiduciary duty to the beneficiaries of this multi-million dollar retirement system.

F.01 – Due Diligence Monitoring

Individual investment managers will be monitored by staff and the investment consultant continuously and report to the Board on a monthly, quarterly, semi-annual, and annual basis.

The Investment Consultant will regularly review *SamCERA's* Investment Managers and when appropriate provide insights and analysis to the Board regarding. It is understood that the Investment Consultant routinely visits managers on-site and in the Consultant's office. That research will be made available to *SamCERA*.

Monthly Reporting: The Investment & Finance Manager (IFM) will prepare a monthly investment activity and compliance report. The report will note individual investment manager statistical compliance to their investment guidelines, objectives and portfolio restrictions. The IFM will review the investment managers' purchases and sales for each month, and note in the report any deviations from the investment guidelines and restrictions, as outlined by the investment manager agreement. The report will also note any significant changes in the following:

- | | |
|---------------------------|----------------------------|
| • portfolio composition | • sector weights |
| • portfolio turnover | • general trading activity |
| • changes in market value | • changes in cash position |

The IFM shall also report monthly on qualitative changes in the Investment Manager's business, including but not limited to change in ownership, personnel, clients, major changes in assets under management or other material events.

Quarterly Reporting: The Investment & Finance Manager, with assistance from the investment consultant, will present an investment performance report to the Board on a quarterly basis, as specified in Section 16.0 Quarterly Investment Performance Reporting. Performance will be measured for the total portfolio as well as individual components such as equities, fixed income and real estate portfolios. In addition, the performance of each component will be broken down into individual portfolios.

Comparisons will be made against market indices defined in this document. A variance from the stated performance objective will be calculated each quarter. Additionally, the portfolios' actual investment approach will be monitored against the required investment style to determine whether the manager is adhering to its acknowledged investment style.

The quarterly investment performance report will compare the total fund, each asset class and individual portfolio return to appropriate market indices and a representative peer group of similar funds or similar style investment managers. The report will note significant changes in the attribution of investment manager performance.

Semi-Annual Reporting: Every six months, the Investment and Finance Manager, with the assistance of the investment consultant, will provide the Board with a review of one of the three major asset categories

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of the total investment portfolio in detail. Therefore, during an eighteen-month period the IFM and the investment consultant will conduct a detailed review of each of the three asset categories in which *SamCERA* invests.

Annual Reporting: Annually, the Investment and Finance Manager will request and review the Investment Manager's ADV Part II form and inform the Board of significant changes in the firm or apparent conflicts of interest. In addition the IFM will request an annual Insurance Certification from each professional service provider. Where appropriate a Statement of Auditing Standards #70 will be obtained and reviewed. (The SAS-70 audit report describes the control structure as it relates to its fiduciary and custodial activities and is prepared in accordance with the American Institute of Certified Public Accountants (AICPA) Statement on Auditing Standards Number 70, entitled "Reports on the Processing of Transactions by Service Organizations" as amended by AICPA Statement on Auditing Standards Number 78, entitled "Consideration of Internal Control in a Financial Statement Audit.")

F.02 – Due Diligence Presentations

SamCERA's Investment consultants and investment managers that are under contract with the Board will make a presentation to the Board at a public Board meeting at least once a year. The presentation shall include, but not be limited to, an update on the manager's organization and business plan, changes to the investment process and investment performance. The Board may request presentations more frequently as circumstances demand. The investment managers will provide on a semi-annual basis a completed Compliance Certification Statement (Appendix D) and in depth response to a list of questions submitted by the Board.

F.03 – Evaluation and Education

On-site meetings provide board and staff with opportunities to:

1. Evaluate an investment manager's staff and observe how they jointly carry out their fiduciary responsibility to *SamCERA*.
2. Interview individuals who directly manage *SamCERA's* account.
3. Evaluate the significance of personnel shifts or other organizational changes that may affect *SamCERA's* portfolio.
4. Observe the systems and controls utilized to handle *SamCERA's* investments.
5. Hold in-depth reviews regarding an investment manager's philosophy, style and approach to investing *SamCERA's* assets.
6. Develop a better understanding of the significance of short-term periods of good or bad performance.

