



**STANISLAUS COUNTY
EMPLOYEES' RETIREMENT ASSOCIATION**
832 12th Street, Suite 600
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AGENDA

BOARD OF RETIREMENT
832 12th Street, Suite 600 – Wesley W. Hall Board Room
Modesto, CA 95354

**August 13, 2014
2:00 p.m.**

The Board of Retirement welcomes you to its meetings, which are regularly held on the second Wednesday and the fourth Tuesday of each month. Your interest is encouraged and appreciated.

CONSENT ITEMS: These matters include routine administrative actions and are identified under the Consent Items heading.

PUBLIC COMMENT: Matters under jurisdiction of the Board, may be addressed by the general public before or during the regular agenda. However, California law prohibits the Board from taking action on any matter which is not on the posted agenda unless it is determined an emergency by the Board of Retirement. Any member of the public wishing to address the Board during the "Public Comment," period shall be permitted to be heard once up to three minutes. Please complete a Public Comment Form and give it to the Chair of the Board. Any person wishing to make a presentation to the Board must submit the presentation in written form, with copies furnished to all Board members. Presentations are limited to three minutes.

BOARD AGENDAS & MINUTES: Board agendas, Minutes and copies of items to be considered by the Board of Retirement are customarily posted on the Internet by Friday afternoon preceding a meeting at the following website: www.stancera.org.

Materials related to an item on this Agenda submitted to the Board after distribution of the agenda packet are available for public inspection at StanCERA, 832 12th Street, Suite 600, Modesto, CA 95354, during normal business hours.

AUDIO: All Board of Retirement regular meetings are audio recorded. Audio recordings of the meetings are available after the meetings at <http://www.stancera.org/sections/aboutus/agendas>.

NOTICE REGARDING NON-ENGLISH SPEAKERS: Board of Retirement meetings are conducted in English and translation to other languages is not provided. Please make arrangements for an interpreter if necessary.

REASONABLE ACCOMMODATIONS: In compliance with the Americans with Disabilities Act, if you need special assistance to participate in this meeting, please contact the Board Secretary at (209) 525-6393. Notification 72 hours prior to the meeting will enable StanCERA to make reasonable arrangements to ensure accessibility to this meeting.

1. Meeting Called to Order
2. Roll Call
3. Announcements
4. Public Comment
5. Consent Items
 - a. Approval of the July 22, 2014, Administrative Meeting Minutes [View](#)
 - b. Approval of Letter Dated July 28, 2014 from SACRS Board of Directors [View](#)

5. Consent Items (Cont.)

c. Approval of Service Retirement(s) – **Sections 31499.14, 31670, 31662.2 & 31810**

1. Ashlock, Ronald – BHRS – Effective 07-23-2014
2. Brodie, Steven – DER – Effective 06-27-2014
3. Bruss, Glen – HSA – 08-16-2014
4. Carvalho, Jennifer – Superior Courts – 08-09-2014
5. Gonzalez, Ramon – BHRS – 07-18-2014
6. Luevano, Michael – Public Works – Effective 08-04-2014
7. Macrury, Peggy – Sheriff – 08-07-2014
8. Mc Donough, Carol – Child & Family SVCS – 08-02-2014
9. Miller, Mary Teresa – Public Health – 08-30-2014
10. Smith, Charamaine – District Attorney – 08-23-2014
11. Whitmore, Dale – Parks & Rec. – 07-31-2014

d. Approval of Deferred Retirement(s) – **Section 31700**

1. Cruz, Jose – Sheriff – Effective 03-21-2014
2. Dhesi, Jaskaran – CSA – Effective 05-03-2014
3. Duncan, Kenneth – BHRS – Effective 05-03-2014
4. Harrelson, Ralph – Sheriff – Effective 06-29-2014
5. Hartzell, Noreen – HSA – Effective 07-12-2014
6. Kochhar, Serena – CSA – Effective 05-17-2014
7. Kole, Melissa – Courts – Effective 07-24-2014
8. McLeland, Matthew – Sheriff – Effective 07-24-2014
9. Merchant, Jeanette – BHRS – Effective 04-23-2014
10. Tovar, Guadalupe – HSA – Effective 06-14-2014

e. Approval of Disability Retirement – **Section 31724**

1. Michael Glinskas, Sheriff, Service Connected, Effective 03-01-2014
2. Plante, Steven, Sheriff, Service Connected, Effective 08-25-2013

6. Executive Director

- a. Monthly Staff Report [View](#)
- b. Discussion and Action Regarding Funding of the \$5,000 Retiree Burial Allowance [View](#)
- c. Educational Presentation – Options and Portfolio Insurance [View](#)

7. Closed Session

- a. Discussion and Action Regarding Allocation of StanCERA's Real Estate Assets Government Code Section 54956.81
- b. Conference with Legal Counsel – Pending Litigation – One Case:
Stanislaus County Employees' Retirement Association v. Buck Consultants, LLC,
Mediation Pursuant to Evidence Code Sections 1115, 1119, 1152
Government Code Section 54956.9(d)(4)
- c. Conference with Legal Counsel – Pending Litigation – One Case:
O'Neal et al v. Stanislaus County Employees' Retirement Association
Stanislaus County Superior Court Case No. 648469
Government Code Section 54956.9(d)(1)
- d. Conference with Legal Counsel – Pending Litigation – One Case:
Nasrawi et al v. Buck Consultants, LLC, et.al, Santa Clara County
Superior Court Case No. 1-11-CV202224; Court of Appeal, Sixth Appellate
District, Case No. H038894 Government Code Section 54956.9(d)(1)

8. Members' Forum (Information and Future Agenda Requests Only)

9. Adjournment



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PLEASE POST FOR EMPLOYEE VIEWING

BOARD OF RETIREMENT MINUTES

July 22, 2014

Members Present: Gordon Ford, Maria De Anda, Donna Riley, Jason Gordo
Mike Lynch, Jim DeMartini, Jeff Grover, and Darin Gharat

Member Absent: Michael O'Neal

**Alternate Member
Absent:** Joan Clendenin, Alternate Retiree Representative

Staff Present: Rick Santos, Executive Director
Luiana Irizarry, Investment/Accounting Technician
Dawn Lea, Benefits Manager
Kathy Herman, Operations Manager
Natalie Elliot, Accountant

Others Present: Fred Silva, General Legal Counsel

1. Meeting called to order at 2:03 p.m. by Gordon Ford, Chair.

2. **Roll Call**

3. **Announcements**

4. **Public Comment**

5. **Consent Items**

Motion was made by Jeff Grover and seconded by Darin Gharat to approve
Consent Items as presented.

