LIVE VIRTUAL COMMITTEE MEETING

SEPTMEBER 8, 2021 AT 9:00 AM*

CREDIT AND RISK MITIGATION COMMITTEE MEETING

*The Committee meeting will either be held after the Real Assets Committee meeting scheduled at 8:00 a.m. or after the Board of Investments meeting scheduled at 9:00 a.m.

TO VIEW VIA WEB

https://members.lacera.com/lmpublic/live_stream.xhtml

TO PROVIDE PUBLIC COMMENT

You may submit a request to speak during Public Comment or provide a written comment by emailing PublicComment@lacera.com. If you would like to remain anonymous at the meeting without stating your name, please let us know.

Attention: Public comment requests must be submitted via email to PublicComment@lacera.com.

LOS ANGELES COUNTY EMPLOYEES RETIREMENT ASSOCIATION
300 N. LAKE AVENUE, SUITE 650, PASADENA, CA

AGENDA

A REGULAR MEETING OF THE CREDIT AND RISK MITIGATION

COMMITTEE AND THE BOARD OF INVESTMENTS*

LOS ANGELES COUNTY EMPLOYEES RETIREMENT ASSOCIATION

300 N. LAKE AVENUE, SUITE 810, PASADENA, CALIFORNIA 91101

WEDNESDAY, SEPTEMBER 8, 2021

8:00 A.M. (Part 1 – At any time thereafter but before 9:00 AM., following the Real Assets Committee preceding it), and
9:00 A.M. (Part 2 – At any time thereafter following the Board of Investments meeting preceding it)

This meeting will be conducted by teleconference pursuant to the Governor's Executive Order N-29-20.

Any person may view the meeting online at
https://members.lacera.com/lmpublic/live_stream.xhtml

The Committee may take action on any item on the agenda, and agenda items may be taken out of order.

I. CALL TO ORDER

II. APPROVAL OF MINUTES

A. Approval of the Minutes of the Special Credit and Risk Mitigation Committee Meeting of August 11, 2021.

III. PUBLIC COMMENT

(**You may submit written public comments by email to PublicComment@lacera.com. Please include the agenda number and meeting date in your correspondence. Correspondence will be made part of the official record of the meeting. Please submit your written public comments or documentation as soon as possible and up to the close of the meeting.

You may also request to address the Boards. A request to speak must be submitted via email to PublicComment@lacera.com no later than 5:00 p.m. the day before the scheduled meeting. Please include your contact information, agenda item, and meeting date so that we may contact you with information and instructions as to how to access the Board meeting as a speaker.)

IV. NON-CONSENT ITEMS

A. Recommendation as submitted by Vache Mahseredjian, Principal Investment Officer, Chad Timko, Senior Investment Officer, Robert Santos, Investment Officer, Quoc Nguyen, Investment Officer, and Adam Cheng, Senior Investment Analyst: That the Committee advance the recommendation for the Credit 2021 Structure Review to the Board of Investments for approval.
(Memo dated August 30, 2021)

B. Recommendation as submitted by Quoc Nguyen, Senior Investment Analyst: That the Committee advance the recommendation for the Illiquid Credit Emerging Manager Program Separate Account Manager Request for Proposal Minimum Qualifications to the Board of Investments for approval.
(Memo dated August 30, 2021)

V. ITEMS FOR STAFF REVIEW

VI. GOOD OF THE ORDER
(For information purposes only)

VII. ADJOURNMENT

****The Board of Investments has adopted a policy permitting any member of the Board to attend a standing committee meeting open to the public. In the event five or more members of the Board of Investments (including members appointed to the Committee) are in attendance, the meeting shall constitute a joint meeting of the Committee and the Board of Investments. Members of the Board of Investments who are not members of the Committee may attend and participate in a meeting of a Committee but may not vote, make a motion, or second on any matter discussed at the meeting. The only action the Committee may take at the meeting is approval of a recommendation to take further action at a subsequent meeting of the Board.***

*****Although the meeting is scheduled for 9:00 a.m., it can start anytime thereafter, depending on the length of the Board of Investments meeting. Please be on call.***

Documents subject to public disclosure that relate to an agenda item for an open session of the Board of Investments that are distributed to members of the Board of Investments less than 72 hours prior to the meeting will be available for public inspection at the time they are distributed to a majority of the Board of Investments Members at LACERA's offices at 300 N. Lake Avenue, Suite 820, Pasadena, CA 91101, during normal business hours of 9:00 a.m. to 5:00 p.m. Monday through Friday.

Requests for reasonable modification or accommodation of the telephone public access and Public

Comments procedures stated in this agenda from individuals with disabilities, consistent with the Americans with Disabilities Act of 1990, may call the Board Offices at (626) 564-6000, Ext. 4401/4402 from 8:30 a.m. to 5:00 p.m. Monday through Friday or email PublicComment@lacera.com, but no later than 48 hours prior to the time the meeting is to commence.

MINUTES OF THE SPECIAL MEETING OF THE CREDIT AND RISK

MITIGATION COMMITTEE AND THE BOARD OF INVESTMENTS

LOS ANGELES COUNTY EMPLOYEES RETIREMENT ASSOCIATION

300 N. LAKE AVENUE, SUITE 810, PASADENA, CALIFORNIA 91101

8:00 A.M., WEDNESDAY, AUGUST 11, 2021

This meeting was conducted by teleconference pursuant to the Governor's Executive Order N-29-20. The public may attend the meeting at LACERA's offices.

PRESENT: Joseph Kelly, Acting Chair

Keith Knox

Patrick Jones (Arrived at 8:07 A.M.)

Elizabeth Greenwood (Arrived at 8:20 A.M.)

Gina Sanchez (Arrived at 8:11 A.M.)

MEMBERS AT LARGE:

Herman Santos

Alan Bernstein

STAFF, ADVISORS, PARTICIPANTS:

Jonathan Grabel, Chief Investment Officer

Santos H. Kreimann, Chief Executive Officer

Steven Rice, Chief Counsel

Vache Mahseredjian, Principal Investment Officer

Chad Timko, Senior Investment Officer

STAFF, ADVISORS, PARTICIPANTS: (Continued)

Robert Santos, Quoc Nguyen, Investment Officers

Adam Cheng, John Kim, Senior Investment Analysts

Meketa Investment Group
Stephen McCourt, Managing Principal, Co-CEO
Timothy Filla, Vice President
Imran Zahid, Assistant Vice President

Albourne
James Walsh, Partner/Head of Portfolio Advisory

I. CALL TO ORDER

The meeting was called to order virtually by Acting Chair Kelly at 8:08

A.M.

II. APPROVAL OF MINUTES

A. Approval of the Minutes of the Meeting of April 14, 2021.

Mr. Knox made a motion, Mr. Kelly seconded, to approve the Minutes of the meeting of April 14, 2021. The motion passed via roll call with Messrs. Knox, Jones and Kelly voting yes. Ms. Sanchez and Ms. Greenwood were absent for the vote.

III. PUBLIC COMMENT

There were no requests from the public to speak.

IV. NON-CONSENT ITEMS

A. Recommendation as submitted by Vache Mahseredjian, Principal Investment Officer, Chad Timko, Senior Investment Officer, Robert Z.

IV. NON-CONSENT ITEMS (Continued)

Santos, Investment Officer, Quoc Nguyen, Investment Officer and Adam Cheng, Senior Investment Analyst: That the Committee advance the recommendation for the Risk Reduction and Mitigation Structure Review to the Board of Investments for approval.
(Memo dated July 30, 2021)

Messrs. Mahseredjian, Santos, Timko, Nguyen and Cheng were present and answered questions from the Trustees.

Mr. Knox made a motion, Ms. Sanchez seconded, to advance the Risk Reduction and Mitigation Structure Review to the Board of Investments for approval. The motion passed unanimously via roll call with Messrs. Knox, Kelly, Jones and Ms. Sanchez and Ms. Greenwood voting yes.

B. Recommendation as submitted by Robert Z. Santos, Investment Officer and Adam Cheng, Senior Investment Analyst: That the Committee advance the recommendation for the Minimum Qualifications for a Long Duration Treasury Manager to the Board of Investments for approval.
(Memo dated July 30, 2021)

Messrs. Santos and Cheng were present and answered questions from the Trustees.

Ms. Sanchez made a motion, Ms. Greenwood seconded, to advance the Minimum Qualifications for a Long Duration Treasury Manager to the Board of Investments for approval. The motion passed unanimously via roll call with Messrs. Knox, Kelly, Jones and Ms. Sanchez and Ms. Greenwood voting yes.

V. ITEMS FOR STAFF REVIEW

There were no items for staff review.

VI. GOOD OF THE ORDER
(For information purposes only)

There was nothing to report.

VII. ADJOURNMENT

There being no further business to come before the Committee, the meeting was adjourned at approximately at 8:49 A.M.

L///CERA

August 30, 2021

TO: Trustees - Credit and Risk Mitigation Committee

FROM: Vache Mahseredjian, CFA, CAIA, FRM, ASA
Principal Investment Officer VM

Chad Timko, CFA, CAIA
Senior Investment Officer CT

Robert Z. Santos
Investment Officer

Quoc Nguyen, CFA
Investment Officer

Adam Cheng, CFA AC
Senior Investment Analyst

FOR: September 8, 2021 Credit and Risk Mitigation Committee Meeting

SUBJECT: **CREDIT STRUCTURE REVIEW**

RECOMMENDATION

Advance the Credit Structure Review (**Attachment A)** including initiatives, guidelines, and recommendations throughout the document as well as those summarized on page 33, to the Board of Investments for approval.

BACKGROUND

The Strategic Asset Allocation ("SAA") analysis completed in May of this year divided the Credit functional category into Liquid and Illiquid components, with target weights of 4% and 7%, respectively.

As part of the IPS updates approved by the Board of Investments ("BOI") in August, the benchmark for Liquid Credit is a 40%/40%/20% mix of High Yield, Bank Loans, and Emerging Market Debt (see the Appendix of **Attachment A** for details). The benchmark for the Illiquid Credit component consists of the Liquid Credit benchmark (lagged 1 month) plus 150 basis points.

SUMMARY

This structure review considers potential portfolio adjustments in response to new SAA targets adopted in May of 2021. The presentation highlights that on the surface, the adjustment to Credit might seem minor, as the total allocation declined from 12% to 11%; however, the rebalancing within Credit is material, amounting to a decrease of approximately $3 billion in the liquid component, and a commensurate increase in the illiquid component.

