BOARD OF INVESTMENTS MINUTES 11-10-10

PRESENT

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

ABSENT

- Leonard Unger

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
- Juan Almaguer, 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. PUBLIC COMMENT

   Chair Santos indicated Action Items III. A and B would be handled after Public Comment, Item I.

   Ms. Arnella Simms of Local SEIU 721 spoke on behalf of its members. She asked that the Board take no action in lowering the current investment return assumption rate or alter the current practice of including STAR COLA Reserves in determining the system's funded status.

   Mr. Blaine Meek stated that he is currently a member of the Coalition of County Unions and spoke on behalf of its members. He conveyed that the Coalition opposes a change in the actuarial assumptions at this time.

Mr. William (Bill) Fujioka, the Chief Executive Officer for the County of Los Angeles conveyed the County's view. He requested that the current 7.75% investment return assumption be retained for the new triennial valuation, and that the current practice with regard to the treatment of STAR COLA reserves remain in place through the three-year term of the new valuation. He also asked that the Board delay the vote for the next meeting to give the County time to hear today's discussion and to allow him to provide a comprehensive report to the Board of Supervisors.

2. REPORT ON CLOSED SESSION ITEMS

   None.

   Chair Santos indicated that item III. Action Items would be handled at this time.

3. ACTION ITEMS
   1. Recommendation as submitted by Gregg Rademacher, Chief Executive Officer: That the Board provide Milliman, the plan actuary, direction on the inclusion/exclusion of the STAR COLA Reserve as a valuation asset. (Memo dated November 3, 2010.)

      Mr. Rademacher reported on staff's recommendation that the Board provide Milliman, the plan actuary, direction on the inclusion/exclusion of the STAR COLA Reserve as a valuation asset in performing the June 30, 2010 actuarial valuation. When the Board faced this decision last year regarding the June 30, 2009 actuarial valuation, there were three primary issues to address: (1) Did the 2002 Retirement Benefit Enhancement Agreement's contract allow counting the STAR Reserve Star Reserve as a valuation asset? (2) Did the Board have discretion to count the STAR Reserve as a valuation asset? (3) Could the Board satisfy its duty of loyalty and prudence to plan members in deciding to include the STAR Reserve as a valuation asset? At the conclusion of the Board deliberation, the Board determined it was appropriate to include the STAR Reserve as a valuation asset for the June 30, 2009 valuation and that the issue should be revisited when conducting the June 30, 2010 valuation.

      Mr. Rademacher also reported that the Retirement Benefit Funding Policy excludes restricted reserves, such as the STAR Reserve, in determining the plan's funded status and setting the employer contribution rate. The employer has requested your Board consider including the STAR Reserve for the next three actuarial valuations beginning with the June 30, 2010 valuation. They argue this action will lower the required employer contribution to LACERA and provide the employer time to survive their current financial troubles. Mr. Rademacher reported that the Board has the flexibility to include a restricted reserve in the valuation assets provided the Board finds it is in the best interest of the plan members to do so. This is done through a deliberative process exploring your fiduciary duty of loyalty and prudence to the plan participants.

      Chair Santos indicated that item I. Public Comment would be handled at this time.

      A motion was made by Mr. Saladino, seconded by Chair Santos that the non-vested portion of the STAR COLA Reserve be included as a valuation asset for one year, and that the Board of Investments revisit the issue prior to next year's asset valuation. The motion carried with Ms. Sandoval and Messrs. Barger and, Schneider voting no.

   2. Recommendation as submitted by Gregg Rademacher, Chief Executive Officer: That the Board 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 2, 2010.)
      1. Milliman
         - Karen I. Steffen, FSA, EA, MAAA
         - Nick J. Collier, ASA, EA, MAAA
         - Jennifer Sorensen

Mr. Rademacher provided an executive summary on the proposed recommendation to revise LACERA's actuarial assumptions as presented by LACERA's actuary, Milliman, based on the 2010 Investigation of Experience report. He also reported that the Retirement system funding policy requires LACERA to do a valuation annually of the retirement system, but every three years under California state law LACERA is are required to challenge our methodology and assumptions. The duty of the Board is to look at the methodology assumptions because they are the cornerstone of the Plan's funding. This year is expected to be a critical year in challenging the assumptions because of the economic turmoil in the capital markets, including political issues with regard to pension funding. He reported that Milliman would provide their results on the experience study with a discussion on the economic and non-economic assumptions. He introduced the principals of Milliman who followed with their presentation on LACERA's actuarial assumptions based on the 2010 Investigation of Experience report. They reported on the results of the actuarial methods and the economic and demographic assumptions to be used in the completion of the upcoming valuation. Milliman believes there is strong evidence that a lower investment return assumption is appropriate for LACERA. They have recommended that the Board consider two sets of economic assumptions, both reflecting a lower inflation assumption, and a correspondingly lower expected return on investments. The current 7.75% investment return assumption still falls in the best estimate range under the actuarial standards of practice; however Milliman's analysis show there is less than a 50% probability that a 7.75% investment return will be achieved going forward, and that analysis 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 off into the future, which may create inequity between generations of taxpayers. Therefore Milliman recommends lowering the investment return assumption to 7.50% or 7.25%. Not lowering the assumption is likely to push Plan costs into the future, if the 7.75% assumption is not achieved.