Motion carried unanimously.

a. Approval of the July 9, 2014 Administrative Meeting Minutes

b. Approval of the StanCERA's Holiday Closure Schedule

6. **Annual Update and Review – Jackson Square Partners**

a. Quarterly Value Added Report

M. De Anda left at 2:49 p.m.

M. De Anda returned at 2:52 p.m.

7. **Strategic Investment Solutions (SIS), Inc.**

- a. Monthly Performance Review for the Month Ending June 30, 2014
- b. Report on "Top 10 Holdings" by StanCERA Investment Managers as of June 30, 2014
- c. Discussion and Action Regarding Infrastructure Investment Option

J. Grover left meeting at 3:40 p.m.

Board of Retirement directed SIS, Inc. to conduct diligence and research in the private, core market space.

8. **Executive Director**

- a. Discussion and Action Regarding Investment Policy Change

Motion was made by Darin Gharat and seconded by Jeff Grover to approve Investment Policy Change.

Motion carried unanimously.

9. **Correspondence**

- a. Letter Dated July 16, 2014 from White Oak Global Advisors, LLC

10. **Closed Session**

- a. Discussion and Action Regarding Allocation of StanCERA's Real Estate Assets Government Code Section 54956.81
- b. Conference with Legal Counsel – Pending Litigation – One Case: Stanislaus County Employees' Retirement Association v. Buck Consultants, LLC, Mediation Pursuant to Evidence Code Sections 1115, 1119, 1152 Government Code Section 54956.9(d)(4)
- c. Conference with Legal Counsel – Pending Litigation – One Case: O'Neal et al v. Stanislaus County Employees' Retirement Association Stanislaus County Superior Court Case No. 648469 Government Code Section 54956.9(d)(1)
- d. Conference with Legal Counsel – Pending Litigation – One Case: Nasrawi et al v. Buck Consultants, LLC, et.al, Santa Clara County Superior Court Case No. 1-11-CV202224; Court of Appeal, Sixth Appellate District, Case No. H038894 Government Code Section 54956.9(d)(1)

11. Members' Forum (Information and Future Agenda Requests Only)

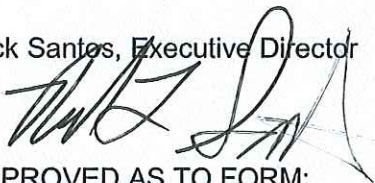
D. Gharat left meeting at 3:54 p.m.

12. Adjournment

Meeting adjourned at 3:54 p.m.

Respectfully submitted,

Rick Santos, Executive Director



APPROVED AS TO FORM:
FRED A. SILVA, GENERAL LEGAL COUNSEL

By:


Fred A. Silva, General Legal Counsel

Date: July 28, 2014
To: SACRS Board of Directors
From: Robert Palmer, SACRS Executive Director
Subject: Update On Ad Hoc Committee's Progress

To Educate Or Not To Educate...That Is The Question....

As Hamlet's contemplates his continued existence in his moving soliloquy, it serves well as an analogy for the future direction that SACRS should consider.

The ad hoc committee appointed by Yves Chery, SACRS President, is very much aware that moving in a direction to provide more educational information on the advantages of defined benefit plans is a new and challenging area for SACRS. SACRS is composed of twenty county pension systems that often see their system's role as quite different from each other.

The initiative filed in Ventura is a line in the sand for us. Some see this as the start of a "domino effect". Others have conveyed that the issue of benefits is really an employer and employee issue. They are the responsible parties and therefore they should be the ones mounting an active defense if they wish to maintain their current benefits.

We in SACRS are supposed to be trustees and fiduciaries, which is true. But we are also the most knowledgeable about our business. We know fact from misrepresentation better than any other entity. Some trustees and administrators want to wait to see the outcome of the initiative, others believe the time is now, and not wait. It is this environment that the ad hoc committee was asked to discuss and make recommendations to the SACRS Board of Directors. The intent is that the SACRS Board of Directors will have a plan and present it to the full membership at the next conference.

To get more actively involved leads to a discussion of public exposure. The topic of SACRS creating more visibility is very difficult. Historically, we have pride ourselves on staying under the radar. So who should lead the discussion on the positive aspects of providing DB plans? There is so much negative information being released that is going unchallenged. We are really the experts on this subject. But it has been the employer and the employees who have negotiated and changed the plans' benefits. They are ultimately responsible for the content of the plans. Many of the systems are signaling that they are uncomfortable with publicly supporting the defined benefit plans as proposed by the SACRS Executive Director.

Is there a role for SACRS in this issue? And what form should it take?

Sometimes, it is necessary to take small steps in matters of great importance. And that is the direction that the ad hoc committee is advising the SACRS Board of Directors to consider.

It has been suggested that we should focus on our own membership and affiliations on the importance of the defined benefit plans. We find that our members have a limited understanding of the benefits to which they are entitled. Also it has been said that the level of interest is primarily because they trust us. They know that we function in the best interests of the members. They know that “the promise” made to them by their employer will be fulfilled by us, the trustees.

At this point in time, the ad hoc committee is suggesting that factual information be gathered and made available for internal use among the SACRS systems and their affiliations. The purpose would be twofold: to educate the members and other interested parties of the SACRS organization on the positive aspects of their defined benefits and also to provide a clear and consistent understanding of our business. So often factual information about our plans is misinterpreted or used in an inappropriate way. Having one source may prove useful to all systems and to their membership.

With this general direction in mind, the ad hoc committee believes it is necessary to establish policies and procedures on how this communication would be undertaken. The ad hoc committee plans to meet with a professional communications firm to explore creating and maintaining a method of providing ongoing and useful information to the SACRS systems. If this appears to be feasible it may become part of the ad hoc committee’s recommendation to the SACRS Board of Directors for consideration to the full membership.

As this project progresses, we will provide you, the Board, with further updates and a possible plan of action.