The presentation consists of an introductory overview followed by sections dedicated to the liquid and illiquid components. A concluding section provides a summary of initiatives and recommendations (see page 33). The new items on page 33 are shown in bold font; the other items entail implementing recommendations the BOI has previously approved, such as the new SAA targets.

- Within Liquid Credit, the recommendation is to transfer the BlackRock (previously Tennenbaum) portfolio from Liquid to Illiquid, as that more accurately reflects the manager's strategy.
- Within Illiquid Credit, the recommendation is to conduct a search for a separate account manager to implement an emerging manager program (the proposed allocation is 15% of the Illiquid Credit target). Please note that if the search is advanced by the Committee and approved by the BOI, minimum qualifications (MQs) will need to be established. Those MQs will be discussed in a separate agenda item immediately following the structure review.
- The third item in bold font is a recommendation to let the legacy investments within Illiquid Credit naturally wind down as investments either mature or funds reach the end of their term.

LACERA's consultants Meketa and Albourne reviewed the structure review and are in support of the recommendation. The consultants' consent memos are included as **Attachments B** and **C**).

Attachments

Noted and Reviewed:

____
Jonathan Grabel
Chief Investment Officer

ATTACHMENT A

Credit
2021 Structure Review

Credit and Risk Mitigation Committee Meeting

September 8, 2021

Vache Mahseredjian – Principal Investment Officer
Chad Timko – Senior Investment Officer
Quoc Nguyen – Investment Officer
Robert Santos – Investment Officer
Adam Cheng – Senior Investment Analyst

LOS ANGELES COUNTY EMPLOYEES RETIREMENT ASSOCIATION

Table of Contents

Credit: Role & Objectives

CREDIT

- Produce current income
- Moderate long-term total returns
- Moderate level of risk
- Fixed and Floating rate instruments

Liquid Credit

- Produce moderate return from lending to companies rated below investment grade
- Higher yields than investment-grade bonds
- Moderate correlation to equities
- EMD provides exposure to non-U.S. issuers and yields

Illiquid Credit

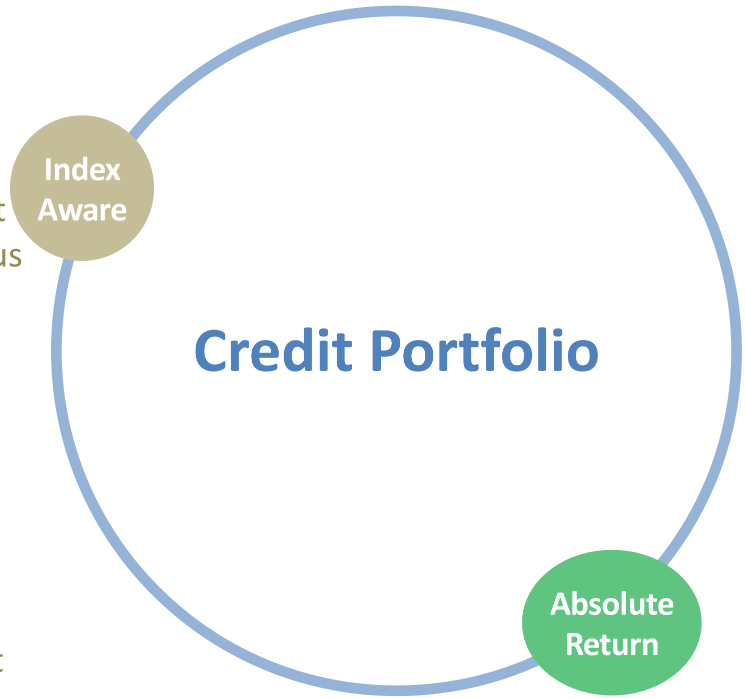
- Moderate to high return and income
- Return sources from contractual yield, complexity, illiquidity, sourcing, upside optionality, and origination
- Broad spectrum of investments

Risk Mitigation: Liquid/Illiquid Comparison

An intentionally designed Credit portfolio:

Liquid Credit

- Clearly defined benchmarks that are investable, so managers focus on performance relative to an index
- Publicly issued or broadly syndicated investments
- Have identifiers (CUSIP/ISIN*)
- Managers can be tactical within their assigned sub-composite, but not across asset sectors (not blended benchmarks)
- Can ramp up/ramp down quickly

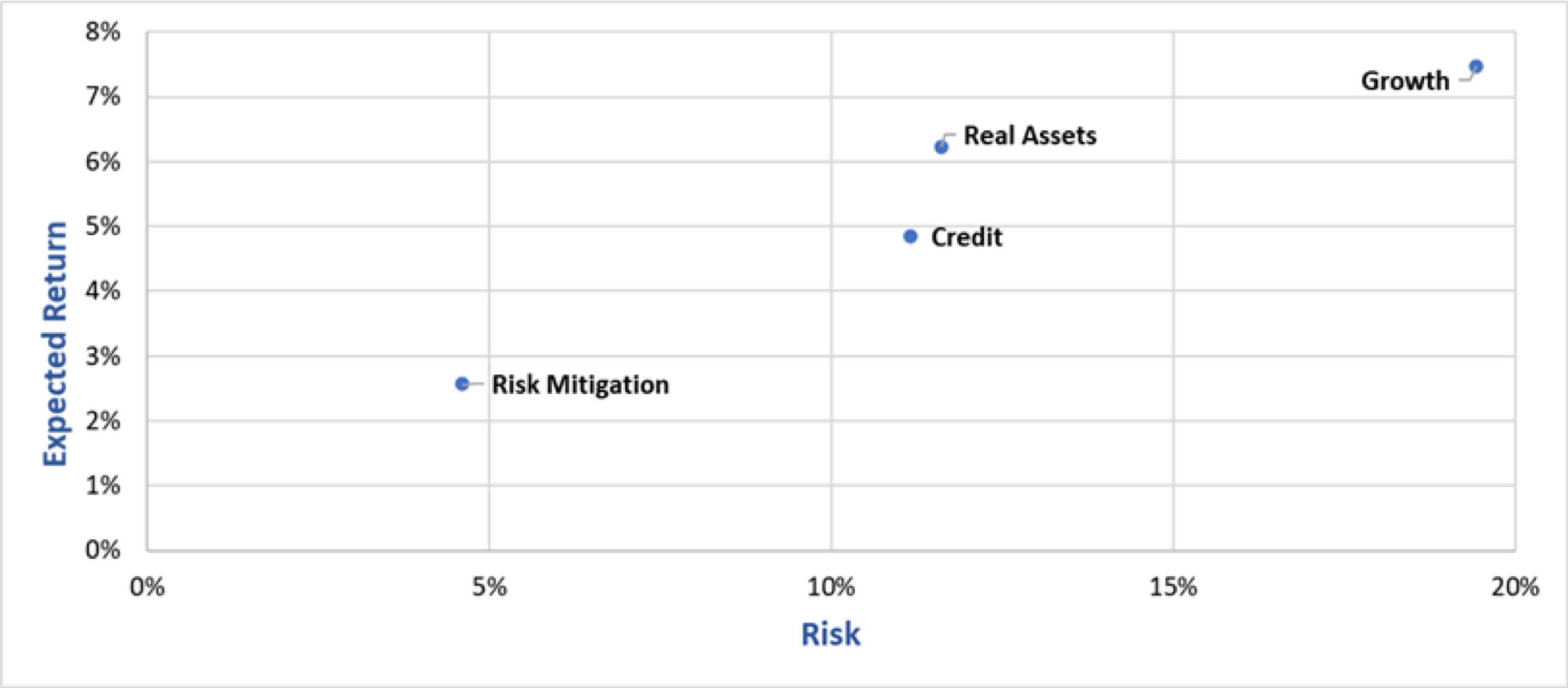


Illiquid Credit

- No investable benchmark
- Greater focus on absolute return vs "Alpha" relative to an index
- Implemented to capture complex or idiosyncratic sources of risk/return
- Private markets and direct origination
- Managers given more tactical flexibility within guideline limits
- Need time to build/liquidate portfolio

* CUSIP is a 9-digit identifier for North American securities that facilitates trade settlement.
ISIN is a similar identification system for international securities that consists of 12 digits.

Credit: Moderate Return and Risk



- Based on the most recent strategic asset allocation assumptions, Credit has an **expected return of 4.9% and expected risk of 11.2%**

Data from the 2021 Board-approved asset allocation study

Credit: Total Fund Risk Contribution as of June 2021

LACERA's Risk Analytics (MSCI BarraOne) confirm that the Credit functional category is a small contributor to Total and Active Fund Risk

Functional Asset Category	Market Value	Weight (%)	Stand Alone Total Risk	% CR to Total Risk	Stand Alone Active Risk	% CR to Active Risk
Growth	36,479,637,511	51.3%	20.3	78.1%	1.3	48.4%
Risk Reduction and Mitigation	14,635,872,141	20.6%	3.1	0.5%	0.8	2.3%
Real Assets and Inflation Hedges	11,886,135,135	16.7%	16.8	19.6%	7.4	53.5%
Credit	7,661,714,481	10.8%	5.4	3.8%	1.9	1.4%
Overlay	485,991,180	0.7%	75.0	-1.9%	75.0	-5.6%
Total Fund	71,149,350,447	100.0%	13.2	100.0%	1.8	100.0%