A brief discussion followed on concerns relating to the current assumption rate and also concerns in changing said assumption rate.

A motion was made by Mr. Pryor, seconded by Mr. Santos for a one year continuation of the 7.75% rate and to revisit the economic assumption annually.

A substitute motion was made by Mr. Barger, seconded by Mr. Saladino, to table this item to the next regularly scheduled meeting of December 8, 2010. The motion carried by unanimous vote.

3. Recommendation as submitted by Vache Mahseredjian, CFA, Principal Investment Officer, James Rice, CFA, Investment Officer, and Esmeralda del Bosque, Senior Investment Analyst: Retain Credit Suisse Asset Management for a $250 million commodities mandate. (Memo dated November 1, 2010.)

   Mr. Mahseredjian provided an executive summary on the proposed finalist interview for the commodities mandate. He reported that Credit Suisse Asset Management ("Credit Suisse") was the only finalist in the search and that the other firms had not advanced mainly because they did not meet the minimum qualifications and that one of the firms was not suitable for the mandate because it obtained commodity exposure via equities. He also reported that Credit Suisse's conservative approach could complement LACERA's existing commodities composite by providing diversification and reducing the program's overall risk.

   He introduced the principals of Credit Suisse who followed with a presentation on the Credit Suisse's historical background, investment strategy and philosophy.

   1. Credit Suisse Asset Management
      - Nelson Louis, Global Head Commodities Group

- Elise Wood, Director, Business Development & Client Service

Credit Suisse reported that it is a unit of the Swiss bank and began managing commodities mandates in 1994. The firm is one of the largest managers in the asset class and has one of the longest institutional track records with more than 150 years experience. Credit Suisse's strategy operates at a lower level of risk than the existing managers. The tracking error of Credit Suisse's strategy has been 1.3% since inception, which compares favorably, to the 3.4% tracking error of LACERA's current commodities composite. In additional, the commodities composite would benefit from the diversification provided by Credit Suisse, as the correlation of its excess returns to the excess returns of the composite has been a modest 0.4. Therefore, adding Credit Suisse to the composite should reduce risk. The low risk approach would also be a very good complement because their investment style counterbalances the approaches utilized by LACERA's commodities managers. A brief discussion followed.

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

4. Recommendation as submitted by Gregg Rademacher, Chief Executive Officer: Determine whether to ratify attendance by Board member John Barger at the Institutional Investing in Infrastructure Conference, held October 31 — November 2, 2010 in Washington, D.C; and approve reimbursement of all conference fees and travel costs associated with conference attendance according to LACERA's Education and Travel Policy. (Memo dated November 3, 2010) (Placed on the agenda at the request of Mr. Barger.)

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

4. REPORTS
   1. Private Equity 2010 2nd Quarter Performance Report
      Christopher Wagner, Senior Investment Officer, Private Equity
      (Memo dated November 3, 2010.) (For information only.)

      The Private Equity 20102nd Quarter Performance Report is for information only and was received and filed.

   2. 2010 Private Equity Performance Review
      Christopher Wagner, Senior Investment Officer, Private Equity
      (Memo dated November 3, 2010.)
      1. Credit Suisse Customized Fund Investment Group
         - David R. Almodovar, Vice President

Mr. Almodovar of Credit Suisse provided an update on the private equity market and reported there is still market volatility, with weak economic factors and low deal volume constraining global private equity activity through 2010.

There are positive signs emerging with housing starts, low corporate default rates, retail sales trends, and low inflation.

Mr. Almodovar reported that LACERA's private equity portfolio represents 9.6% of LACERA's total portfolio by market value as of June 30, 2010. Also, as of June 30, 2010, the 10-year net performance of 6.8% exceeds the benchmark by 270 basis points.

The portfolio is well-diversified and continues to generate strong performance. Mr. Almodovar also reported that LACERA has built a well diversified private equity program which continues to contribute strong, long-term performance. A brief discussion followed and the report was received and filed.

