

**ORANGE COUNTY EMPLOYEES RETIREMENT SYSTEM
BOARD OF RETIREMENT
2223 E. WELLINGTON AVENUE, SUITE 100
SANTA ANA, CALIFORNIA**

**INVESTMENT COMMITTEE MEETING
March 28, 2017**

MINUTES

Attendance was as follows:

Present: Chris Prevatt, Chair; Wayne Lindholm, Vice Chair; Eric Gilbert; Charles Packard; Russell Baldwin; Shawn Dewane; Roger Hilton; David Ball; Frank Eley; and Shari Freidenrich

Also Present: Steve Delaney, Chief Executive Officer; Shanta Chary, Director of Investment Operations; David Beeson, Investment Officer; Adam Cheng, CFA, Investment Officer; Stina Walander-Sarkin, Investment Analyst; Gina Ratto, Chief Legal Officer; Chad Takimoto, Visual Technician; and Julius Cuaresma, Recording Secretary

Meketa Investment Group: Stephen McCourt, CFA; and Holly Heiserman
Pension Consulting Alliance: Allan Emkin

The Chair called the meeting to order at 9:02 a.m. Mr. Eley led the Pledge of Allegiance.

CONSENT AGENDA

All matters on the Consent Agenda to be approved by one action unless a Committee Member or a member of the public requests separate action on a specific item.

A **motion** was made by Mr. Ball and **seconded** by Mr. Dewane to approve the Consent Agenda. The **motion carried unanimously**.

C-1 COMMITTEE MEETING:

Approval of Meeting and Minutes

Investment Committee Meeting
Manager Monitoring Subcommittee Meeting

February 22, 2017
March 2, 2017

Recommendation: Authorize meetings and approve minutes.

C-2 QUIET PERIOD - INVESTMENT RELATED SEARCHES

Recommendation: Receive and file.

C-3 ECONOMIC DASHBOARDS

Recommendation: Receive and file.

******* END OF CONSENT AGENDA *******

INDIVIDUAL ITEMS AGENDA

I-1 INDIVIDUAL ACTION ON ANY ITEM TRAILED FROM THE CONSENT AGENDA

I-2 CEO & STAFF COMMENTS

Presentation by Steve Delaney, CEO & Shanta Chary, DIO, OCERS

Mr. Delaney provided an update on OCERS' CIO search.

Ms. Chary provided a contract update on Meketa's real estate oversight contract.

I-3 PORTFOLIO ACTIVITY REPORT

Presentation by Shanta Chary, DIO, OCERS & Stephen McCourt, CFA, Meketa

Ms. Chary presented staff's streamlined version of the portfolio activity report.

Mr. Packard, Mr. Delaney, and Ms. Chary discussed the report, including the appropriate amount of data reported in quarterly reports versus monthly reports.

Mr. Gilbert arrived at 9:06 a.m.

Mr. Lindholm suggested that a more suitable report for the Committee's benefit may be one that focuses on the prior one year performance data.

Ms. Freidenrich arrived at 9:13 a.m.

Mr. Lindholm and Ms. Chary discussed the inherent limitations of performance reporting, i.e., lagged data, and the noise generated from frequent performance review, particularly in regards to private investments.

Mr. Hilton expressed support for the streamlined version of the report.

Mr. Dewane observed that monthly reporting generally does not provide actionable steps for the Committee. He expressed his preference for monthly data to be rolled up into quarterly performance reporting.

Ms. Chary continued the portfolio activity report presentation, including the total fund overview, subscriptions and redemptions, as well as the asset allocation for February 2017.

Mr. Ball, Ms. Chary, and Mr. McCourt discussed the cash overlay program.

A **motion** was made by Mr. Dewane and **seconded** by Mr. Packard to receive and file I-3. The **motion carried unanimously.**

I-4 ASSET ALLOCATION - TARGET RANGES & IMPLEMENTATION

Presentation by Stephen McCourt, CFA & Holly Heiserman, Meketa

Mr. McCourt described Meketa's asset allocation process and summarized the recent steps and actions that the Committee has taken since the start of this multi-month process. He noted that while much has been accomplished in recent months, the Committee is still at the beginning of the process versus the end.

Mr. McCourt presented Meketa's recommended target ranges for OCERS' asset allocation.

Mr. McCourt explained the motivation for wider ranges versus narrow ones, including the frictional costs (i.e., trade commission costs from rebalancing activity) involved with narrow, as well as the qualitative need for flexibility in various markets.

