

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

April 25, 2006 – 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
- 4.0 Oral Communications From the Committee
- 5.0 Oral Communications From the Public
- 6.0 Investment Management Services - the Investment Committee Shall Review & Discuss
 - 6.1 Monthly Portfolio Performance Report
 - 6.2 Review of Security Lending
 - 6.3 Acceptance of Semi-Annual Compliance Certification Statement – Brandes Investment Partners, Chartwell Investment Partners and Goldman Sachs Asset Management
- 7.0 Other Business
- 8.0 Investment & Finance Manager's Report
- 9.0 Adjournment

MINUTES OF SAMCERA's Investment Committee

- 1.0 Call to Order:** Ms. Colson called the Public Session of the Investment Committee of the Board of Retirement to order at 10:02 a.m. April 25, 2006, in *SamCERA's* Board Room, Suite 125, 100 Marine Parkway, Redwood Shores, California.
- 2.0 Roll Call:** Mr. Bryan (dep 11:13 a.m.), Ms. Colson, Mr. Hackleman and Ms. Tashman. *Other Board Members in Attendance:* Ms. Salas and Ms. Stuart. *Alternate Board Member:* None. *Staff:* Mr. Bailey, Mr. Clifton, Ms. Dames and Ms. Wong. *Consultants:* Mr. Azfar and Mr. Blackman of State Street Bank & Trust; Ms. Jadallah of Strategic Investment Solutions. *Public:* None. *Retirees:* One.
- 3.0 Approval of the Minutes:** None.
- 4.0 Oral Communications From the Committee:** None.
- 5.0 Oral Communications From the Public:** None.
- 6.1 Monthly Portfolio Performance Report:** Mr. Clifton presented the Preliminary Monthly Performance Report for the period ending March 31, 2006. He stated that *SamCERA's* Total Fund Return of 1.36% for March 2006 underperformed the Total Plan Policy Benchmark return of 1.47%. The Fund's Fiscal Year to Date (FYTD) return, 11.12%, is 518 basis points above the FYTD Actuarial Discount Rate, 5.94%, and 2 basis points above *SamCERA's* Total Plan Policy Benchmark of 11.10%.

The U.S. equity market registered its strongest first quarter gains since 1999 due to tame inflation and solid economic growth in the midst of rising short-term interest rates. In March, short-term interest rates rose modestly, led by the Federal Open Market Committee's (FOMC) decision to raise its target funds rate one more time to 4.75%. The market was disappointed by a more hawkish than expected tone to the statement that accompanied the FOMC's 15th consecutive rate hike. The market now fully prices a move to 5.00% on May 10th.

The table presented below shows the composite returns.

March 31, 2006	Market Value	One Month	Trailing Three Months	Trailing Six Months	Trailing Twelve Months
Equity Aggregate	\$1,205,792,096	1.97%	7.07%	9.75%	18.35%
Equity Composite Benchmark		2.29%	7.14%	9.83%	18.54%
Variance		-0.32%	-0.07%	-0.08%	-0.19%
Fixed Income Aggregate	\$493,495,462	-0.62%	-0.14%	0.54%	3.25%
Fixed Income Composite		-0.98%	-0.65%	-0.06%	2.26%
Variance		0.36%	0.51%	0.60%	0.99%
Real Estate Aggregate (2)	\$110,629,327	5.49%	5.49%	8.32%	21.06%
NCREIF (one quarter lag)		4.44%	4.44%	10.11%	15.00%
Variance		1.05%	1.05%	-1.79%	6.06%
Cash Aggregate	\$2,619,388	0.28%	0.93%	1.76%	3.34%
91 Day Treasury Bill		0.39%	1.02%	1.95%	3.53%
Variance		-0.11%	-0.09%	-0.19%	-0.19%
Total Fund Returns	\$1,812,536,273	1.36%	4.80%	6.88%	13.66%
Total Plan Policy Benchmark		1.47%	4.70%	6.95%	13.86%
Variance		-0.11%	0.10%	-0.07%	-0.20%
Performance versus Actuarial Discount Rate					
Total Fund Returns		1.36%	4.80%	6.88%	13.66%
Actuarial Discount Rate		0.64%	1.94%	3.92%	8.00%
Variance		0.72%	2.86%	2.96%	5.66%

Action: No action is required. The Monthly Portfolio Performance Report is an informational report.

6.2 Review of Security Lending

Richard Blackman and **Asim Azfar** from State Street Bank & Trust were present at the Investment Committee to re-visit the topic of securities lending through an educational presentation. Mr. Blackman discussed the historical perspective of the security lending industry, the mechanics of lending along with security lending's associated risks and the various levels of built-in controls to minimize those risks. The estimated annual revenue potential from security lending is approximately \$550,000.