Thank you,

Robert Palmer

Robert Palmer,
SACRS Executive Director

Cc: Members of the ad hoc Committee



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**For the Board of Retirement Meeting
Held on August 13, 2014**

TO: Board of Retirement

FROM: Rick Santos, Executive Director

- I. SUBJECT: StanCERA Monthly Staff Report
- II. ITEM: #6a
- III. ITEM TYPE: Information
- IV. STAFF RECOMMENDATION: None
- V. ANALYSIS: The monthly staff report's intent is to report out to the Board of Retirement important issues/tasks staff has been working on over the past month.
 - a. *Regular workload* – Staff's main focus over the past month has been getting the regular work product out. StanCERA has been down 2.5 staff members for the past month due to extended medical leaves and will be losing one more permanently this week. In the meantime, StanCERA has hired one temporary person and has put the data audit process on hold temporarily until we are at or near fully staffed. We have also farmed out some of the disability summarizing and organization duties to our disability attorney.
 - b. *Strategic Realignment* – Management continues to meet regularly as it assesses its technology, staff and process needs over the next 10 years. In some ways, we have learned a great deal about potential Organizational soft spots due to the recent staff shortages we have experienced. Management has also been meeting with individual staff members to redefine job duties if necessary and make sure that position is and can function at the level the Organization requires over the next 10 years. Research continues towards the assessment and capabilities of our pension software. Staff is still on track to bring the long term Organizational realignment to the Board late summer or early fall.
 - c. *Preparation for financial audit* – The Northern Trust bank transition is now complete. The audited reports have been received and reconciled as required prior to closing the general ledger. Interest was posted to member accounts and statements were processed. The 2014 earnings have been calculated and allocated to the appropriate reserves, contributions have been posted and cash has been reconciled. Staff is working to complete all the year-end processes necessary for the upcoming financial audit. In addition, each year a schedule of work listing approximately 74 items is requested by the auditors. Most of these items are to be completed and uploaded electronically prior to the auditors arriving on site. This year GASB 67 & 68 will add complexity to the process as well. Staff has also been coordinating with the actuary and employers for any information the auditors may require from them.

VI. RISK: None

VII. STRATEGIC PLAN: Refine StanCERA's business and policy practices in ways that enhance stakeholder awareness, the delivery of member services and the ability of the Organization to administer the System effectively and efficiently.

VIII. ADMINISTRATIVE BUDGET IMPACT: None

A handwritten signature in blue ink, appearing to read "Rick Santos", written over a horizontal line.

Rick Santos, Executive Director

A handwritten signature in blue ink, appearing to read "Kathy Herman", written over a horizontal line.

Kathy Herman, Operations Manager

A handwritten signature in blue ink, appearing to read "Dawn Lea", written over a horizontal line.

Dawn Lea, Benefits Manager



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**For the Board of Retirement meeting
Held on August 13, 2014**

TO: The Board of Retirement

FROM: Rick Santos, Executive Director

- I. SUBJECT: Funding of the \$5,000 Retiree Burial Allowance
- II. ITEM NUMBER: #6b
- III. ITEM TYPE: Discussion and Action
- IV. STAFF RECOMMENDATION: As of June 30, 2014, include the liability from the \$5,000 Retiree Burial Allowance into the annual actuarial valuation and pay the benefit from valuation reserves. Modify the excess earnings policy to allocate future earnings to the Retiree Benefit Allowance reserve in the same way as all other valuation reserves
- V. ANALYSIS: The \$5,000 burial allowance is a benefit StanCERA offers which pays the family of a passing retiree a lump sum of \$5,000. Actuarially, the benefit is small and the present value of all benefits that will ever be paid to current retirees is around \$6.8 million.

Recently, StanCERA's actuary inquired about the possibility of including the \$5,000 burial allowance in the annual actuarial valuation. Our actuary has said that the benefit should be included within the new GASB 67/68 reporting requirements and as a result, recommends bringing it within the normal actuarial process as well. Currently, StanCERA pays the benefit directly from a non-valuation reserve called the Retiree Burial Allowance reserve. Placing the burial allowance benefit within the normal actuarial process will eliminate the need for the actuary to calculate the benefit independently for funding requirements and from having to pay the benefit from a non-valuation reserve.

Currently, there is approximately \$5.6 million in the Retiree Burial reserve which means if its liability is included in the normal actuarial valuation process, there would be an initial unfunded liability of around \$1.2 million. This equates to about a .04% increase in the employer rate beginning fiscal year 2015-2016.

1937 Act law does not place restrictions on how the benefit may be funded or where the assets that pay the benefit come from. And in 2012, the Board of Retirement affirmed the benefit as vested. As such, staff recommends as of June 30, 2014, including the liability from the \$5,000 Retiree Burial Allowance reserve into the annual actuarial valuation and pay the benefit from valuation reserves. Staff also recommends modifying the excess earnings policy to allocate future earnings to the Retiree Benefit Allowance reserve in the same way as all other valuation reserves.

VI. RISK: None

VII. STRATEGIC PLAN: Refine StanCERA's business and policy practices in ways that enhance stakeholder awareness, the delivery of member services and the ability of the Organization to administer the System effectively and efficiently.

VIII. ADMINISTRATIVE BUDGET IMPACT: No appreciable impact



Rick Santos, Executive Director



Kathy Herman, Operations Manager



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**For the Board of Retirement meeting
Held on August 13, 2014**

TO: The Board of Retirement

FROM: Rick Santos, Executive Director

- I. SUBJECT: Options and Portfolio Insurance
- II. ITEM NUMBER: #6c
- III. ITEM TYPE: Information
- IV. STAFF RECOMMENDATION: None
- V. ANALYSIS: This item is an educational item related to the concept of portfolio insurance and the use of equity options. In November 2013 at the SACRS semi-annual meeting, one of the speakers spent a short period of time discussing the concept of portfolio insurance and its application to pension funding.

Portfolio insurance is a way to alter the annual return distribution of a portfolio by essentially giving up some favorable investment returns in exchange for downside protection against poor returns.

This item is essentially educational in nature and is meant to gauge the Board's interest in this concept for future consideration.