Mr. Baldwin and Mr. McCourt further discussed the logic driving Meketa's recommended ranges for each asset class.

Mr. Prevatt and Mr. McCourt discussed the rationale behind wider target ranges, including the flexibility to allow for an allocation aimed at capitalizing on significant price dislocations, i.e., an opportunistic allocation.

Mr. Baldwin and Ms. Freidenrich expressed concern that wider bands could unintentionally negate the intended benefits of diversification.

Mr. Hilton expressed his preference for the proposed target ranges, observing that they are wider than the previous ranges, which allows the Committee to more strategically steer the portfolio.

Mr. Eley expressed support for flexibility through broader ranges rather than the tyranny that narrow bands can create. He observed that OCERS benefits from its positive cash flow through capitalizing on illiquid securities (i.e., private equity). He observed that this flexibility permits OCERS to be buyers when other market participants may be forced sellers.

Mr. Emkin discussed the importance of portfolio diversification versus the squandered efforts in market timing.

A **motion** was made by Mr. Ball and **seconded** by Mr. Hilton to adopt Meketa's proposed asset allocation policy ranges.

Ms. Freidenrich and Mr. McCourt discussed the implementation timing of Meketa's proposed targets and ranges.

Mr. McCourt expressed Meketa's preference to wait until OCERS hires a new CIO.

Mr. Dewane suggested that Meketa and staff draft an implementation timeline in the interim due to the likely lengthy process involved in hiring and onboarding of the new CIO.

Mr. Ball clarified his earlier motion, stating it is to adopt Meketa's policy target ranges, and then wait until the CIO is hired to implement those targets and ranges.

Ms. Chary expressed staff's preference to pause implementation until the CIO is hired.

After further discussion, the Committee voted on the **motion** made by Mr. Ball and **seconded** by Mr. Hilton to adopt Meketa's recommended asset allocation policy ranges. The **motion carried unanimously.**

Mr. McCourt presented Meketa's proposed recategorization of managers.

Mr. Hilton and Ms. Chary discussed fees from OCERS' absolute return portfolio.

Mr. Ball and Mr. McCourt discussed the inherent challenges in classifying asset class and manager strategies, particularly the proposed new asset class of Real Assets.

Mr. Emkin and Mr. McCourt noted that as part of this asset allocation process, there will be Meketa-led presentations that will summarize risk-return characteristics, as well as explain the pros and cons, costs and benefits of each asset class.

A **motion** was made by Mr. Ball and **seconded** by Mr. Dewane to approve Meketa's proposed recategorization of managers and elimination of selected managers.

Mr. Eley suggested that the Committee separately discuss Meketa's proposed recategorization of managers from the elimination list of selected strategies.

Mr. Prevatt agreed with Mr. Eley's remark and suggested that the Committee separately discuss and vote on Meketa's proposed recategorization from the elimination of strategies.

The **original motion** made by Mr. Ball and **seconded** by Mr. Dewane was modified to only approve Meketa's proposed recategorization list of managers. The **motion carried unanimously.**

Mr. McCourt provided Meketa's reasoning for their proposed elimination of existing strategies.

Mr. Eley noted that despite Meketa's recommendation, there was no memo from an acting CIO or Mr. Delaney explaining the rationale behind the elimination of existing strategies. He supported the measured approach of Meketa and staff during this period without the CIO, i.e., recent dollar average trades. He expressed agreement with the proposed ranges, and allowing staff to move towards those adopted targets, but explained his preference to wait for the new to CIO to be hired and involved, who may or may not have a divergent view from Meketa's. Mr. Eley suggested

this is tantamount to outsourcing the CIO role to Meketa, who is only OCERS' consultant and still in its probationary period. He suggested that Meketa pause on its elimination list of existing strategies until OCERS hires its new CIO.

A **motion** was made by Mr. Eley and **seconded** by Mr. Baldwin to not approve Meketa's recommended list of managers to be terminated and instead wait for the new CIO before making a decision on terminations.

Mr. Baldwin noted that his support for Mr. Eley's motion was to spur further discussion. He observed that this recommendation appeared to be a firesale and wanted to hear staff's thoughts.

Ms. Chary responded that Meketa has been discussing this recommended list for some time, and observed that the adopted asset allocation does reflect some of these recommendations. She noted the importance in having a conversation amongst the consultants, Committee, and staff with the new CIO. She provided a possible untenable situation where: 1. the Committee decides to eliminate a strategy, and; 2. the elimination is not yet completed when the CIO arrives. Consequently, she envisions that the CIO's role is reduced to only comply and fulfill that mandate for elimination.