3. Real Estate Performance Measurement Report 2nd Quarter 2010
John McClelland, Principal Investment Officer, Real Estate (Memo dated October 20, 2010.)

The Townsend Group

- Micolyn Yalonis
- Nakeyshia Kendall

Mr. McClelland provided an executive summary on the Real Estate Performance Measurement Report's 2nd Quarter for 2010. He introduced the principals of The Townsend Group, LACERA's Real Estate Portfolio Consultant who followed with a presentation on the fund's performance.

Townsend reported that LACERA's portfolio recorded a net appreciation of 0.8% during the second quarter 2010, its first increase since second quarter of 2007. The portfolio continues to be impacted by the weak economy. LACERA's portfolio is fairly well-positioned to weather this cyclical downturn since 78% of the investments are in core, lowly-leveraged properties. LACERA's core holdings have delivered a 4.1% net return over a five-year period. The core investments have served the Fund well, meeting the goals of diversifying the total portfolio and generating cash flow. Townsend also reported that the non-core investment did not fare as well during the downturn. The current slow pace of the job growth suggests that non-core investments will continue to suffer. A brief discussion followed and the Report was received and filed.

4. Eagle Asset Management — U.S. Equity Manager Review
June Kim, Senior Investment Officer, Equities and
Esmeralda del Bosque, Senior Investment Analyst, Equities (Memo dated October 28, 2010.)

Eagle Asset Management

- Todd McCallister Ph.D., CFA
- Jas Short, Senior Vice President

Ms. Del Bosque provided an executive summary of Eagle Asset Management, U.S. Equity Manager Review ("Eagle") and reported that LACERA's Manager and Monitoring and Review Policy stipulate 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 Eagle who followed with a presentation on their performance, investment strategy and philosophy.

Eagle employs a fundamental bottom-up investment process which aims at investing in stocks that exhibit high-quality characteristics. Some of these characteristics include companies that practice conservative financial practices, generate strong cash flow, evidence distinct long-term competitive advantages,and have top-caliber management. The portfolio is constructed with individual security weightings no greater than 3% (absolute and sector weightings of +/- 7%) relative to the benchmark. These limits ensure that the portfolio is not inadvertently biased by issuer or economic sector. It was reported that as of September 30, 2010, Eagle trailed their benchmark for the one and three year periods by 370 basis points and 80 basis points respectively. However, longer time period returns are positive relative to the benchmark. Over five years, Eagle outperformed by 110 basis points and since inception by 70 basis points. Eagle was one of LACERA's strongest equity managers through the duration of the economic downturn, outperforming its benchmark by an impressive 5.5%, net-of-fees. A brief discussion followed and the Report was received and filed.

    5. Performance Review as of September 30, 2010
       Lisa Mazzocco, Chief Investment Officer
       Investment Staff (For information only.)

       The September 30, 2010 Performance Review is for information only and was received and filed.

    6. Wilshire Consulting Investment Performance Analysis — September 30, 2010

       (For information only.)

       Wilshire's September 30, 2010, Investment Performance Analysis is for information only and was received and filed.

    7. Review and Evaluation of LACERA's Securities Monitoring Services
       Michael D. Herrera, Senior Staff Counsel (Memo dated November 3, 2010.) (For information only.)

       The Review and Evaluation of LACERA's Securities Monitoring Services is for information only and was received and filed.

       Vice-Chair Barger reported that item VI. Good of the Order would be handled at this time and that item V. Executive Session would follow.

5. EXECUTIVE SESSION
    1. Public Employee Performance Evaluation (Pursuant to California Government Code Section 54957.) Title: Chief Executive Officer

       This Item was carried over to the next regularly scheduled Investment Board meeting.

   ## Green Folder Items

    1. Chief Executive Officer's Report dated October 29, 2010.
    2. Memo from Michael D. Herrera, Senior Staff Counsel, dated November 3, 2010, regarding Review and Evaluation of LACERA's Securities Monitoring Services.
6. GOOD OF THE ORDER

   (For discussion purposes only.)

   Mr. Schneider reported on the Pacific Pension Institute seminar in Hong Kong. He found it to be very informative and recommends the conference.

   Mr. Rademacher reported that the Board of Supervisors' adopted LACERA's Benefit Replacement Plan and provided a few highlights on the Plan, with emphasis on the IRS limits. Ms. Mazzocco reminded the Board that she's working on the proposed Agenda items to be presented at the Board Off-Site to be held in January 2011.

   Mr. Barger reported that item V. Executive Session would be carried over to the next regularly scheduled Investment Board meeting.

7. ADJOURNMENT