- VI. RISK: None
- VII. STRATEGIC PLAN: Refine StanCERA's business and policy practices in ways that enhance stakeholder awareness, the delivery of member services and the ability of the Organization to administer the System effectively and efficiently
- VIII. ADMINISTRATIVE BUDGET IMPACT: None

Rick Santos, Executive Director

Options & Portfolio Insurance

August 13, 2014

Objectives

- Understand how equity options work
- Understand theory behind portfolio insurance
- Gauge Board's interest in using hedging assets

Portfolio Insurance

- *Definition:* Portfolio Insurance is a way to guard against those extreme events that can cripple a portfolio
- *Concept:* Eliminate extreme bad scenarios in exchange for giving up some favorable returns
 - Example: Eliminate returns less than -15% by giving up returns greater than 13%

Options

- Basically an insurance policy
 - Buyer pays a premium
 - Receives a payout if some event happens



Financial Options

- Options come in many forms
 - Weather
 - Price of corn
 - Dollar price of a euro
 - Pork Bellies
 - Interest Rates
 - Equities

Financial Options Example

- Weather
 - Insured gets paid if annual rainfall is below 15" in Sacramento
- Dollar price of a euro
 - Insured gets paid if dollar price of a euro goes above \$1.35 sometime over the next 3 months
- Equities
 - Insured gets paid if Apple goes below \$75 over the next year

Option Terminology

- *Strike Price*
 - Price or event at which payment is triggered
- *Option Price*
 - Price of the premium
- *Expiration Date*
 - Term (period that you're insured)

Two Types of Options

- Call Options

- Buyer pays a premium
- Buyer receives payout if and only if the stock price is greater than strike price over some period

- Put Options

- Buyer pays a premium
- Buyer receives payout if and only if the strike price is greater than stock price over some period

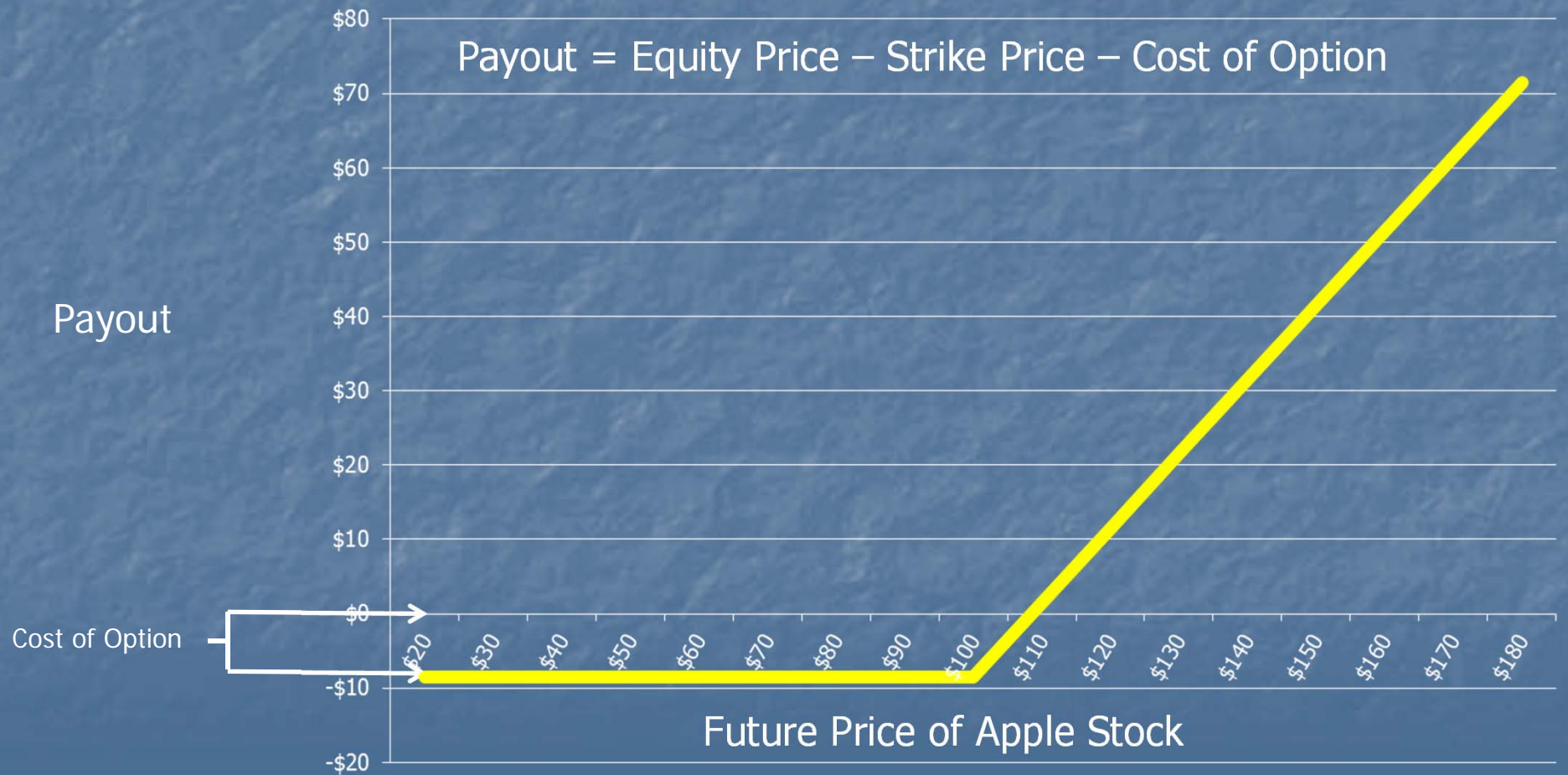
Call Option Example

- Buy an option for \$8.50 on 1 share of Apple stock with a strike price of \$100
- Option pays off if Apple stock goes *above* \$100
- Option is worthless if Apple stock ends up *below* \$100

<u>Future Apple Price</u>	<u>Payout</u>	<u>Profit*</u>
\$80	\$0	\$-8.50
\$100	\$0	\$-8.50
\$120	\$20	\$11.50

*Profit takes into account the price of the option

Call Option Payout Pattern for the Buyer



Put Option Example

- Buy an option for \$8.50 on 1 share of Apple stock with a strike price of \$100
- Option pays off if Apple stock goes *below* \$100
- Option is worthless if Apple stock ends up *above* \$100

<u>Future Apple Price</u>	<u>Payout</u>	<u>Profit*</u>
\$80	\$20	\$11.50
\$100	\$0	\$-8.50
\$120	\$0	\$-8.50

