

September 8, 2010

To: Members of the Board of Retirement

From: Keith Carson - Chair

**Subject: Summary of the September 8, 2010 Investment Committee Meeting**

The Investment Committee met on Wednesday, September 8, 2010 at 9:08 a.m. The Committee members present were Dale Amaral, Annette Cain-Darnes, Keith Carson, George Dewey, Liz Koppenhaver, Elizabeth Rogers, Donald White and George Wood. Also present were Alternate Retired member Dave Safer and Alternate Safety member Darryl Walker. Members of the Staff present were Kathy Foster – Assistant Chief Executive Officer, Robert Gaumer – Chief Counsel, J.P. Singh – Chief Financial Officer, Betty Tse – Chief Investment Officer and Catherine Walker – Acting Chief Executive Officer.

### **ACTION ITEMS**

1. Review of ACERA's Directed Brokerage Policy (DB Policy) and Possible Motion to Adopt the Amendments to the DB Policy
  - Staff completed its second review of ACERA's DB Policy since adoption and made necessary changes to the Policy. Some of the changes included the following: 1) update the two Appendices to the Policy and permit Staff to update these two Appendices quarterly or as needed; 2) reference Federal and California laws which apply to directed brokerage and soft dollar activities of investment managers and brokers/dealers; 3) clarify some terms in the DB Policy and/or reflect the current practice of the DB Program.
  - After discussion, Mr. Donald White moved, seconded by Ms. Liz Koppenhaver, to adopt ACERA's amended DB Policy. The motion passed unanimously.
2. Review of ACERA's Directed Brokerage (DB) Program and Possible Motion to Continue the Program
  - Staff presented a comprehensive review of ACERA's DB Program since inception. Upon completion of the review, Staff concluded that, to date, ACERA has achieved all four goals as set forth in the DB Policy: (1) ACERA has recaptured 68% of its total directed commissions since inception of the DB Program in a timely manner; (2) all participating Investment Managers found that their necessary investment research had not been compromised due to the flexibility in the target percentages as assigned by ACERA's Trading Cost consultant – Zeno Consulting Group, LLC (Zeno); (3) ACERA's Investment Managers are actively seeking Best Execution; and (4) the brokers on the CAPIs Global Trading Network (GTN) have consistently provided ACERA's Investment Managers with a variety of brokerage firms to choose from including local and emerging brokers. In addition, Staff provided the Committee with a cost-benefit analysis which

shows, as of the second quarter of 2010, a net gain of approximately \$444K since inception (approximately \$126K annually).

- Staff and the Committee noted that none of the local and emerging brokers on CAPIS' Correspondent Broker list have actively participated in ACERA's DB Program to date. After much discussion (see Trustee/Public Input below), the Committee recommended and Staff agreed to the following actions: 1) post additional information regarding ACERA's DB Program on the ACERA website; 2) develop an Investment Manager directional letter with assistance from ACERA Legal Staff and CAPIS (ACERA's Third-Party DB Administrator) to define "local" and "emerging" brokers in compliance with California law; 3) finalize all amendments to the DB Policy; and 4) monitor the DB Program in accordance with the amended DB Policy. Staff also agreed to update the Committee on its progress of these four actions in a couple of months.
  - Zeno discussed recent developments and trends in the directed brokerage and commission recapture environment and provided an overview of the ACERA Investment Manager's participation. Zeno expressed its satisfaction with ACERA's DB Program and with CAPIS. Zeno also stated that Staff continues to perform exceptional due diligence work on the Program compared to its peers.
  - After discussion, Mr. Donald White moved, seconded by Mr. Dale Amaral, to continue ACERA's DB Program. The motion passed unanimously.
3. Discussion of ACERA's International Small Cap Equity Manager Search and Recommendation to Adopt a Short List for the Search
- Staff and SIS presented the process used to independently evaluate and rank the eight Request For Proposal (RFP) responses to ACERA's International Small Cap Equity manager search. Applying the Board-adopted Evaluation Matrix, Staff and SIS agreed on the same top four ranking managers who have demonstrated over-all excellence in both Staff's and SIS' evaluations as the short-listed candidates for this search. The top four candidates (in alphabetical order) are: American Century Investments, Franklin Templeton Investments, Pyramis Global Advisors, LLC, and William Blair & Company, LLC.
  - After discussion, Mr. George Dewey moved, seconded by Ms. Liz Koppenhaver, to adopt American Century Investments, Franklin Templeton Investments, Pyramis Global Advisors, LLC, and William Blair & Company, LLC as the short-listed candidates for ACERA's International Small Cap Equity manager search. Upon completion of the site visits to these four candidates, Staff and SIS will recommend three finalists to the Committee for its interview and selection. The motion passed unanimously.