F.04 - Official Due Diligence Trip

An official due diligence trip shall be condoned under three scenarios listed below. In all cases the visit

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requires prior approval of the Board. The scenarios under which site visits should occur are:

1. Manager Searches - The top two finalists will be visited prior to offering an Agreement to the successful firm. When occasions demand that only one, or more than two, finalists are to be visited, the Board will approve, via motion, the variance from policy.
2. Extraordinary Events – From time to time an Investment Management firm may experience an extraordinary event, including but not limited to, a change in ownership, personnel, investment strategy, style shift, prolonged underperformance, etc. The Board will be appraised of the circumstances and determine if a site visit to the firm's headquarter or branch location is appropriate.
3. Investment Consultant Scheduled Visit – SamCERA's Investment Consultant will inform the Board when it plans to visit one of SamCERA's Investment Managers, ~~although it may be at the request of another of the Consultant's clients.~~ The Board will determine if it is appropriate to send a representative(s). ~~The consultant may find it inappropriate to commingle client visits or to schedule additional time for a SamCERA only visit. The Board will respect the Investment Consultant's schedule.~~

F.05 - Unofficial Due Diligence Trip

An unofficial due diligence trip shall occur when a *SamCERA* representative finds himself or herself in the proximity of an Investment Manager's Office at no additional cost to the Association. The representative's visit will be unofficial unless otherwise determined by the Board.

F.06 – Coordination of Due Diligence

The Investment & Finance Manager or the Chief Executive Officer coordinate all official and unofficial visits to SamCERA's service providers. ~~No one may will introduce themselves to a service provider as a representative of SamCERA without prior approval from the Board.~~

F.07 – Policy Review

The Due Diligence Policy Manual shall be reviewed every three years and updated as necessary.

Action: Motion by Mr. Lewis, second by Ms. Arnott, to recommend to the Board of Retirement that it adopt the Due Diligence Policy and Procedures as amended.

- 6.6 Review, Revision & Reaffirmation of Investment Committee Charter.** The Board of Retirement created the Investment Committee with the adoption of Resolution 99-00-09 on January 25, 2000. The Board reviewed the Resolution on April 24, 2001. By consensus, it directed staff to provide amended language regarding the Committee's authority to direct the Board in its ongoing evaluation of the Investment Consultant Structure & Performance and the ongoing evaluation of the Actuary's Economic & Asset Considerations. Sections 10.0 & 11.0 were amended into the Charter on May 22, 2001. The Charter has not been reviewed or amended since that date.

In anticipation of approval by the Board of the Due Diligence Policy & Procedures, staff proposed an amendment to the Investment Committee Charter, which expands upon the Investment Committee's oversight of manager performance. The proposed amendment, which follows, is to section nine of the first resolve.

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... RESOLVED that the Board hereby establishes a standing Investment Committee to direct the Board in its ongoing evaluation of SamCERA's Investment Plan, including but not limited to . . .

- 9.0 Evaluate Manager performance
 - 9.1 Monitor results of managers
 - 9.2 Assess consistency of portfolio decision making
 - 9.3 Evaluate organizational, ownership, personnel & other firm developments
 - 9.4 Assess compliance with SamCERA's Investment Plan including, but not limited to, the General Investment Performance Guidelines, Due Diligence Policy, Compliance Certification Statement, and the Investment Manager Requirements.

After a brief discussion the Committee adopted the recommended amendment.

Action: Motion by Ms. Colson, second by Mr. Lewis, to recommend to the Board of Retirement that it approve the amendment to the Investment Committee Charter.

- 6.7 **Approval of Amendments to SamCERA's Investment Plan – Asset Allocation / Capital Market Assumptions.** Mr. Clifton explained that amending the Investment Plan for changes to the Asset Allocation and Capital Market Assumptions have a greater impact throughout the document than first anticipated. He recommended delay of amendments to the Investment Plan until completion and implementation of the manager structure. By consensus the Committee agreed.

Action: No Action is required.

- 7.0 **Other Business: None**

- 8.0 **Adjournment:** There being no further business Mr. Bryan adjourned the Committee at 11:00 A.M.