*Profit takes into account the cost of the option

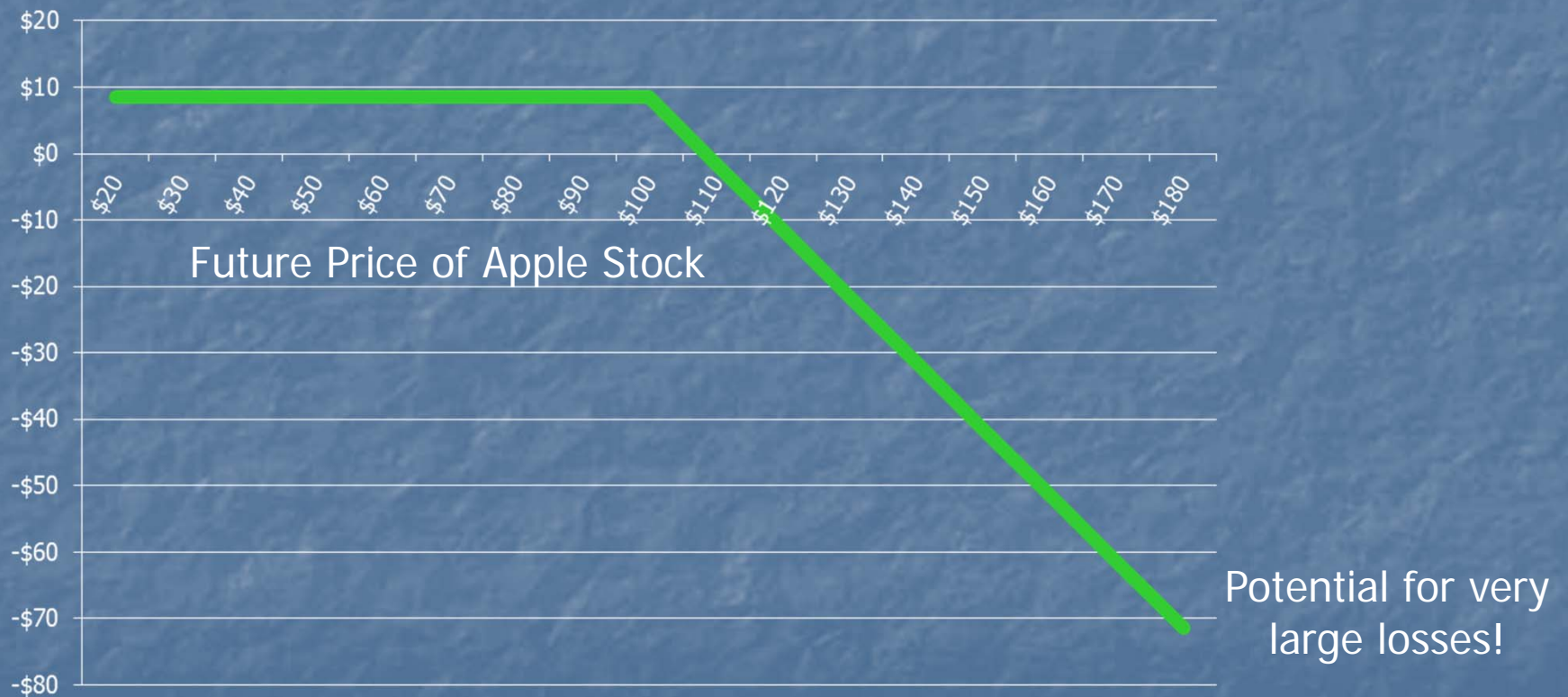
Put Option Payout Pattern for the Buyer



Portfolio Insurance

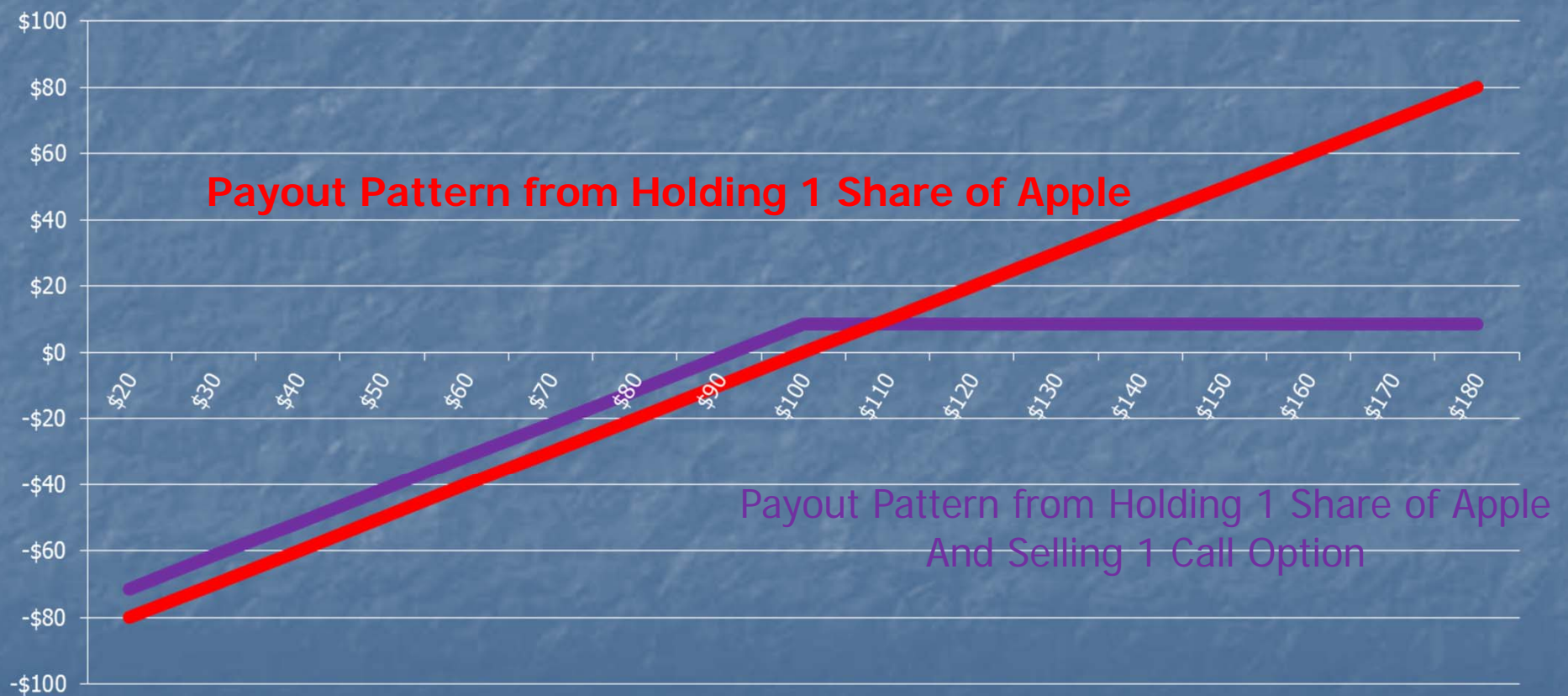
- Institutional funds sometimes use portfolio insurance strategies to hedge their risk or change their distribution of returns
 - *Sell* a call option on their equity portfolio
 - *Buy* a put option on their equity portfolio