### **INFORMATION ITEMS**

1. Review of ACERA's Third-Party Directed Brokerage Administrator – Capital Institutional Services, Inc.

- Staff conducted the second service review of ACERA's Third-Party DB Administrator – Capital Institutional Services, Inc. (CAPIS) and concluded that CAPIS fulfilled its roles and responsibilities as set forth in the DB Policy as well as its contractual obligations since inception with ACERA.
- CAPIS answered Trustees' questions regarding various issues such as CAPIS' current process for adding brokers to the Global Trading Network, the utilization of step-out trades by some of ACERA's participating Investment Managers, and total commissions CAPIS has captured from ACERA's DB Program in 2009 and since inception of the Program. It also reported that commission rates appear to have stabilized in recent months after falling in previous years.

2. Quarterly performance review for the second quarter of 2010 – equities and fixed income

Representatives of SIS presented the following information:

- ACERA's total Fund returned -6.9% in the second quarter of 2010 and was ranked in the 97<sup>th</sup> percentile among public funds greater than \$100 million. The Fund outperformed its Policy Index by 0.7% but underperformed the median public fund by 1.8%. Longer term, the three-year gross return of -4.8% (77<sup>th</sup> percentile) underperformed its Policy Index by 1.3% and five-year gross return of 2.7% (49<sup>th</sup> percentile) underperformed its Policy Index by 0.6%. The market value of the total Fund as of 6/30/10 was \$4,456,445,546.

3. Quarterly performance review for the second quarter of 2010 – real estate

Representatives from The Townsend Group presented the following information:

- ACERA's real estate portfolio returned 1.3% in the second quarter of 2010, underperforming its benchmark NPI of 3.3% by 2.0%. Longer term, the three-year and five-year gross returns of -10.8% and -1.1% underperformed the benchmark by 6.1% and 4.9%, respectively. As of 6/30/10, the total market value of ACERA's real estate portfolio was about \$245.0 million, approximately 5.5% of ACERA's total Fund.

4. Quarterly report on ACERA's securities lending activities for the second quarter of 2010

- Staff presented the first quarterly report on ACERA's securities lending activities. In the second quarter of 2010, ACERA's consolidated earnings from Securities Lending activities was \$737,376.03. The Non-U.S. Equity program generated the highest earnings (\$441,448.99). As of June 30, 2010, the market value of securities on loan was \$561,764,464.60. Goldman Sachs & Co. was the largest borrower of ACERA's securities (33.85%).

5. Quarterly report of ACERA's investment manager, consultant, and custodian bank fees for the second quarter of 2010

- In the second quarter of 2010, ACERA paid approximately \$4.14 million in investment manager fees, about 9.30 bps of ACERA's total market value of about \$4.45 billion. ACERA also paid approximately \$294K in consultant and custodian fees, about 0.66 bps of ACERA's total market value.
6. Quarterly report on ACERA's Directed Brokerage (DB) Program for the second quarter of 2010
- In the second quarter of 2010, the total recaptured dollar amount for ACERA's Directed Brokerage (DB) Program was \$37,417.44. For the quarter, TCW directed the highest percentage (26.22%) of trading volume and Pzena generated the largest directed commission dollar amount (\$26,776.00). CAPIS received the highest total percentage of ACERA's directed trades (64.31%) among all correspondent brokers within the network. The program continues to operate in compliance with ACERA's DB Policy.
7. Updated Investment Committee Workplan for 2010
- Staff has distributed a copy of the Investment Committee Workplan (Workplan) for the year 2010. This Workplan is subject to change without prior notice. An updated Workplan will be provided to the Committee on a quarterly basis.
8. Quarterly report on Investment Products and Services Introduction (IPSI) for the second quarter of 2010
- In the second quarter of 2010, Staff received a total of 33 inquiries from prospective investment vendors and met with 12.

### **TRUSTEE/PUBLIC INPUT**

- A representative of Blaylock Robert Van, LLC, explained to the Committee about his difficulties in establishing a brokerage relationship with ACERA's DB Participating Investment Managers.

### **RECOMMENDATION**

- The Committee recommends, and I move, that the Board adopt the Amendments to the DB Policy.
- The Committee recommends, and I move, that ACERA's Directed Brokerage Program continue.
- The Committee recommends, and I move, that the Board adopt American Century, Franklin Templeton, Pyramis and William Blair as the short-listed candidates for ACERA's International Small Cap Equity manager search. Upon completion of the site visits to these four candidates, Staff and SIS will recommend three finalists to the Committee for its interview and selection.

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**FUTURE DISCUSSION ITEMS**

None

**ESTABLISHMENT OF NEXT MEETING DATE**

October 13, 2010

**ADJOURNMENT**

The meeting adjourned at 12:22 p.m.