

BOARD OF INVESTMENTS MINUTES 12-8-10

PRESENT

- Herman Santos, Chair
- John M. Barger, Vice Chair
- Diane Sandoval, Secretary
- William Pryor
- Simon S. Russin
- Mark J. Saladino
- Michael Schneider
- Leonard Unger
- Estevan Valenzuela
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STAFF, ADVISORS, PARTICIPANTS

- Gregg Rademacher, Chief Executive Officer
- Robert Hill, Assistant Executive Officer
- Janice Golden, Assistant Executive Officer
- Lisa Mazzocco, Chief Investment Officer
- John McClelland, CRE, Principal Investment Officer, Real Estate
- Vache Mahseredjian, CFA, Principal Investment Officer
- Christopher J. Wagner, Senior Investment Officer, Private Equity
- June H. Kim, Senior Investment Officer, Equities
- Robert Z. Santos, Investment Officer, Fixed Income
- Gerald P. Flintoft, CAIA, Investment Officer, Private Equity
- Shelly P. Tilaye, Senior Investment Analyst, Private Equity
- Esmeralda Vita del Bosque, Senior Investment Analyst, Equities
- Dale Johnson, Senior Investment Analyst
- James Rice, Investment Officer
- Robb Van Der Volgen, Chief Counsel
- Earl W. Buehner, Senior Staff Counsel
- Johanna Fontenot, Senior Staff Counsel
- Michael D. Herrera, Senior Staff Counsel
- Christine Roseland, Staff Counsel
- Cynthia Lau, Legislative Analyst

1. APPROVAL OF THE MINUTES

1. APPROVAL OF THE MINUTES OF THE MEETING OF THE BOARD OF INVESTMENTS OF AUGUST 11, 2010.

A motion was made by Ms. Sandoval, seconded by Mr. Saladino to approve the Minutes of the meeting of the Board of Investments of August 11, 2010. The motion carried by unanimous vote.

2. APPROVAL OF THE MINIUTES OF THE MEETING OF THE BOARD OF INVESTMENTS OF SEPTEMBER 8, 2010.

A motion was made by Mr. Saladino, seconded by Ms. Sandoval, to approve the Minutes of the meeting of the Board of Investments of September 8, 2010, as corrected. The motion carried by unanimous vote.

2. PUBLIC COMMENT

Linda Dent, Arnella Sims, Keenan Sheedy, Doris Fletcher, Rosie Martinez, Sol Fingold, Cindy Singer, Leslie Simon, and Blaine Meek, both active and retired members of LACERA addressed the Board asking that they take no action in lowering the current investment return assumption and to keep the current rate at 7.75%.

Mr. William (Bill) Fujioka, the Chief Executive Officer for the County of Los Angeles reported that the County's retirement system was well funded and financially healthy. He stated that the current 89% funded ratio was strong in relation to other pension systems and that the current Unfunded Actuarial Accrued Liability (UAAL) would be recouped on schedule through the amortization mechanism established by the Board of Investments. The UAAL payments are a County obligation and are supported by both policy and practice. He reiterated that the system was sound. He also conveyed that there are no identifiable trends among other jurisdictions to reduce the assumption below LACERA's 7.75% at this time and the County has no opposition to continue the current 7.75% investment return assumption for at least one more year, with the understanding this issue will be revisited with updated information next year.

Mr. Joe Silver spoke on behalf of Edgeline Capital and expressed to the Board that Edgeline is against the adoption of the proposed revision to the Placement Agent Policy.

3. REPORT ON CLOSED SESSION ITEMS

None.

4. ACTION ITEMS

1. Recommendation as submitted by Gregg Rademacher, Chief Executive Officer: That the Board of Investments adopt recommendations to revise LACERA's actuarial assumptions as presented by LACERA's actuary, Milliman, based on the 2010 Investigation of Experience report. (Memo dated November 30, 2010.)

Mr. Rademacher provided an executive summary on the proposed recommendations to revise LACERA's actuarial assumptions. He reported that California State Law requires the Board of Investments to review the methodologies and assumptions at least every three years. This periodic review provides for rate stability, the ability for the Board to fine-tune the assumptions and methodologies, and ensuring the adequate funding of the plan liability. The 2010 valuation coincides with the triennial review of assumptions and methodologies. The actuary will be seeking Board's direction on retaining or adjusting the assumptions.

At the November meeting there was a motion by Mr. Pryor, and seconded by Mr. Saladino: To keep the 7.75% return assumption for the June 30, 2010 valuation and to revisit this assumption next year, when the next valuation is conducted. Mr. Barger then moved that the motion be tabled to the December Investment Board meeting, which was seconded by Mr. Valenzuela and the motion was approved. In making a point of parliamentary order, Mr. Rademacher pointed out the Board needs to pick up Mr. Barger's November motion off the table and address it before any other motion can be made on this matter.