Call Option Payout Pattern for the *Seller*



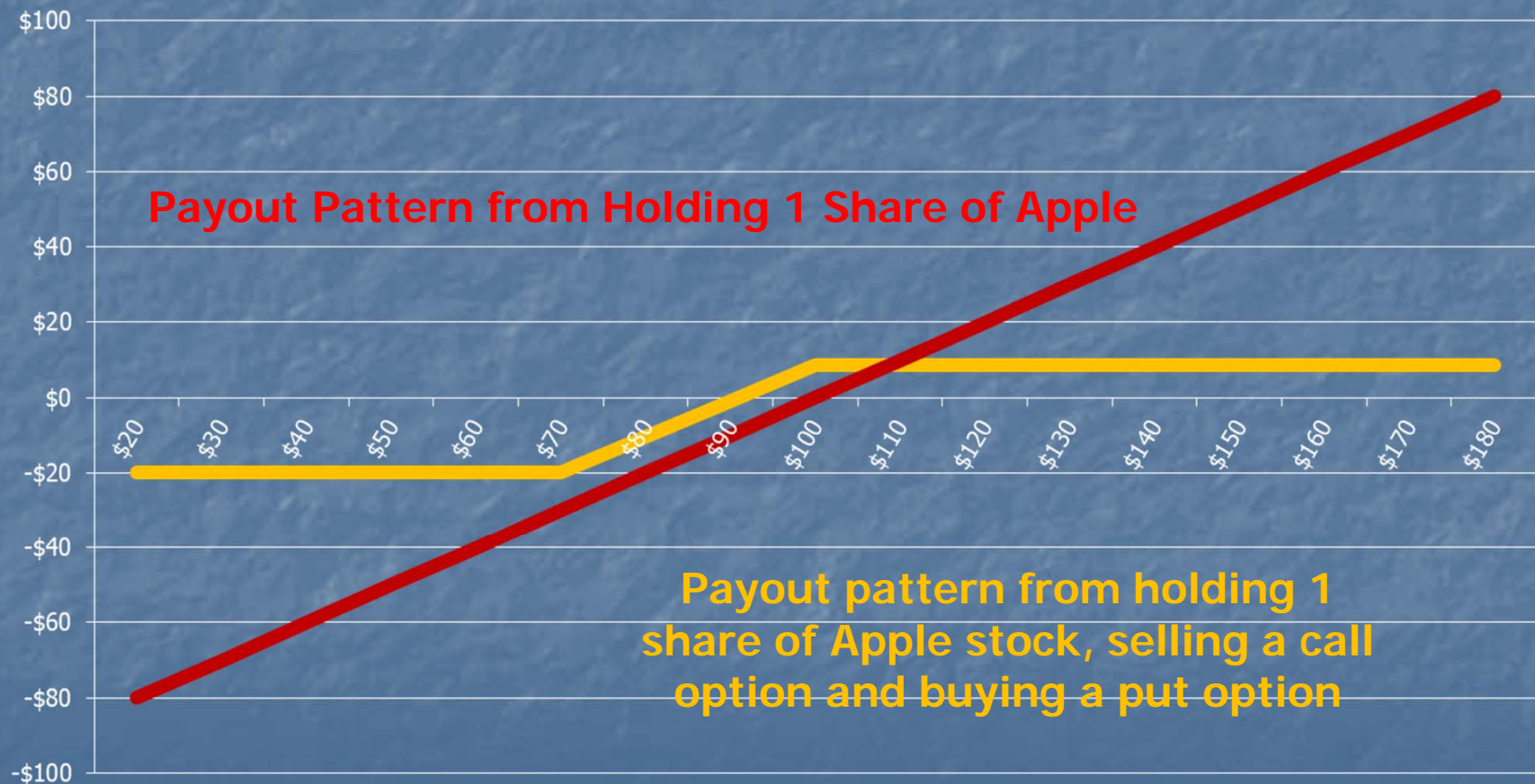
Why would a pension plan sell a call option?

Payout Pattern from Holding 1 Share of Apple Stock and Selling a Call



Aren't we giving up too much upside for very little downside protection?

Payout Pattern from Holding 1 Share of Apple Stock, Selling a Call and Buying a Put



Why Don't Pensions Simply Use Put Options?