Mr. Prevatt asked for staff and consultants' thoughts on the possible downside in not approving this recommended list at this time.

Ms. Chary responded and reported that nothing is broken with the managers on Meketa's recommended list of managers to be terminated. Ms. Chary also noted that the unconstrained fixed income asset class is likely where there is more of a divergent view between staff and Meketa.

Ms. Freidenrich expressed agreement with some of Meketa's recommended list of eliminating strategies (i.e., where OCERS could save on fees). She also opined that her recommendation for the other strategies were less obvious and so she recommended that the Committee wait and in the interim, suggested developing a pacing plan for these strategies.

Mr. Gilbert asked that staff clarify why they have a different opinion on the unconstrained fixed income allocation from Meketa.

Ms. Chary responded that staff prefers the unconstrained allocation's ability to be nimble and flexible during various market environments, particularly during changing interest rate regimes. She noted that the timing of moving away from unconstrained managers may not be an opportune time.

Mr. Gilbert opined that should staff and OCERS consultants all agree, the Committee should be able to move accordingly without a CIO.

Mr. Dewane expressed agreement with Mr. Gilbert. Mr. Dewane also discussed the intrinsic challenges in reclassifying strategies, while also stating that the fee savings alone should move the Committee to liquidate the those strategies.

Mr. Packard observed the possibility of timing issues with the recommended elimination of selected existing strategies.

Mr. Delaney discussed that a number of potential CIO candidates did question the increase to the core bonds index in the current rising rate environment.

Mr. Emkin observed that the Committee does not necessarily need to adopt Meketa's list of eliminating strategies in its entirety, but can view the list as four individual asset classes and independently discuss and vote on each of the respective asset classes. That said, he observed that the Committee appears to agree on the asset classes where termination would translate into fee savings.

Mr. Eley commented that he is not hearing that the Trustees are in agreement. He suggested that the Committee should refrain from approving Meketa's proposed list of terminating strategies until the CIO is hired.

Mr. McCourt outlined Meketa's rationale for their recommended list of eliminated strategies:

1. Assist the Committee's goal of simplifying the portfolio, particularly through controlling the number of OCERS' invested managers.
2. These recommended changes, in terms of prioritization, are not urgent, as Meketa has recommended this list for some time.
3. That said, Mr. McCourt discussed which of Meketa's proposed strategies to be eliminated were easier to redeem from, stating that those are not aligned with the recently adopted asset allocation since they have performance issues and charge high fees. He described Unconstrained strategies as less likely to be resolved today and welcomed further discussion and analysis of those strategies.

A **substitute motion** was made by Mr. Baldwin, **seconded** by Mr. Ball to 1. Liquidate Global Equity and transfer those proceeds to 50% US Equity Index/50% International Equity Index; 2. Liquidate the Real Return and GTAA strategies, as staff is able to, while using the consultants in determining the redeployment of those proceeds; and 3. Table the Unconstrained strategies.

Ms. Freidenrich asked about the staff and consultant's Board communication plans as it pertains to the implementation of redeploying the proceeds from the eliminated strategies.

Ms. Chary responded that staff and consultants will come back to the to the Committee with precise redeployment and implementation plans with those proceeds, noting that staff wants to minimize trading costs.

Mr. Eley stated that he opposes Mr. Baldwin's substitute motion, observing that the consultant is not the CIO.

After further discussion, the Committee voted on a **substitute motion** made by Mr. Baldwin, **seconded** by Mr. Ball. The **motion carried 8-1** with voting as follows:

AYES

Mr. Hilton
Mr. Packard
Mr. Lindholm
Mr. Baldwin
Ms. Freidenrich
Mr. Dewane
Mr. Ball
Chair Prevatt

NAYS

Mr. Eley

ABSTAIN

ABSENT

The Committee recessed at 10:41 a.m.

The Committee reconvened at 10:57 a.m.

I-5 EUROPEAN DIRECT LENDING UPDATE

Presentation by Stephen McCourt, CFA & Holly Heiserman, Meketa

Mr. McCourt provided an update on OCERS' direct lending portfolio, with a particular emphasis on the portfolio's European managers and exposures.

Mr. McCourt described the global direct lending opportunity set that arose from the regulatory changes aimed at alleviating the ills of the 2008 global financial crisis. He described the supply-demand lending imbalance but noted that this robust opportunity set is not quarantined from typical boom-bust cycles that other asset classes experience.