A motion was made by Mr. Saladino, seconded by Mr. Pryor to take the motion off the table. The motion carried by unanimous vote.

Mr. Rademacher then introduced the principals of Milliman, LACERA's actuary, who followed with their presentation on the 2010 Investigation of Experience. Milliman provided a brief overview of the 2010 Investigation of Experience and reported that the findings of the investigation included several recommended changes in the assumptions. Although the demographic changes are relatively minor, reflecting these changes will have an immediate financial impact. Milliman is recommending that the Board make changes to the economic assumptions to reflect a lower price inflation and

correspondingly lower wage and expected rate of return on investment assumptions. The most compelling reason to lower the investment return assumption is the significant reduction in Milliman's expectations of future investment returns. The current 7.75% assumption is no longer expected to be achieved in either the short or long term. Milliman's capital market assumptions predict an expected return based on the LACERA's asset allocation of 7.50% or less. Although, the current investment return assumption falls in the best estimate range under the actuarial standards of practice, Milliman's analysis shows there is less than a 50% probability that the current 7.75% investment return will be achieved going forward, as such, Milliman characterizes the current assumption as "aggressive." This can cause several issues when funding a pension plan. In particular, when the assumption is not met, it tends to push costs into the future. Milliman therefore recommends that the investment return assumption be lowered to 7.25% or 7.50%. A brief discussion followed on concerns relating to the current County economic situation and their ability to fund additional contributions and other funding issues.

A motion was made by Mr. Valenzuela, seconded by Mr. Pryor to retain the 7.75% current rate of assumption for one year and to be revisited in one year. The motion carried with Ms. Sandoval and Messrs. Schneider, Russin and Barger voting no. A motion was made by Mr. Saladino, seconded by Chair Santos, to reconsider the motion of lowering the price inflation assumption to 3.00%, and reduce the wage inflation assumption to 3.50%.

A substitution motion was made by Mr. Unger, seconded by Mr. Santos to amend the motion retaining the price inflation assumption at 3.50%. and the wage inflation assumption at 4.00%, which are consistent with the current rate of assumption at 7.75%, and adopt the non-economic assumption. The motion failed with Ms. Sandoval and Messrs. Schneider, Russin, Saladino, Barger voting no and Messrs. Valenzuela, Pryor, Unger and Chair Santos voting yes.

A motion was made by Mr. Saladino, seconded by Mr. Russin to lower the price inflation assumption to 3.00%, and reduce the wage inflation assumption to 3.50% and keep the current rate of assumption at 7.75% and adopt the non-economic assumption. The motion failed with Messrs. Valenzuela, Pryor, Unger, Barger, Ms. Sandoval and Chair Santos voting no.

A motion was made by Chair Santos, seconded by Mr. Pryor to retain price inflation assumption at 3.50% and the wage inflation assumption at 4.00%, which are consistent with the current rate of assumption at 7.75%, and adopt the non-economic assumptions. The motion carried with Ms. Sandoval and Messrs. Schneider, Russin, and Barger voting no.

2. Recommendation as submitted by Earl W. Buehner, Senior Staff Counsel: (1) Approve the attached revised Placement Agent Policy, effective January 1, 2011; and (2) Determine whether to adopt a policy to inform the County Board of Supervisors periodically of LACERA's existing and prospective investment advisors. (Memo dated December 1, 2010.)

Chair Santos indicated that Joe Silver of Edgeline Capital would address the Board and that [Item II. Public Comment](#) would be handled at this time.

Mr. Van Der Volgen and Mr. Buehner provided a brief overview on the proposed recommendations relating to the proposed amendments to the Placement Agent Policy and the Securities Exchange Commission's "Pay to Play" Rule. After a brief discussion a motion was made to defer this item to the next regularly scheduled meeting for further evaluation.

A motion was made by Mr. Barger, seconded by Mr. Schneider to defer this item to the next regularly scheduled meeting of the Board of Investments. The motion carried by unanimous vote.

Chair Santos pointed out that section [VI. Executive Session Item A. 1.](#) would be handled at this time.

3. Recommendation as submitted by Christopher J. Wagner, Senior Investment Officer, Private Equity: That your Board adopt the 2011 Private Equity Investment Plan. (Memo dated December 1, 2010.)

Mr. Wagner gave a presentation on the proposed adoption of the 2011 Private Equity Investment Plan (“Plan”) and reported that the primary purposes of the Investment Plan are to establish an appropriate commitment pace for the upcoming calendar year and, to determine the capital allocation between the Core Program and the discretionary separate accounts, ensuring appropriate diversification to private equity investment strategies. He also reported that the Core Program focuses on existing general partner relationships that are typically raising buyout and opportunistic funds. The proposed Plan should result in the private equity allocation remaining within policy range, with the objective of returning to its target allocation. A brief discussion followed.