- Too expensive to use consistently
 - Depending on strike price, options can be expensive
- May not be enough sellers for pension-size portfolios
- Must use a lower discount rate
 - Price of options is an investment cost

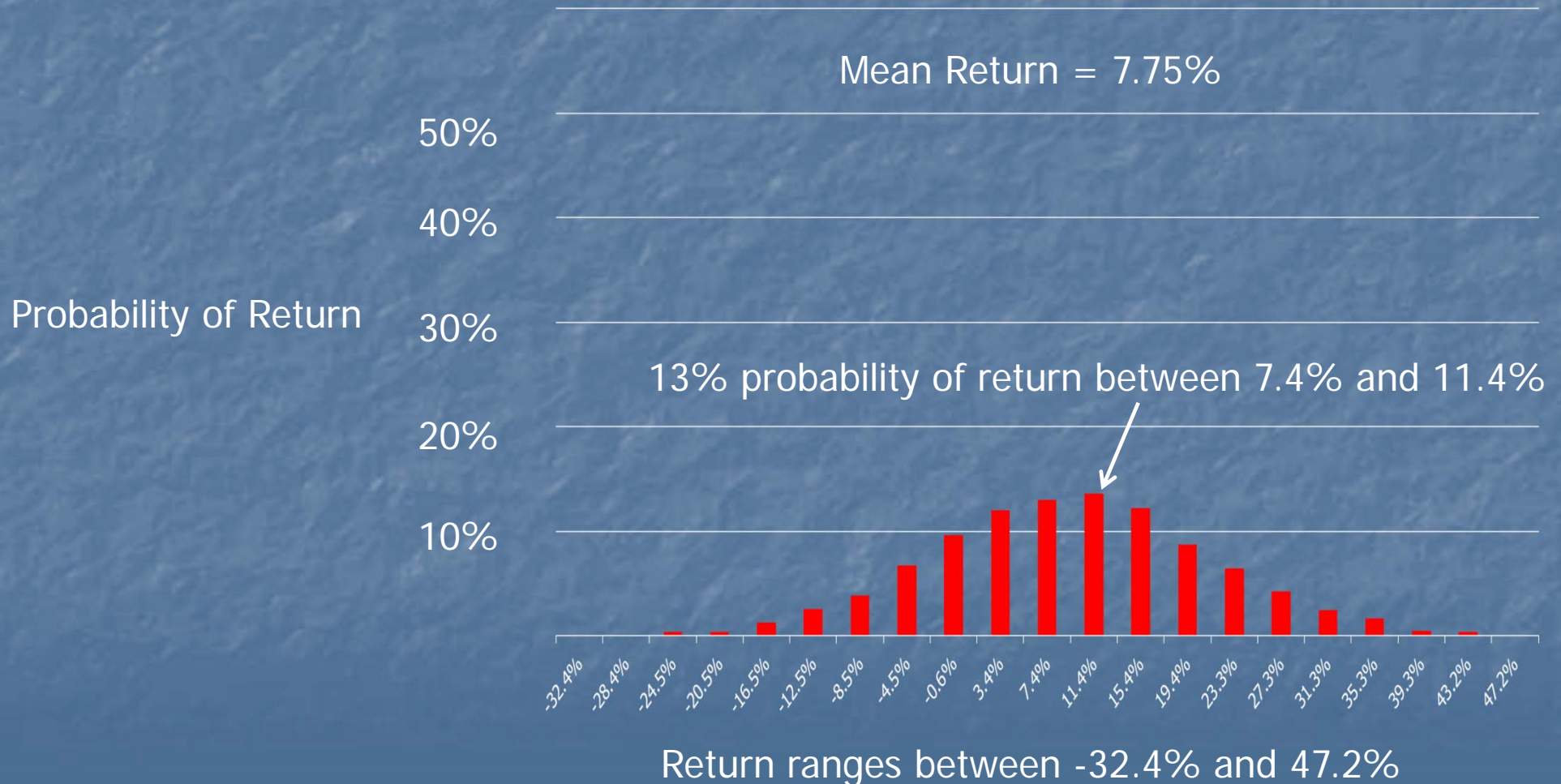
Portfolio Insurance

- Pension *buys put options* on its portfolio
 - Hedges the downside risk
- Pension *sells call options* on its portfolio
 - Income from sale of calls offsets price of puts
 - Price is cheaper, but you give more upside in exchange