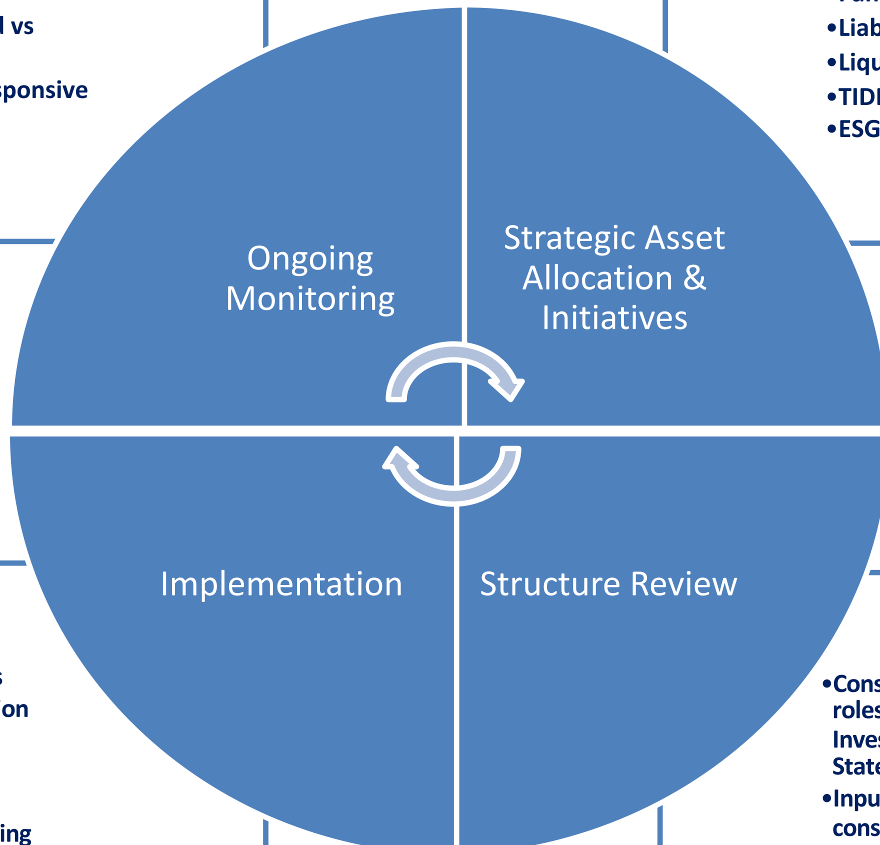
Asset Grouping	Market Value	Weight (%)	Stand Alone Total Risk	% CR to Total Risk	Stand Alone Active Risk	% CR to Active Total Risk
Credit	7,661,714,480	100.0%	5.40	100%	1.89	100%
Liquid Credit	5,729,908,584	74.8%	5.68	76%	0.94	14%
Illiquid Credit	1,931,805,895	25.2%	6.83	24%	7.03	86%

Source: MSCI BarraOne

Credit: Investment Program Oversight Life Cycle*

- Rebalance to target
- IDD/ODD/compliance
- Compare realized vs expected
- Proactive and responsive

- Total Fund risk & return
- Functional categories
- Liabilities
- Liquidity
- TIDE
- ESG



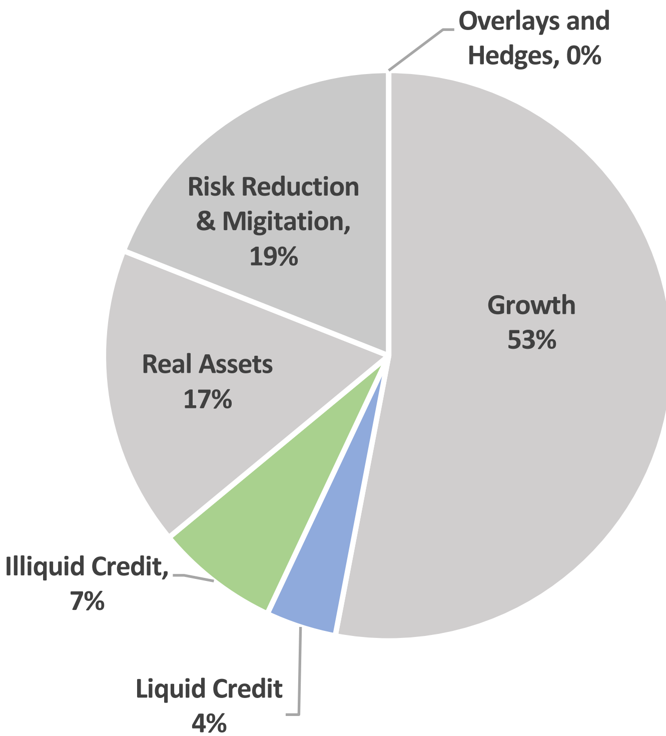
- Manager searches
- Contract negotiation
- Governance and stewardship
- Custody
- Legal and accounting
- Reporting

- Consistent with asset class roles and objectives in the Investment Policy Statement
- Input from asset category consultants
- Compare exposures to benchmark

* Items may reside in multiple categories

Credit: Asset Allocation Changes

Total Fund 2021 Asset Allocation



Credit Asset Allocation Targets

As of June 30, 2021

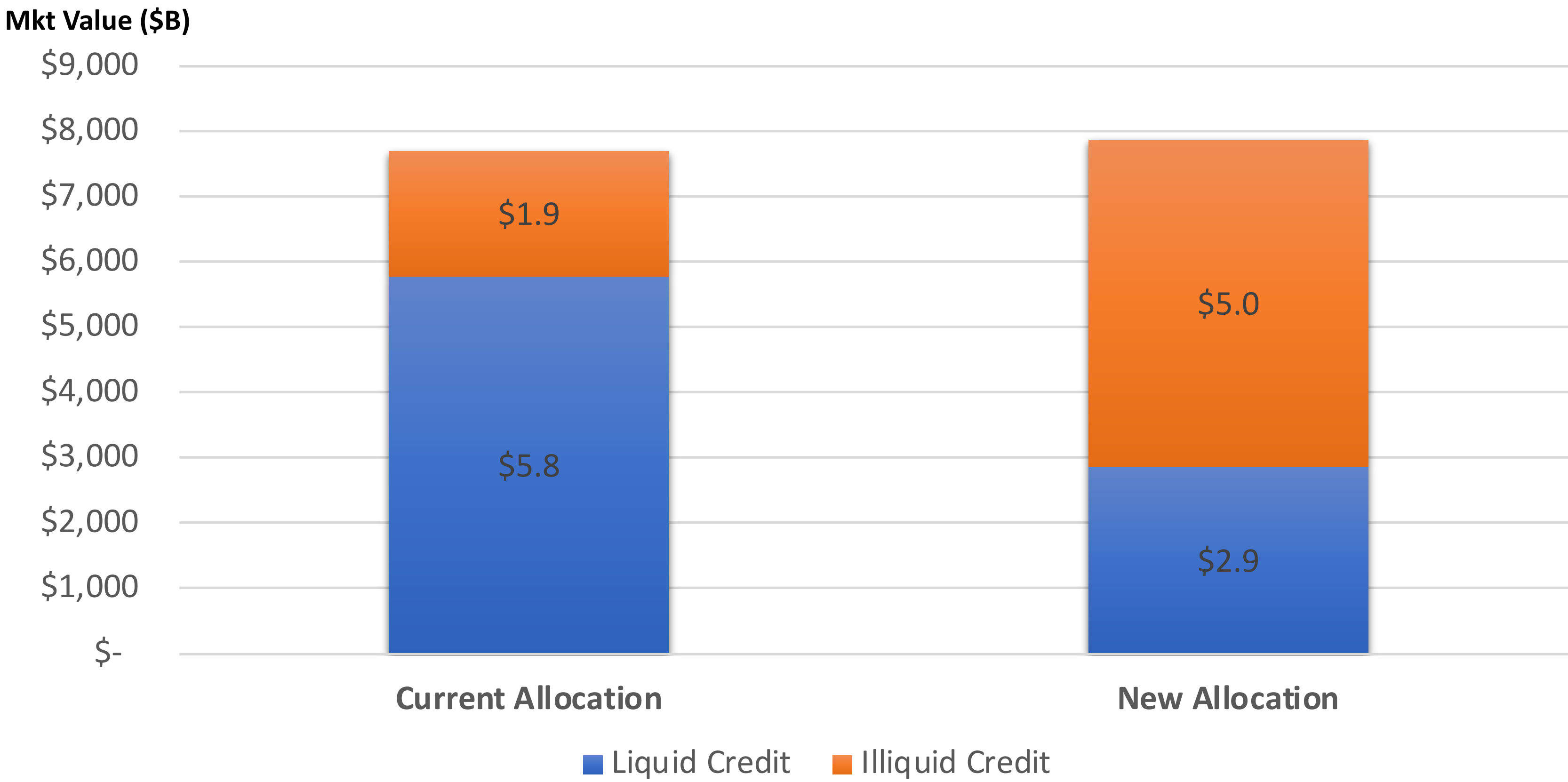
	Prior SAA Targets	New SAA Targets*	Change in %	Actual Change in ($ Billions)
Credit	12.0%	11.0%	**-1.0%**	**-$ 0.1**
Liquid	9.0%	4.0%	**-5.0%**	**-$ 2.9**
High Yield	3.0%	1.6%	-1.4%	-$ 1.1
Bank Loans	4.0%	1.6%	-2.4%	-$ 1.5
Emerging Market Debt	2.0%	0.8%	-1.2%	-$ 0.3
Illiquid	3.0%	7.0%	**4.0%**	$ 3.0

* Strategic Asset Allocation approved at May 19, 2021 Board of Investments Meeting

Percentage weight for High Yield, Bank Loans, and Emerging Market Debt are based on a 40%/40%/20% benchmark allocation, respectively. - approved at August 2021 BOI Meeting