A motion to approve the recommendation was made by Mr. Barger, seconded by Ms. Sandoval. The motion carried by unanimous vote.

4. Recommendation as submitted by Christopher J. Wagner, Senior Investment Officer, Private Equity: That your Board approve the Private Equity Strategic Plan. (Memo dated December 1, 2010.)

Mr. Wagner gave a brief overview on the proposed adoption of the Private Equity Strategic Plan (“Strategic Plan”) and stated that the Strategic Plan defines and describes the strategy for investing in private equity assets by outlining investment objectives and guidelines, delineating the responsibilities of investment Staff, the private equity advisors and LACERA's general consultant, Wilshire Associates. The Strategic Plan also calls for Staff to annually review the entire document and LACERA's target allocation to the various-sub-asset classes of private equity and, if needed, make any necessary revisions for Board approval.

A motion to approve the recommendation was made by Mr. Pryor, and seconded by Ms. Sandoval. The motion carried by unanimous vote.

5. Recommendation as submitted by June Kim, Senior Investment Officer, Equities, and Dale Johnson, Senior Investment Analyst, Equities: (1) Adjust the target policy ranges for active regional and active emerging markets mandates to the proposed ranges shown in Table 1 of the attached memorandum; and (2) Authorize Staff to issue a request for proposal for active small cap non-U.S. equity managers using the modified minimum qualifications. (Memo dated November 30, 2010.)

Ms. Kim reported that the Non-U.S. Equity Structure review confirms that the Composite is meeting its main objectives, which are to: (1) maintain a neutral allocation to each regional component of the benchmark; (2) remain style and market capitalization neutral to the benchmark over time; and (3) maintain allocation ranges to passive and active mandates. As of September 30, 2010, the Composite outperformed the benchmark on a net of fee basis for the one, three, five and ten year annualized periods and is structured well. A brief discussion followed.

A motion to approve the recommendation was made by Mr. Barger, seconded by Mr. Valenzuela. The motion carried by unanimous vote.

6. Recommendation as submitted by Lisa Mazzocco, Chief Investment Officer, and James Rice, CFA, Investment Officer: Approve the minimum qualifications to issue a Request for Information for a Hedge Fund of Funds manager. (Memo dated December 1, 2010.)

Ms. Mazzocco presented a brief overview on the proposed minimum qualifications to issue a Request for Information (“RFI”) for a Hedge Fund of Funds manager and stated that the Board had authorized staff to issue an RFI for a Hedge Fund of Funds (“HFOF”) manager at the October 13, 2010 meeting. LACERA is using the RFI process to identify managers that can offer a customized HFOF solution that is expected primarily to diversify LACERA's global equity allocation, thereby

dampening Total Fund volatility. The two key objectives for issuing the RFI will be: (1) evaluating the feasibility of a customized hedge fund program; and (2) facilitating knowledge transfer.

Ms. Mazzocco also reported that both staff and Wilshire Associates, LACERA's general consultant identified the minimum qualifications (“MQs”) to be used in the RFI. The MQs are intended to focus the search on institutional quality managers with sufficient experience and resources to build a custom hedge fund portfolio for a public pension plan and expect that the MQs will result in qualified responses. A brief discussion followed.

A motion to approve the recommendation was made by Mr. Barger, seconded by Mr. Schneider. The motion carried with Ms. Sandoval and Mr. Russin voting no.

7. Recommendation as submitted by Richard Bendall, Chief Audit Executive and Ted Granger, Senior Internal Auditor: That your Board authorize staff to issue a Request for Proposal seeking both actuarial consulting services and actuarial auditing services. (Memo dated December 1, 2010.)

Mr. Granger provided a brief overview on the proposed Request for Proposal (“RFP”) to seek both actuarial consulting services and actuarial auditing services. A brief discussion followed.

A motion to approve the recommendation was made by Mr. Russin, and seconded by Mr. Pryor. The motion carried by unanimous vote.

8. Recommendation as submitted by the Travel Policy Committee: That your Board adopt the changes to the Education and Travel Policy. (Memo dated November 23, 2010.)

Mr. Buehner provided an executive summary on the proposed amendments to the Education and Travel Policy. A brief discussion followed.

A motion to approve the recommendation was made by Mr. Schneider, and seconded by Ms. Sandoval. The motion carried with Mr. Pryor voting no.

9. Recommendation as submitted by Gregg Rademacher, Chief Executive Officer: Determine whether to ratify travel by Board members Herman Santos and Michael Schneider in connection with their November 18, 2010 on-site inspection of LACERA's real property investments in Kauai, Hawaii, and reimburse expenses in accordance with LACERA's Education and Travel Policy. (Memo dated December 1, 2010.)

A motion to approve the recommendation was made by Mr. Pryor, and seconded by Mr. Unger. The motion carried with Mr. Russin and Ms. Sandoval voting no.