Mr. Ball, Mr. Lindholm, and Mr. McCourt remarked upon European regulation that allows for significantly higher banking leverage relative to U.S. regulation.

Mr. Ball discussed Meketa's presentation and suggested that prospective presentations, particularly on Direct Lending given OCERS' exposure (i.e., analysis of underlying manager's underwriting research and skills), provide recommended actionable steps (i.e., what should OCERS do in anticipation of left-tail risks) for the Committee.

Mr. McCourt responded that Meketa will provide recommended actionable steps during the upcoming Asset Class Reviews, particularly when Meketa presents a deep dive into the diversified credit asset class.

Mr. Ball and Mr. McCourt discussed the importance of the current and impending phase of the credit cycle, particularly as it relates to risk management and what possible recommended steps the Committee can undertake. They also discussed the importance of understanding the illiquidity associated with direct lending and the return objectives needed to justify such illiquidity risks.

Mr. McCourt discussed some of the risks associated with direct lending, including: 1. default risk (i.e., though direct lending tends to be higher in the capital structure, over time, there is still default risk); 2. currency risk (European loans are denominated in differing currencies); 3. regulatory risk (i.e. differing country-by-country bankruptcy laws).

Mr. Packard requested a slide that presented the following data, by fund name, for OCERS' direct lending portfolio: net IRR, capital drawn down and OCERS' capital commitment.

Ms. Freidenrich asked for PCA's opinion on OCERS' direct lending portfolio.

Mr. Emkin observed that OCERS' portfolio, relative to peers, is an outsized allocation. He qualified this observation, opining that it is neither good nor bad, but suggested that the Committee appreciate that it is a big allocation, particularly to the European direct lending market. He also observed that the direct lending portfolio likely included too many managers and thus incurred more fees. He concluded that OCERS has received a return premium relative to straightforward credit investing.

Mr. Dewane suggested that the consultants create risk management credit parameters and limits.

Mr. Packard and Ms. Chary discussed OCERS' capital commitments.

A **motion** was made by Mr. Ball and **seconded** by Mr. Dewane to receive and file I-5, with staff and consultants to provide further guidance. The **motion carried unanimously.**

I-6 KEY LEGAL TERMS & CONCEPTS FOR INVESTMENT CONTRACTING
Presentation by Thomas A. Hickey, III, Esq., Foley & Lardner

Mr. Hickey presented key legal terms and concepts for investment contracting.

Mr. Packard and Mr. Hickey discussed California Government Code 7514.7.

Ms. Freidenrich, Mr. Hickey, and Ms. Ratto discussed investment governance, particularly as it relates to the CIO Charter.

Mr. Prevatt directed further investment governance and contractual discussions to the Governance Committee.

Mr. Dewane thanked Mr. Hickey for his presentation and suggested that his presentation prospectively also include definitions for the key legal terms presented and discussed.

A **motion** was made by Mr. Eley and **seconded** by Mr. Ball to receive and file I-6. The **motion carried unanimously.**

*** * * * *END OF INDIVIDUAL ITEMS AGENDA * * * * ***

PUBLIC COMMENTS: At this time members of the public may address the Committee of Retirement regarding any items within the subject matter jurisdiction of the Committee, provided that no action may be taken on non-agendized items unless authorized by law.

COMMITTEE MEMBER COMMENTS

None

CHIEF EXECUTIVE OFFICER/STAFF/CONSULTANT COMMENTS

Mr. Emkin suggested that the Committee provide clearer and more precise governance as to what the Committee's responsibilities are relative to the CIO's responsibilities.

The Committee recessed for lunch at 12:30 p.m.

The Committee reconvened at 1:13 p.m.

Mr. Delaney continued the governance discussion and noted that staff and consultants would provide actionable items at a future meeting as it relates to investment delegation and authority for the Committee to discuss and vote on.

Mr. Delaney also discussed his and Ms. Chary's recent call with Ontario Municipal Employees Retirement System (OMERS). He discussed OMERS' focus on investment governance.

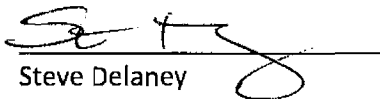
Ms. Chary addressed Mr. Packard's earlier question about the liquidity terms of managers recommended by Meketa for termination.

COUNSEL COMMENTS


None

ADJOURNMENT: The Chair adjourned the meeting at 1:17 p.m.

Submitted by:


Steve Delaney
Secretary to the Committee

Approved by:


Wayne Lindholm
Vice Chair