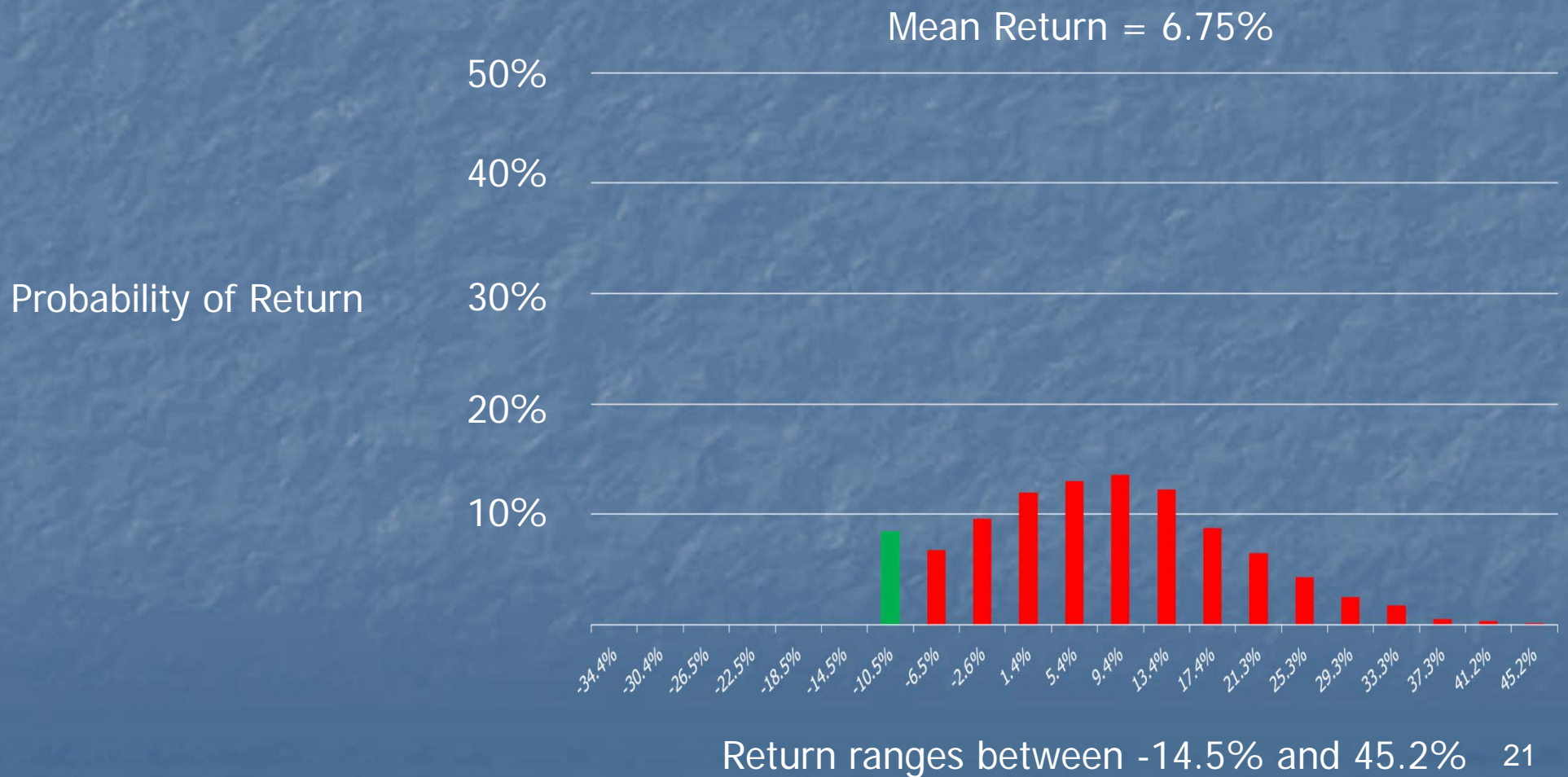
Portfolio Insurance

- Problem: *There may still be a limited number of buyers and sellers of options for a portfolio the size of StanCERA's*
- Solution: *Can apply strategy to only a portion of the portfolio*
- Consequence: *May not be able to hedge all risk*

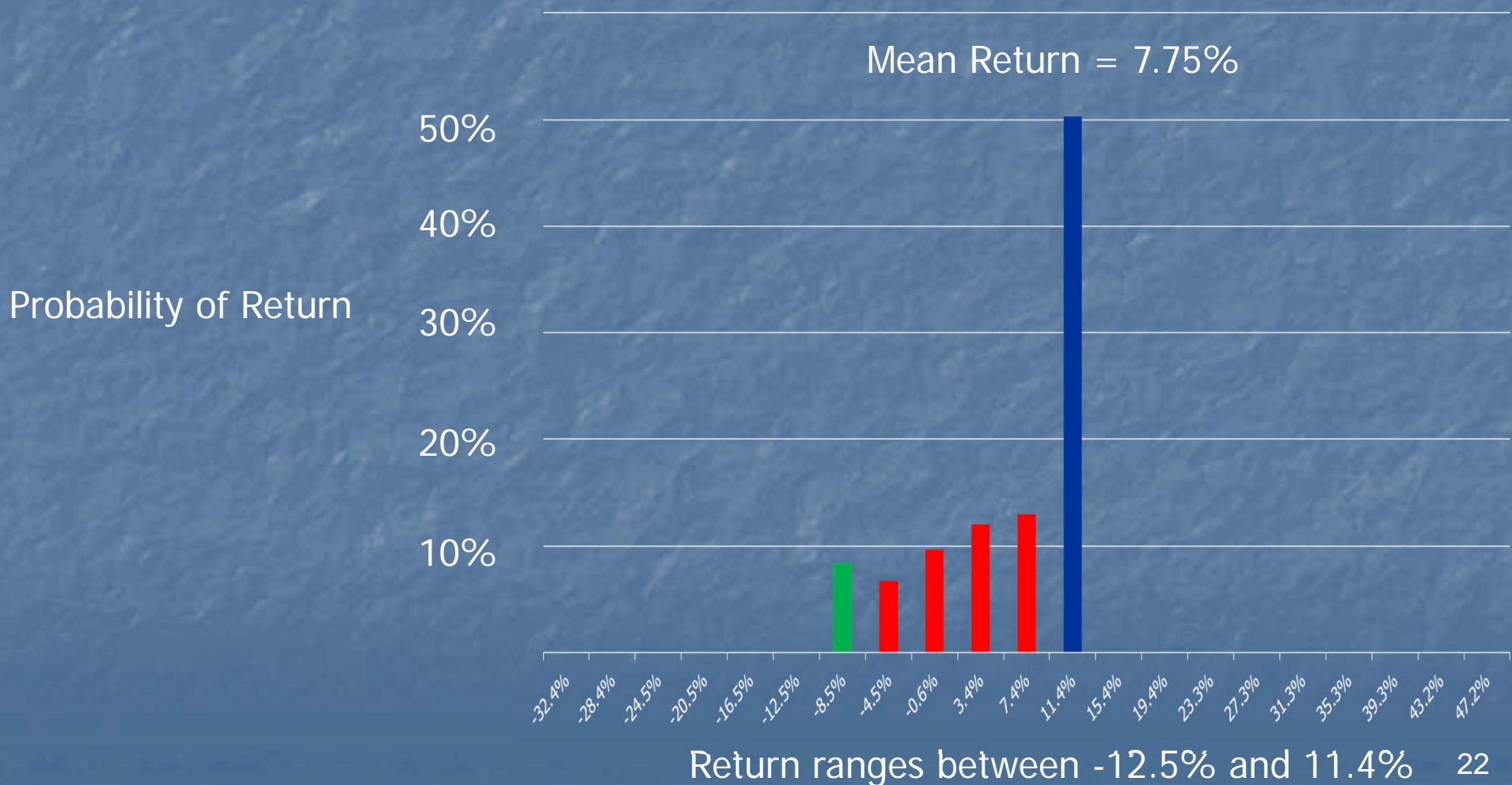
Return Distribution from StanCERA Portfolio



Return Distribution Buying Put Options



Return Distribution Buying Put Options and Selling Call Options



Outcome

- Theoretically, you can create a “priceless” hedge if you are willing to accept the return distribution that goes along with it
- Portfolio Performance
 - No difference as long as normal portfolio returns are between -12.5% and 11.4%
 - Bad returns are capped at -12.5%
 - Good returns won't exceed 11.4%

Portfolio Insurance

- More “expensive” in times of uncertainty
 - Return distribution is less favorable
- Can be implemented for a week, a month or a year whenever desired
 - Longer periods are more “expensive”

Next Step

- Theory vs. execution
 - Staff understands theory, but not execution
 - Actual return distributions hard to model
 - There are other hedging tools available
 - Can the theoretical “priceless” hedge be implemented?
- Private sector plans use
 - Don't know if public plans are using

Next Step

- Gauge further interest
 - Would StanCERA be comfortable using options?
 - Would StanCERA find value setting a corridor around its expected returns?
 - Bring in a consultant to discuss further?