10. Recommendation as submitted by Lisa Mazzocco, Chief Investment Officer: Approve attendance of staff, as designated by the Chief Executive Officer, at the Elkind Emerging Markets forum hosted by Elkind Economics, Inc. on January 19-20, 2010, at the Four Seasons Hotel at Las Colinas in Dallas, Texas; and approve reimbursement of all costs associated with conference attendance in accordance with LACERA's Education and Travel Policy. (Memo dated December 1, 2010.)

A motion to approve the recommendation was made by Mr. Barger, seconded by Ms. Sandoval. The motion carried by unanimous vote.

5. REPORTS

1. Manager Review – Genesis Investment Management
June Kim, Senior Investment Officer, Equities and
Esmeralda Vita del Bosque, Senior Investment Analyst, Equities:
(Memo dated November 29, 2010)

Genesis

- Catherine Vlasto, Partner/Portfolio Manager
- Lisa Smart, Client Services

Ms. del Bosque reported that LACERA's Manager and Monitoring and Review Policy stipulates that formal investments manager reviews occur when a manager's last three consecutive quarters of one-year rolling excess returns are outside pre-determined performance bands. She introduced the principals of Genesis Investment Management (“Genesis”) who followed with a presentation on the fund's performance, investment strategy and philosophy. They stated that Genesis is headquartered in London, England and was founded in 1989, specializing in emerging markets. Returns in the emerging markets are gained by discovering underpriced companies through rigorous independent analysis. Genesis employs a research--inspired culture and their approach to emerging markets investing is long-term, team driven and company focused.

Since inception Genesis surpassed their benchmark by 450 basis points, net-of-fees, which far outpaces their excess return objective of 50-100 basis. They have added value for LACERA in both up and down markets. The results were primarily attributable to stock selection as well as their exposure to small cap stocks and to the frontier markets. A brief discussion follows and the Report was received and filed.

2. Commercial Real Estate Debt RFI Update

John D. McClelland, CRE, Principal Investment Officer, Real Estate
James Rice, CFA, Investment Officer
Gerald Flintoft, CAIA, Investment Officer, Private Equity
(Memo dated November 30, 2010.)

Messrs. McClelland and Rice provided an update on the Request for Information (“RFI”) for the commercial real estate debt investment management services. They reported that 28 firms had replied to the RFI, indicating broad interest from the investment management community in executing a subordinated debt strategy for LACERA on a separate account basis. The responses also confirmed that managers believe that a relatively conservative strategy of originating a portfolio of subordinated commercial real estate debt, at a level not exceeding 75% loan-to-value (“LTV”) is indeed feasible and that net returns of 7% or greater should be achievable.

Mr. McClelland stated that implementing a strategy of originating loans targeting the incremental 50% to 75% LTV portion of the capital stack is viable and likely to produce attractive risk-adjusted returns. Staff plans to complete the manager evaluation process and present finalist recommendations as soon as possible. A brief discussion followed and the Report was received and filed.

3. Corporate Governance Quarterly Review

Volume 6, Issue #3: July 1, 2010, September 30, 2010

- Dale Johnson, Senior Investment Analyst

(Memo dated November 23, 2010.) (For information only.)

The Corporate Governance Quarterly Review is for information only and was received and filed.

6. EXECUTIVE SESSION

1. CONFERENCE WITH LEGAL COUNSEL — ANTICIPATED LITIGATION (Subdivision (c) of California Government Code Section 54956.9)

1. Initiation of litigation pursuant to subdivision (c) of California Government Code Section 54956.9: One Potential Case.

Mr. Van Der Volgen reported that the Board met in closed session pursuant to Government Code Section 54956.9 to consider a potential litigation. The Board gave direction to staff concerning this matter.

2. Pursuant to Government Code Section 54957
Public Employee Performance Evaluation
Title: Chief Executive Officer

The Board met in Executive Session pursuant to California Government Code Section 54957 to consider the performance evaluation of the Chief Executive Officer. No reportable action was taken.

7. GOOD OF THE ORDER


(For discussion purposes only.)

The Board thanked Mr. Unger for his service on the Board of Investments and wished everyone a happy holiday season.

Green Folder Items

1. Chief Executive Officer's Report dated December 1, 2010.
2. Memo dated December 2, 2010, from Beulah S. Auten, Chief Financial Officer, regarding the Semi-Annual Interest Crediting for Reserves as of June 30, 2010 (Audited)
3. Memo from Lisa Mazzocco, Chief Investment Officer, regarding the 2011 Board of Investments Off-Site.
4. A copy of the Assumed Rate of Return for Large Retirement Plans in California & 1937 Act Counties as of December 7, 2010.

8. ADJOURNMENT

 PROTECT | We continue to employ solid investment and business strategies designed to serve the best interests of our members and their beneficiaries.

5/2/11