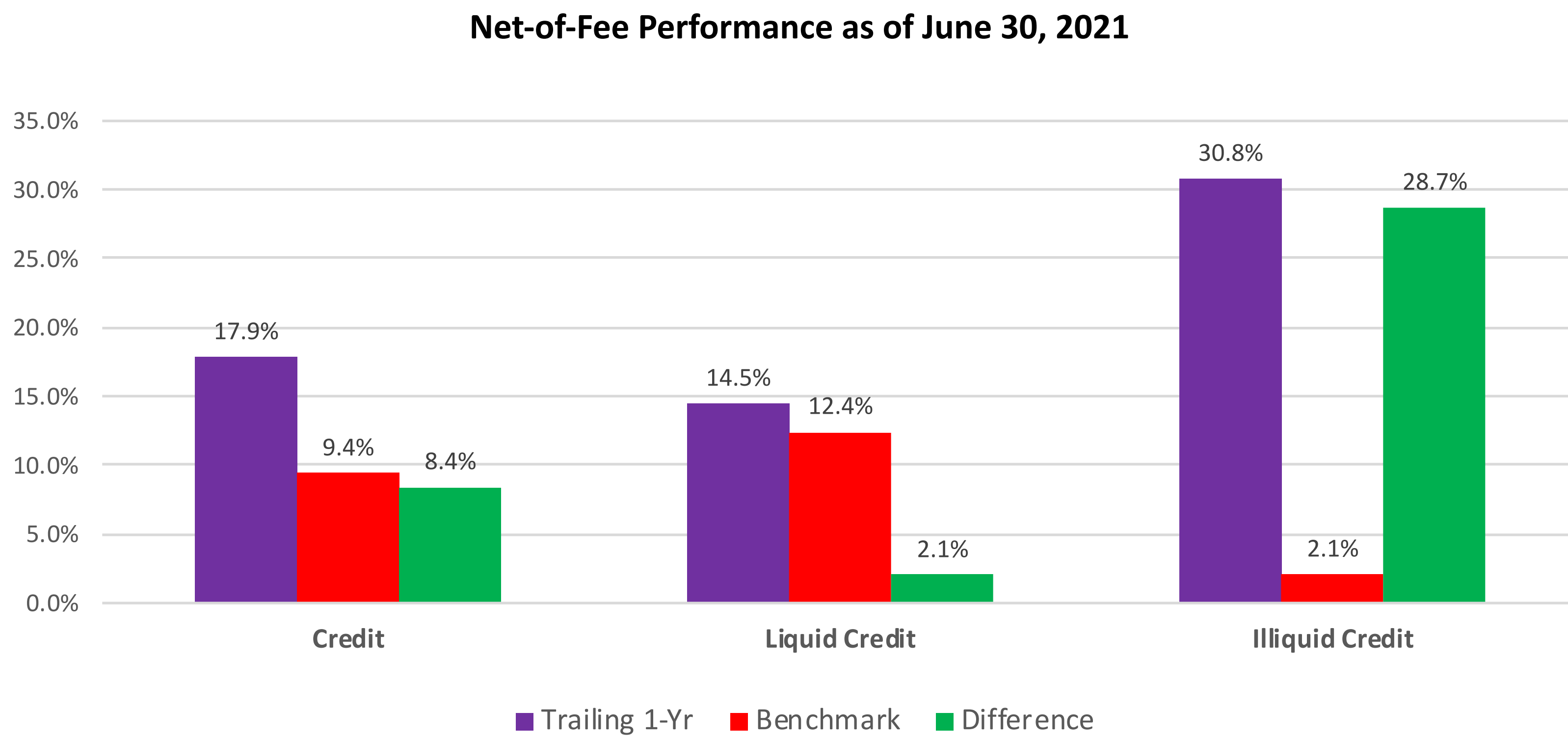
- Reduction in overall Credit appears small ($0.1 B), but there are large shifts between Liquid and Illiquid Credit
- Liquid Credit will be reduced by approximately $3 B
- Illiquid Credit will increase by $3 B

Liquid Credit



- **Substantial shift in assets within Credit**
- **Transition of assets from Liquid to Illiquid Credit strategy to occur when opportunities within Illiquid are funded**

Credit: Performance



- Solid 1-year trailing relative performance by Credit functional asset category
- Liquid and Illiquid components of Credit outperformed their respective benchmarks

Section Break

<u>Credit</u>

Liquid Credit

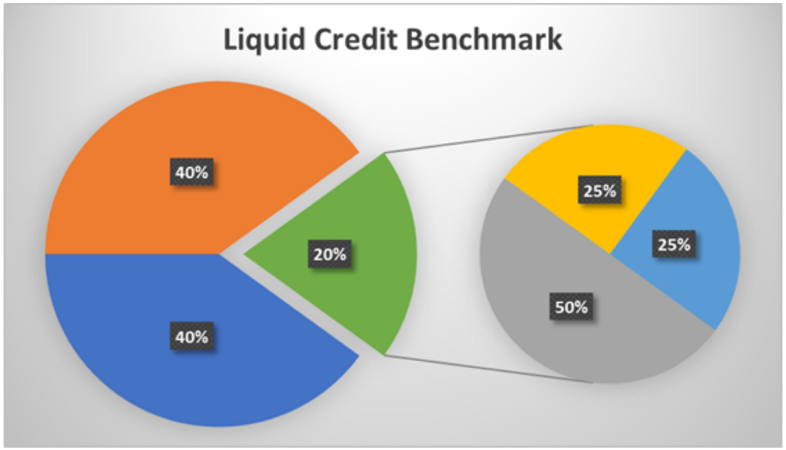
Liquid Credit: Composition

High Yield	Bank Loans	Emerging Market Debt

• Bloomberg Barclays US Corporate High Yield Index
• Corporate bonds rated below investment grade
• Index statistics:
  • Mkt Value: $1.7T
	• CS Leveraged Loan Index
	• Floating rate instruments
	• Index statistics:
	  • Mkt Value: $1.3T
		• 50% J.P. Morgan EMBI GD*
		25% J.P. Morgan CEMBI BD
		25% J.P. Morgan GBI-EM GD
		• Index statistics: (combined)
		  • Mkt Value: $4.6T**
		  • Over 70 countries

Board-approved Liquid Credit benchmark: 40%/40%/20% (HY/BL/EMD)

20% EMD split into U.S. $ denominated Sovereign (50%) and Corporate Debt (25%) plus Local Currency Debt (25%)



* See Appendix for explanation of index acronyms
** Mkt Values: EMBI GD=$0.8T, CEMBI BD=$1.4T, GBI-EM GD=$2.4T

Liquid Credit: Risk Decomposition as of June 2021

Portfolio Risk Contribution is in line with the 40/40/20 Liquid Credit benchmark *

Liquid Credit: % of Total Risk by Risk Factor				
Risk Source	High Yield Bonds	Bank Loans	EM Debt	Total Liquid Credit
Term Structure Contribution	-4%	-3%	3%	-4%
Spread Contribution	41%	38%	8%	87%
Currency Risk Contribution	0%	-1%	9%	9%
Specific Risk Contribution	0%	1%	0%	1%
Other	4%	4%	0%	7%
Portfolio Risk Contribution	40%	39%	21%	100%

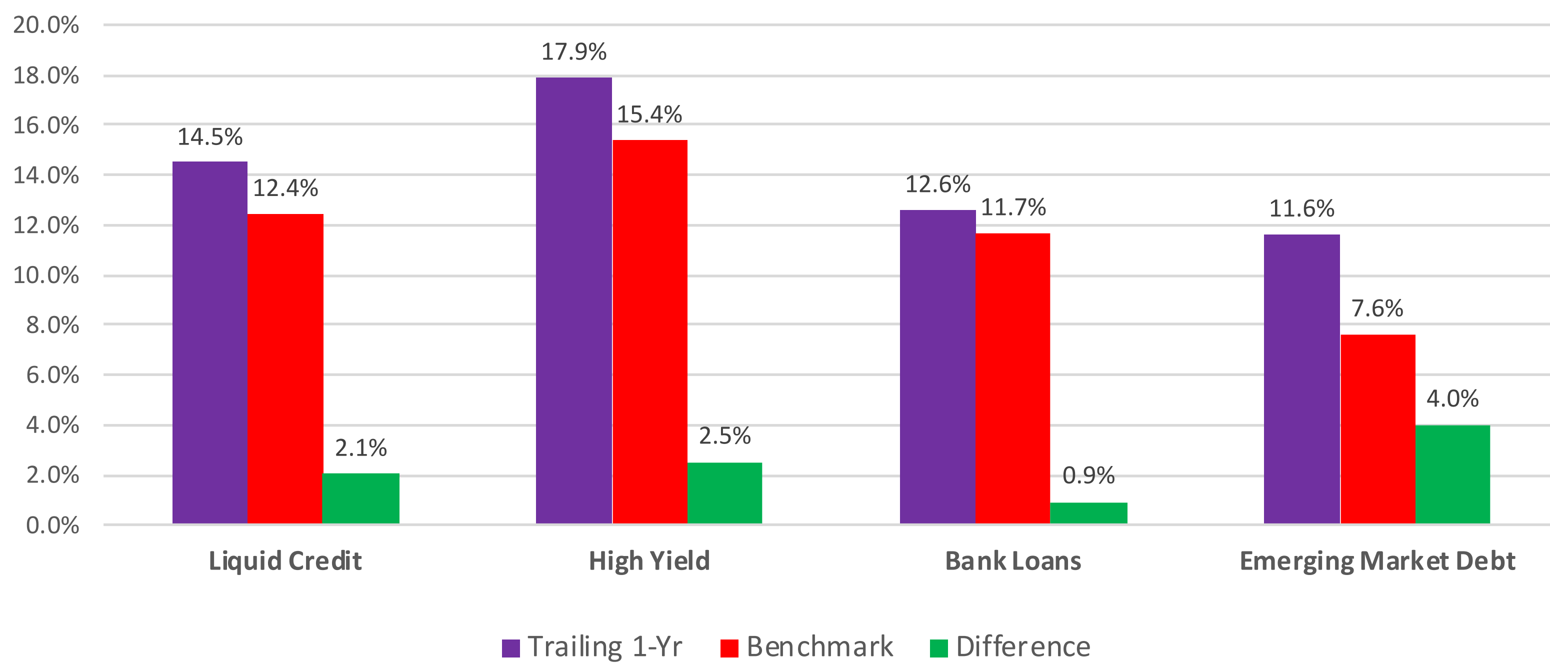
Liquid Credit: Active Risk by Factor	
Risk Source	% of Active Risk
Term Structure Contribution	2%
Spread Contribution	37%
Currency Risk Contribution	9%
Specific Risk Contribution	53%
Other	-1%
Portfolio Risk Contribution	100%

- Nearly 90% of Total Risk is attributable to credit spreads
- Active Risk in the Liquid Credit portfolio consists mostly of Credit Risk (37%) and specific security risk (53%). Currency risk is under 10%.