In response to a question from Ms. Colson, Mr. Blackman indicated that hedge funds and alternatives were significant drivers of demand in the securities lending market. He reiterated that State Street will only be directly dealing with prime broker/dealers. Prime brokers would be contractually obligated to return securities back to the plan. *SamCERA* has ultimate flexibility to limit the universe of broker/dealers that have been approved by State Street's credit risk group.

In response to a question from Ms. Tashman regarding State Street's credit risk, Mr. Blackman stated that State Street takes on excess collateral to protect the plan. US equity is marked at 102% collateral on a daily basis. Domestic fixed income is at 102% collateral which can float down to 100% before it is marked back up to 102%. Due to volatility and foreign exchange exposure, foreign equity is at 105% collateral. Mr. Blackman stated that State Street has indemnification in the case of collateral shortfall.

In summary, he listed three events that must occur simultaneously in order for *SamCERA* to experience exposure: (1) The prime broker/dealer must default, (2) the cash collateral must be insufficient to replace the securities, and (3) State Street, who has indemnification to make up the collateral shortfall, must also default. Mr. Blackman noted that all three events are uncorrelated and the possibility of all three events occurring simultaneously is highly unlikely. Broker/dealers have defaulted in the past, but he said that State Street has never had exposure to these events nor incurred any loss. He attributed this to State Street's daily monitoring of credit risks.

Proxy voting is the one beneficial ownership right which is transferred and cannot be manufactured back to the plan. Should *SamCERA* wish that their investment manager vote on a proxy issue, State Street will incorporate that into the program by restricting a certain percentage of the stock, so that the manager may vote on the item. If any issues arise, *SamCERA* also has the ability to recall the security. Mr. Blackman informed the committee that *SamCERA* has the authority and right to restrict a portfolio from being lent at any time.

Ms. Jadallah said that most of SIS' clients who are in relative size to *SamCERA* with a similar asset allocation have a 70% / 30% split with their securities lending agents— a more preferable split to that of 65% / 35% that State Street was initially offering. Mr. Blackman stated that *SamCERA*'s revenue opportunity with securities lending has increased since it was initially reviewed approximately 15 months ago when the 65% / 35% was first utilized. State Street will look into the client share split to bring the committee and board to a higher comfort level with the program.

Normal reports that staff and managers receive will remain unchanged. If *SamCERA* participates in the security lending program, Ms. Tashman suggested that the Investment Committee perform monthly monitoring during the first few months of the program. Ms. Colson also noted that not every public fund is engaged in security lending and that trustees must seriously look into the risks associated with the program.

The Investment Committee requested a list of parameters for both State Street's second-most conservative fund, also known as the "Quality D Investment Fund," as well as State Street's most conservative fund. The committee also wished to compare the parameters set by plan sponsors regarding what brokers to use, what investments to consider and other guidelines in order to get a better sense of security lending prior to making an explicit recommendation.

Action: No action is required by the Investment Committee. The pros and cons will be discussed at the board meeting in order to open the topic up discussion and get a better sense of direction from other trustees.

6.3 Acceptance of Semi-Annual Compliance Certification Statement – Brandes Investment Partners, Chartwell Investment Partners and Goldman Sachs Asset Management

As part of *SamCERA*'s ongoing due-diligence, Investment Managers are asked, on a semi-annual basis, to respond to a questionnaire and to complete a Compliance Certification Statement (CCS). The questionnaire is fairly generic with certain questions adapted to the manager's investment mandate. The questions are designed to gain insight into the Investment Manager's organization, performance, investment strategy & process, and its outlook on certain subjects. *SamCERA* tailors its CCS toward the manager's investment mandate. It then asks specific questions related to the governance of that mandate in accordance with *SamCERA*'s *Investment Plan*.

The Committee reviewed the Compliance Certification and responses to the questionnaires.

Ms. Tashman stated that the committee should continue to monitor GSAM. She requested that more analysis be done to review the dispersion between *SamCERA*'s GSAM separate account versus the commingled fund. Mr. Clifton stated that *SamCERA* initially selected a GSAM separate account due to its lower fees. Further review of the separate account composite will also be performed. Ms. Jadallah also was concerned with not only the dispersion but with GSAM's stock-specific "residual bucket" as well.

There were no other issues that stood out for further review.

Action: By consensus the committee accepted the Compliance Certification Statement of Brandes Investment Partners, Chartwell Investment Partners and Goldman Sachs Asset Management's response to the questionnaire. The committee will recommend to the Board of Retirement that it accept the semi-annual due diligence documents.

7.0 Other Business: None

8.0 Investment & Finance Manager's Report: Mr. Clifton stated that David Gallagher of Chartwell Investment Partners has accepted a position at a different investment firm effective May 1. He also said that he has seen several flyers aiming towards education on social investing and fiduciary duty.

9.0 Adjournment: There being no further business, Ms. Colson adjourned the committee at 11:56 a.m.