* Please see Appendix for Benchmark Information
**Source: MSCI BarraOne

Liquid Credit: Performance

Net-of-Fee Performance: Trailing 1-Year returns as of June 30, 2021



- Solid performance by all components of Liquid Credit, led by 4% excess returns in Emerging Market Debt accounts

Liquid Credit: Portfolio Investment Guidelines

Benchmarks	Tailored to respective high yield, bank loan, and emerging market debt benchmarks
Return Objective	Meet or exceed the return of each Board approved benchmark
Risk Target	Target tracking error of 2% over 5 years
Sectors	Benchmark weight +/- 10%
Geography	Target non-U.S. 35%, max 40%
Currency	Target non-U.S. dollar 5%, max 7.5%
Credit Quality	Benchmark weight +/- 10%
Leverage	None
Allocation Range	High yield 40% +/- 10% Bank loan 40% +/- 10% Emerging market debt 20% +/- 10%

Liquid Credit: Update Background

Jan 2019 Structure Review
- Reduced High Yield allocation from 5% to 3%
- Increased Bank Loans allocation from 1% to 4%
  - Recommendation to issue an RFP to add to the existing roster of managers
- Increased EMD allocation from 1% to 2%

Jan 2020 – Board of Investments approves recommendation to hire Bank Loan manager

Aug 2020 Mid-Cycle Structure Review
- Continued transition from multi-strategy (blended benchmarks) to single strategy mandates
- Aligned EMD portfolios to LACERA's EMD benchmark

May 2021 – Strategic Asset Allocation
- Liquid Credit reduced from 9% to 4%

2019 | **2020** | **2021**

April 2019 – Board of Investments approves Minimum Qualifications to launch Bank Loans RFP

July 2020 – Board of Investments approves Minimum Qualifications to launch High Yield Bond RFP to add to the existing roster of managers

Apr 2021 – Board of Investments approves recommendation to hire High Yield manager

- **Portfolio structure has been refined over the past 3 years to eliminate custom (blended) benchmarks, and more closely aligning strategies to Board-approved policy benchmarks**
- **Renegotiated investment management fees, saving approximately $4.8 million per year (or 8.4 bps)**
- **Terminated strategies (such as structured credit) and underperforming portfolios**
- **Current roster includes 4 bank loan, 4 high yield, and 2 emerging market debt managers**

Recommendation

Background & Rationale

- Tennenbaum Capital Partners* was hired in 2014 as part of the Legacy Opportunistic fixed income structure. Tennenbaum's direct lending strategy seeks to originate middle-market senior debt either directly or via lightly syndicated "club deals." The major sources of risk for direct lending strategies are credit and illiquidity.

- The Board of Investments adopted a functional asset category approach several years ago dividing the Credit functional asset category into Liquid and Illiquid Credit strategies.

- The Tennenbaum portfolio ($579 million as of 6/30/21) resides in Liquid Credit under Bank Loans, however based on the sources of risk and characteristics of the portfolio, Tennenbaum aligns more with Illiquid Credit.

- Tennenbaum is a better fit for illiquid Credit because they originate their own loans, versus buying broadly syndicated loans. The average yield and coupon of the portfolio are 300-350 bps in excess of the broadly syndicated loan index, reflecting the illiquidity premium of these privately negotiated loans.

- Tennenbaum's absolute net-of-fees returns for the 1, 3, and 5-yrs ending 6/30/21 were 14.3%, 7.2%, and 8.2%, respectively, resulting in excess return of 158, 299, 315 bps, respectively. Since the account's inception, the portfolio has generated annualized returns of 7.3%, outperforming the benchmark by 303 bps net-of-fees.

Recommendation

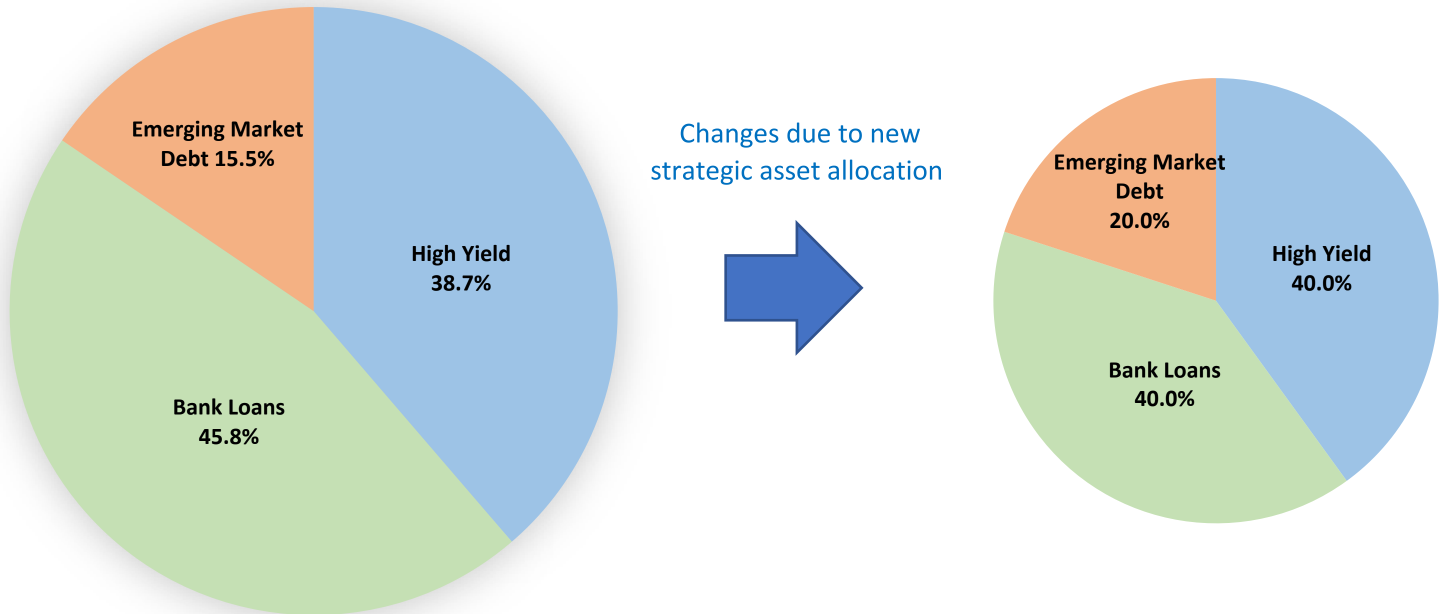
Recategorize Tennenbaum/BlackRock portfolio from Liquid Credit to Illiquid Credit

* Acquired by BlackRock Inc. in 2018

Liquid Credit: Portfolio Structure

Current Composition
(8.1% of Total Fund or $5.8 B)

New Composition*
(4% of Total Fund or $2.9 B)



- Timing/reduction in Liquid Credit assets will be dependent upon the pace of the increase in Illiquid Credit assets.
- Individual portfolio reductions within Liquid Credit will be based on manager concentration, portfolio fit, performance, etc.

* Each target allocation has a range of +/- 10%

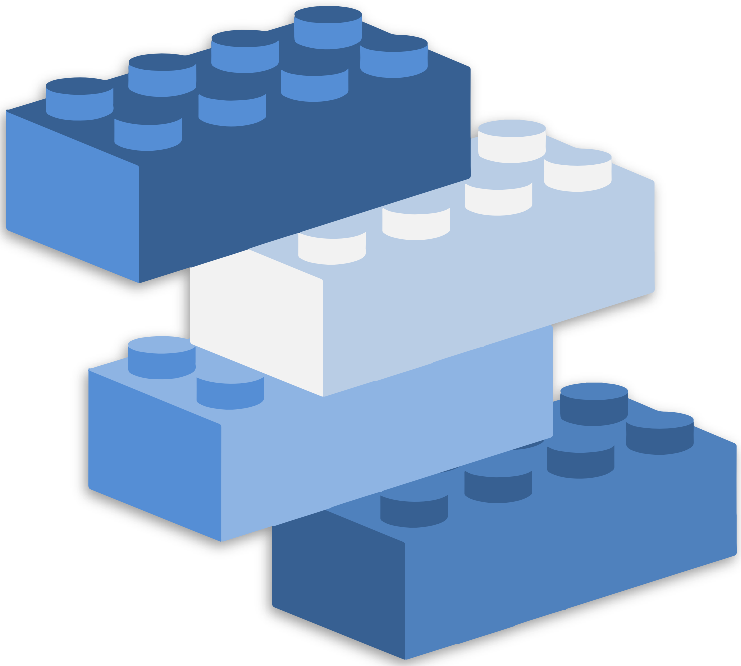
Liquid Credit: Future Initiatives

Implement New Asset Allocation Target

- Coordinate portfolio rebalancing of Liquid Credit with Illiquid Credit

Continue to improve analytics and reporting

- Onboard MSCI Barra risk system
- Enhance dialogue with managers on ESG/climate risk
- Elevate T.I.D.E. reporting



Recommendation

Recategorize Tennenbaum

- Transfer from Liquid Credit to Illiquid Credit
- $579 million as of 6/30/21

Section Break - Credit

Illiquid Credit: Role and Objectives

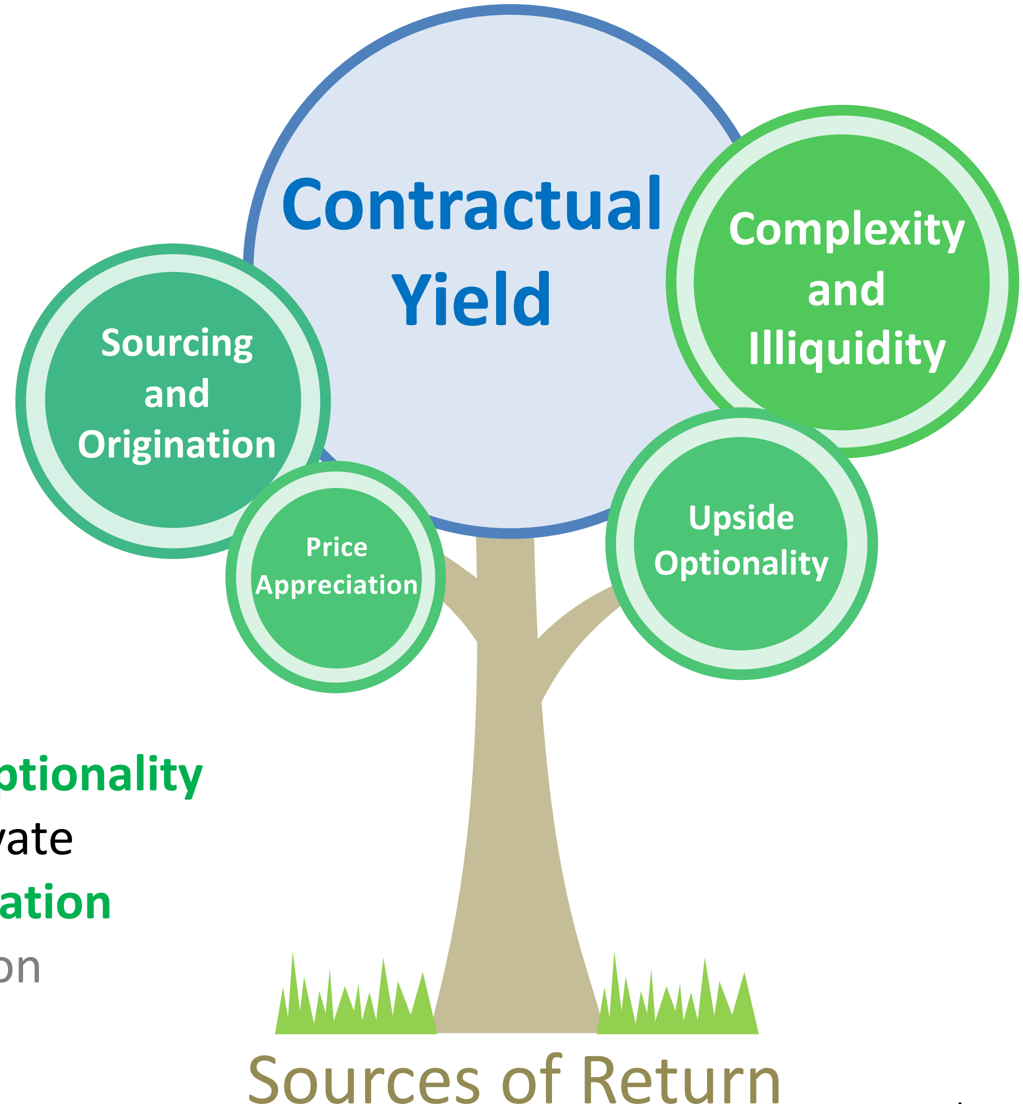
Illiquid Credit

Role:

- **Current Income**
- **Moderate Returns**

Objective:

- Emphasize **yield**
- Profit from **complexity**, **illiquidity**, and **upside optionality**
- Be compensated for private **sourcing** or direct **origination**
- Limited price appreciation expectations



Illiquid Credit: Desired Portfolio Attributes

Evergreen Mandates

We will not be forced sellers based on fund terms

Hard Hurdle Fee Structures

Only paying performance fees for above-expectation returns

Single-Investor Portfolios

Other investor actions do not impact LACERA; includes dedicated managed accounts

Complementary Exposures

Beyond corporate credit, which is a dominant exposure in LACERA's Growth portfolio

Scale Value

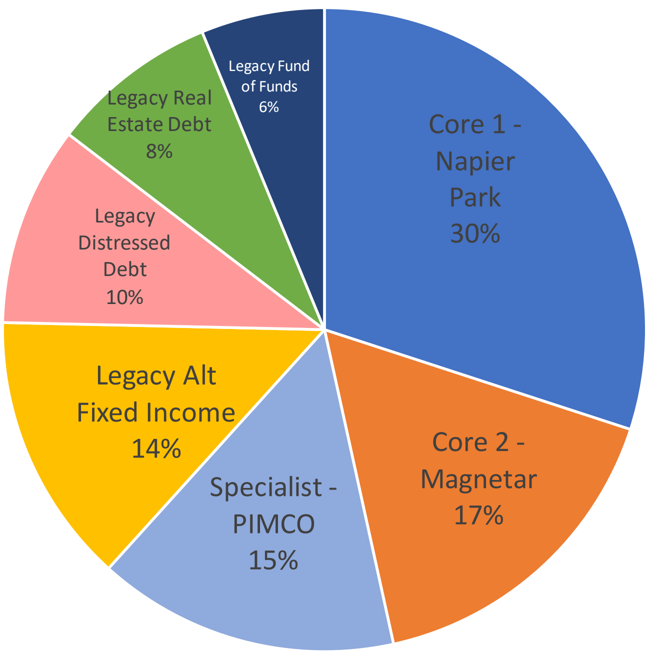
Benefit from LACERA's larger size: fees and other terms

Dynamic or Multi-Dimensional

Illiquid credit markets are inefficient and proper active management can add value

Illiquid Credit: Portfolio Composition

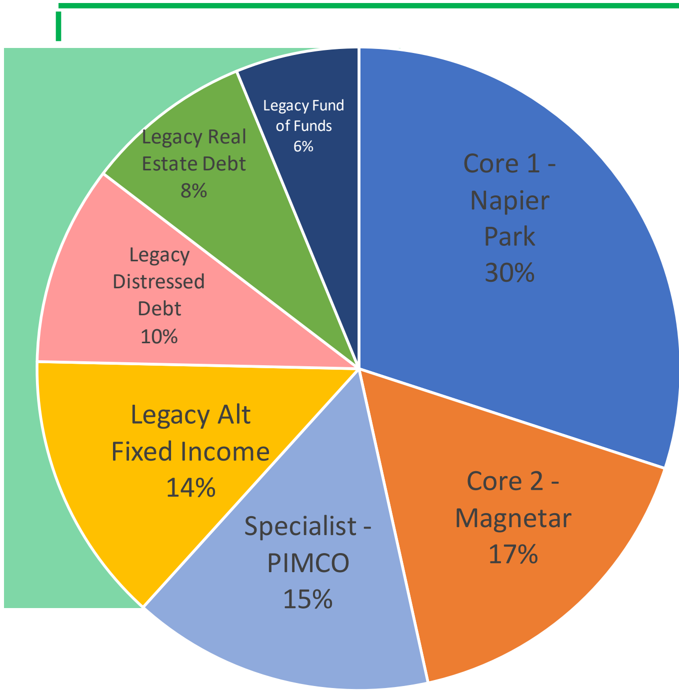
Current



- 18 funds and a fund of funds mandate
- Several existing categories:
  1. Legacy investments inherited from individual asset categories; investments identified as legacy are closed-end and have a fixed life. These investments are in the process of winding down.
  2. Core mandates are single-investor and evergreen mandates that invest dynamically across multiple Illiquid Credit markets as the opportunity set evolves; core mandates are designed to be relatively larger in size; example: Napier Park and Magnetar hired in 2020
  3. Specialist mandates are smaller in size, have fewer sub-strategy dimensions, or are less dynamic over time compared to Core mandates; example: an existing PIMCO strategy

Illiquid Credit
Portfolio Positioning

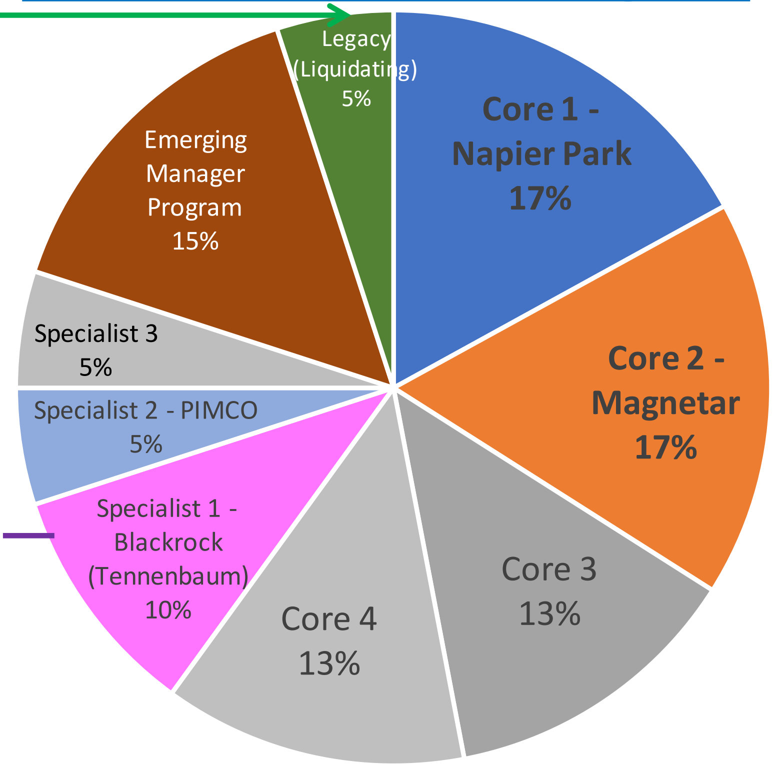
Current



Increasing portfolio by ~ $3 Billion →

Recommending to transfer Blackrock (Tennenbaum) from LACERA's Bank Loan portfolio to the Illiquid Credit portfolio.

Next Phase (1-3yrs)



Legacy and liquidating mandates identified above would be wound down over the natural life of the underlying investments and any investment vehicles or separate account agreements would be dissolved when appropriate after no underlying investments or activity remained to be managed.

Future steps

- **Hire ~2 Core mandates**
- **Augment with Specialist mandate(s)**
- **Establish and build an Emerging Manager Program**

- Percentage allocations and the quantity of core or specialist managers in Next Phase are imprecise and likely to evolve with further discussions

Illiquid Credit: Portfolio Analysis

Illiquid Credit Net Returns (%)

	LACERA Illiquid Credit	Illiquid Credit Benchmark (US Agg + 2.5%)	Bloomberg Barclays US Corporate High Yield Index	Credit Suisse Leveraged Loan Index
1-Year as of 6/30/21	30.8	2.1	15.4	11.7

- The Illiquid Credit portfolio is outperforming its Board-approved benchmark and public market indices

Illiquid Credit Gains since April 2020 (Napier Park Inception)

	$ Gain (in millions)	% of Total Gain	% Monthly Average Allocation
Napier Park and Magnetar	$ 241	75%	41%
Other Illiquid Credit (Legacy and PIMCO)	$ 79	25%	59%
Total Illiquid Credit	$ 320	100%	100%

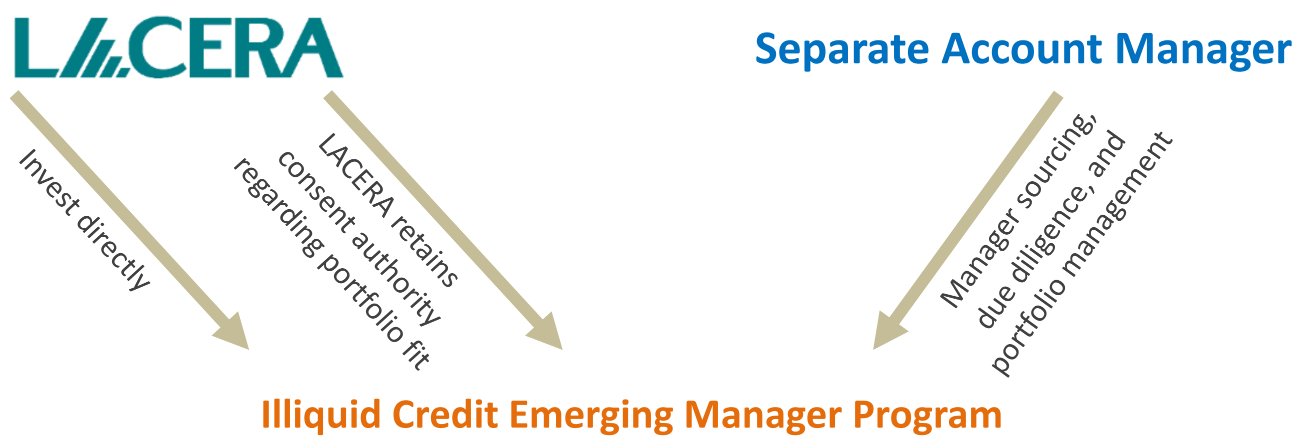
- The two most recent investments, Napier Park and Magnetar, drove outperformance
  - 75% of gains from an allocation averaging 41% of the total Illiquid Credit portfolio
  - Napier Park and Magnetar generated these strong returns with low downside volatility
  - Single-investor, evergreen, dynamic, and multi-dimensional mandates with investor-friendly fee structures are working well for LACERA

Data from State Street and through 6/30/21

Illiquid Credit: Emerging Manager Program

Background:

- LACERA does not currently have an Illiquid Credit Emerging Manager Program (“IC EMP”)
- Emerging Manager Programs are consistent with LACERA’s Investment Beliefs, benefit LACERA’s T.I.D.E. initiative, and can improve risk-adjusted return outcomes
- A separate account manager structure would allow LACERA to focus limited resources on larger allocations while casting a relatively larger net of diligence
- A qualified separate account manager may be better equipped than LACERA to cover the universe of newly launching investment firms and guide investment firm development



This structure is used in LACERA’s hedge funds and private equity emerging manager programs

Illiquid Credit: Emerging Manager Program

Portfolio Fit Considerations:

- The recommended IC EMP would directly uplift and benefit several strategic plan initiatives:

LACERA T.I.D.E.

- Due diligence
- Capital formation
- Engagement
- Industry advocacy

Strengthen Influence on Fees and Cost of Capital

- Shared ownership benefits such as revenue sharing
- Future capacity rights at attractive fee terms
- Early-stage strategic partnerships with high influence
- Mandate tailoring, co-investments, and transparency

Optimize Investment Model

- Casting a wide net
- Graduation is the goal and negotiated capacity rights allow for it at scale
- Diversifying sources of risk and return

- 15% target allocation considerations:
  - A 15% of Illiquid Credit target allocation (with a 10-20% range) would be approximately $750 million of a $71 billion Total Fund, while Illiquid Credit is a 7% strategic target allocation
  - This allocation target is attractive in several ways:
    - A $750 million IC EMP allows for manager diversification across ~ 8-12 managers
    - A $750 million IC EMP allows for individual allocations of $50-100 million, which can both be impactful to LACERA and underlying emerging firms
    - A $750 million IC EMP aligns LACERA's actions with messaging that we support inclusion, diversity, and equity efforts as well as investing in smaller and younger investment firms

Illiquid Credit: Emerging Manager Program

Expand in-house capabilities	Hire a separate account manager
Consistent with allocator to investor aspirations	Less costly for like-quality implementation
Fewer agency issues	Scale – greater breadth and depth of coverage
Potential future portability of knowledge to other parts of the portfolio or division	Likely quicker implementation
Lower "investment fees"	Lower division budget and expenses
	Potential core competency with easier severability options
	Capital efficiency

Illiquid Credit: Emerging Manager Program

Recommendation

- Establish an Illiquid Credit Emerging Manager Program with details noted below:
  - Launch a request for proposal ("RFP") search to identify a separate account manager
  - Utilize an evergreen separate account manager structure
  - Target an allocation of 15% of Illiquid Credit with a range of 10-20%

Illiquid Credit: Portfolio Guidelines

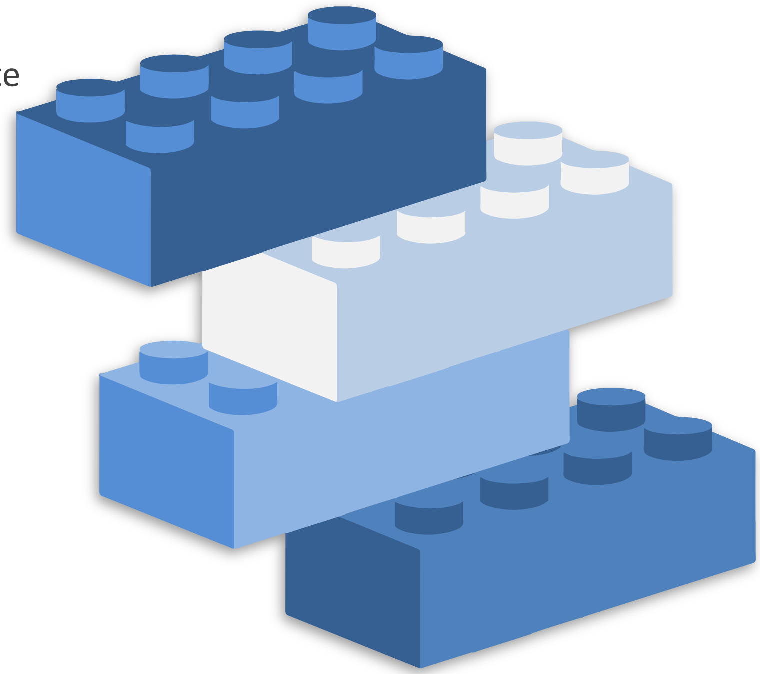
	Proposed
Return Objective	Greater than liquid credit markets; more than compensating for incremental risk
Benchmark	LACERA's Custom Liquid Credit Benchmark plus 1.5% per year
U.S. Exposure	Minimum of 50% invested in the U.S. market
Geographic Exposure	Maximum of 15% invested in non-developed markets
Currency Exposure	Minimum of 90% invested in assets that are denominated in or hedged to the U.S. dollar
Manager Count	~ 10 direct portfolio and ~ 10 emerging manager portfolio
Emerging Manager Program	Evergreen separate account emerging manager program 15% target allocation with a 10-20% range (of the Illiquid Credit portfolio)
Emerging Manager Definition	An emerging Illiquid Credit manager meets the following three criteria: - Organization has less than $1 billion of assets under management; - Organization has managed external capital in an institutional vehicle for less than 5 years; and - Organization is at least 66% owned by managing principals and employees A manager is no longer emerging if any of the following occur: - Organization managing the fund has assets under management that exceed $2 billion for the trailing 24 months and the fund has a performance track record of at least 60 months; - LACERA's initial investment occurred greater than 7 years ago; or - Organization is not at least 66% owned by managing principals and employees

- The above guidelines are in addition to policies and guidelines established in LACERA's Investment Policy Statement.
- The above benchmark guideline is scheduled to start October 1, 2021 per the approved Investment Policy Statement.
- The Geographic Exposure guideline above is intentionally more conservative than the guideline for LACERA's Liquid Credit portfolio and has a lower maximum allocation to non-developed markets because these markets potentially have fewer or less tested laws and legal precedence to protect investors in Illiquid Credit assets which may need to be held for long periods of time.

Illiquid Credit: Future Initiatives

Grow Portfolio to 7% Strategic Target

- Continue build-out while targeting the aforementioned role, objectives, and portfolio attributes
- Allow legacy portfolios to wind down and dissolve
    - Closed-end vehicles previously transferred from Private Equity, Opportunistic Fixed Income, and Hedge Funds
    - Real Estate debt separate account mandates



Build-out Pathway

- Upsize existing Core managers as portfolio size grows and within CIO-delegated rebalancing authority
- Hire ~ 2 additional core managers
- Hire specialist managers over time to augment the portfolio across strategy or geographic gaps
- Establish and build an emerging manager program

Emerging Manager Program

- Launch an RFP for a separate account manager
- Build an emerging manager program
- Highlight graduations as the goal

Next Steps

Credit: Summary of Initiatives and Timeline

Recommendation: Advance the Credit Structure Review including initiatives, guidelines, and recommendations throughout the document as well as those summarized on page 33, to the Board of Investments for approval.

2021 3Q	2021 4Q	2022 1Q	2022 2Q
Begin implementing New SAA Conduct due diligence on potential Asian Private Lending strategies	**Establish an Illiquid Credit emerging manager program and launch a separate account manager search** **Transfer Tennenbaum from Liquid to Illiquid** **Wind down legacy mandates over time** →	Manager recommendations to expand Illiquid Credit over time	Complete transition to New SAA targets

On-going Projects:

- Fine-tune/customize MSCI Risk reporting
- Enhance monitoring of ESG/Climate risks
- Improve manager reporting on Diversity & Inclusion

Note: The items shown in bold are new and require approval; remaining items entail implementing recommendations previously authorized by the BOI.

Appendix

Appendix: Credit Benchmarks

	Benchmark
Credit	**Custom Blend=(4/11)* Liquid Credit Benchmark + (7/11)* Illiquid Credit BM[1]**
Liquid Credit	40%/40%/20% blend of the following:
- High Yield	Bloomberg Barclays U.S. High Yield Index
- Bank Loans	Credit Suisse Leveraged Loan Index
- Emerging Market Debt	50% J.P. Morgan EMBI (Emerging Market Bond Index); 25% J.P. Morgan GBI-EM GD (Government Bond Index-Emerging Markets Global Diversified); 25% J.P. Morgan CEMBI BD (Corporate Emerging Market Bond Index Broad Diversified).
Illiquid Credit	Liquid Credit Benchmark + 150 basis points

[1] Weights reflect SAA target weights of 4% to Liquid Credit and 7% to Illiquid Credit

The above benchmarks are scheduled to start October 1, 2021 per the approved Investment Policy Statement

MEKETA
INVESTMENT GROUP

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Meketa.com

MEMORANDUM

TO: Each Member, Credit and Risk Mitigation Committee
FROM: Stephen McCourt, Leo Festino, Tim Filla, and Imran Zahid
CC: Jon Grabel, CIO - LACERA
DATE: August 25, 2021
RE: Credit Structure Review

The purpose of this memo is for Meketa Investment Group to formalize its support for the recommendations related the recommendations contained in LACERA's Credit 2021 Structure Review presentation.

We support Staff's recommendation to reclassify the Tennenbaum / BlackRock portfolio from the liquid credit category where it currently resides, over to the illiquid credit category within the pension trust based on the characteristics of the investment. Taking into consideration that the manager is originating loans and given the illiquidity associated with this strategy, in our view, housing this investment in the illiquid credit category appears to be a logical decision.

We also support Staff's recommendation to establish an illiquid credit emerging manager program targeting an allocation of 15%, which translates to approximately $750 million fund size within the illiquid credit category of the pension portfolio. Utilizing an external manager for this initiative is a prudent decision and we are in agreement that a qualified separate account manager would be well suited to provide the guidance needed as it relates to the development of an emerging firm, while being able to source from the full universe of newly launching investment firms. Lastly, we agree with staff's recommendation to let the legacy illiquid credit investments naturally wind down as they mature or reach the end of their terms.

If you have any questions, please feel free to reach us at 760-795-3450. We thank you for your continued trust in Meketa. We look forward to speaking with you soon.

SPM/LF/TF/IZ/sf

ALBOURNE

LACERA Illiquid Credit Structure Review Concurrence Memo

August 24, 2021

To: Each Member
Credit and Risk Mitigation Committee
Board of Investments

From: James Walsh, G. Stephen Kennedy
Albourne America LLC

For: September 8, 2021 Credit and Risk Mitigation Committee Meeting

Recommendation: Albourne America LLC ("Albourne") recommends that the 2021 Structure Review of LACERA's Illiquid Credit Portfolio be advanced to the Board of Investments for approval.

Background: Staff has prepared the 2021 Illiquid Credit Structure Review for the Credit and Risk Mitigation Committee and the Board of Investments for its consideration and ultimately its approval. Albourne has reviewed the Structure Review and agrees with the recommendations.

The Structure Review re-asserts the Investment Role and Objectives as updated in December 2019 and reviewed in August 2020, which emphasize current income, moderate returns, to profit from complexity, illiquidity, and upside optionality. The Structural Review notes that, with the approval the portfolio will continue to be built out to a 7% Strategic Target. The Next Phase of this build out is anticipated to be implemented over 1-3 years adding two Core Managers and to implement an Emerging Manager Program.

Conclusion: Staff's Structure Review outlines the focus on current income, moderate returns, and expanding the size of the program, and the actions necessary to move in that direction.

Sincerely,

James Walsh
Head of Portfolio Group

G. Stephen Kennedy
Senior Analyst

LACERA Illiquid Credit Structure Review Concurrence Memo

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L/A CERA

August 30, 2021

TO: Trustees - Credit and Risk Mitigation Committee

FROM: Vache Mahseredjian, CFA, CAIA, FRM, ASA VM
Principal Investment Officer

Chad Timko, CFA, CAIA CT
Senior Investment Officer

Quoc Nguyen, CFA QN
Investment Officer

FOR: September 8, 2021 Credit and Risk Mitigation Committee Meeting

SUBJECT: **ILLIQUID CREDIT EMERGING MANAGER PROGRAM SEPARATE ACCOUNT MANAGER REQUEST FOR PROPOSAL – MINIMUM QUALIFICATIONS**

RECOMMENDATION

Advance the proposed minimum qualifications, evaluation criteria, and scope of work within the **attachment** to the Board of Investments for approval.

BACKGROUND

The September 2021 Credit Structure Review presentation to the Credit and Risk Mitigation Committee discusses an Illiquid Credit Emerging Manager Program. Emerging Manager Programs are consistent with LACERA's Investment Beliefs, benefit LACERA's T.I.D.E. initiative, and can improve risk-adjusted return outcomes.

The **attachment** contains the recommendation and background, evaluation process, proposed search timeline, minimum qualifications, evaluation criteria, and scope of work for the proposed illiquid credit emerging manager separate account manager search.

Attachment

Noted and reviewed:

Jonathan Grabel
Chief Investment Officer

ATTACHMENT

Illiquid Credit Emerging Manager Program
Separate Account Manager
Request for Proposal
Minimum Qualifications

Credit and Risk Mitigation Committee Meeting

September 8, 2021

Recommendation and Background

Recommendation

- Advance the proposed minimum qualifications, evaluation criteria, and scope of work to the Board of Investments for approval

Background

- LACERA does not currently have an Illiquid Credit Emerging Manager Program ("IC EMP")
- Emerging Manager Programs are consistent with LACERA's Investment Beliefs, benefit LACERA's T.I.D.E. initiative, and can improve risk-adjusted return outcomes
- A separate account manager would source, conduct due diligence on, and manage a portfolio of emerging managers that adhere to LACERA's policies
- A qualified separate account manager may be better equipped than LACERA currently to cover the universe of newly launching investment firms and guide investment firm development

Evaluation Process

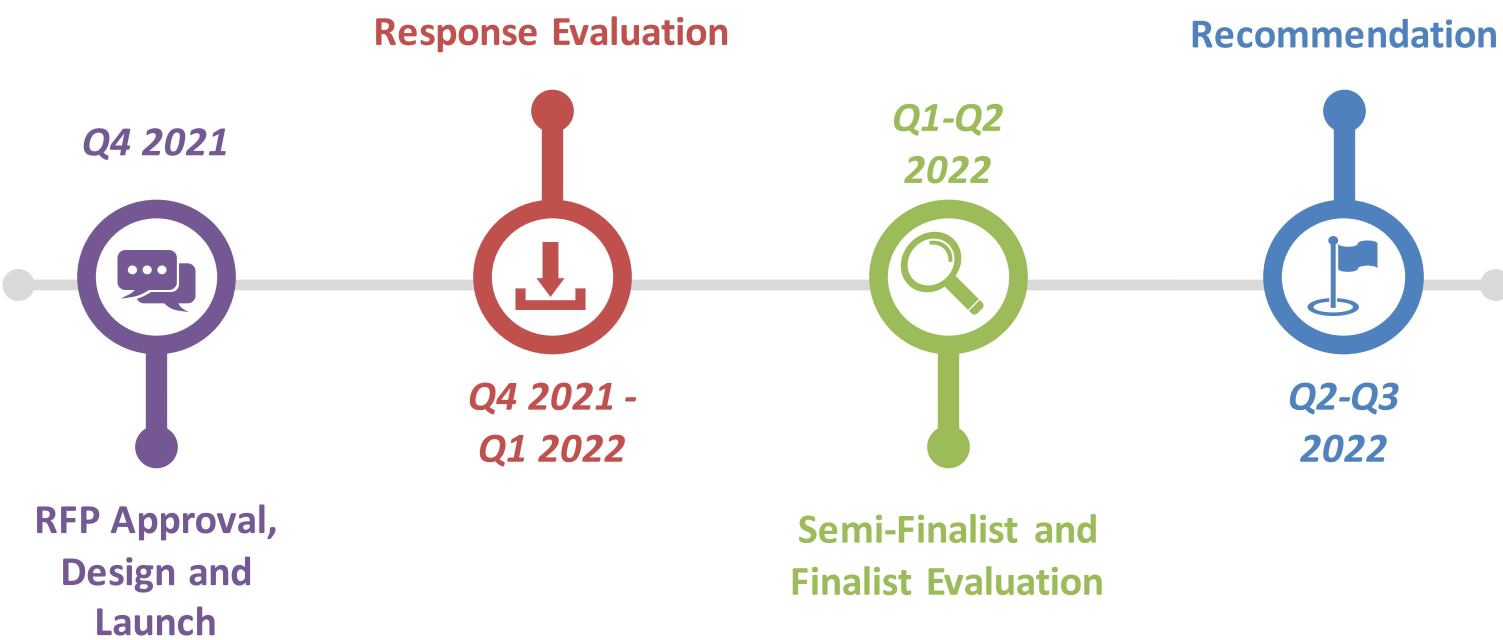
- Proposed Evaluation Team would consist of members of the Credit and Risk Reduction and Mitigation team

- Evaluation Team will conduct the Request for Proposal process in two phases:
  - Phase One: evaluation of written RFP responses
  - Phase Two: candidate interviews

- Final scores, evaluation review, and recommendation will be advanced to the Board of Investments

- Selection authority for this RFP will be the Board of Investments

Proposed Search Timeline



Minimum Qualifications

1. The organization must have sourced and invested at least $200 million in total in at least five emerging managers who managed Illiquid Credit strategies.

2. The organization must have at least three institutional emerging manager program clients with portfolio sizes that exceed $200 million, with at least one U.S. public pension fund client.

3. The organization must have three years of experience building an emerging manager program tailored to client objectives.

4. The organization must be registered with the U.S. Securities and Exchange Commission as an investment adviser, unless the organization is exempt from registration.

5. The organization must agree to be a fiduciary to LACERA under California and other applicable laws.

Evaluation Criteria

All responses received shall be subject to evaluations on the following seven categories:

1. Organization and professional staff
2. Experience with similar mandates and tailoring portfolio
3. Experience establishing shared ownership benefits for investors
4. Experience with early-stage investments and negotiations
5. Investment performance (past investments and proposed model portfolio), sourcing, portfolio construction, risk management
6. Operations, operational due diligence, and related experience
7. Fees

Scope of Work

A separate account manager would source, conduct due diligence on, and manage a portfolio of emerging managers that adhere to LACERA's policies

LACERA would seek firms with the following experiences and competencies:

- Identifying outstanding firms early in the firm's lifecycle
- Working with institutional investors and various service providers
- Constructing portfolios with objectives that are tailored to institutions such as LACERA and initiatives such as T.I.D.E.
- Inspiring credible portfolio managers to launch new firms and helping them through a launch process
- Strong operational due diligence capabilities and experience providing related guidance to new investment organizations
- Providing start-up and growth capital to emerging firms in exchange for preferred investor economics