Retiree Health Care Trust Fund Board

BOARD MEETING MINUTES

Special Meeting

Monday, October 2, 2017

1:00 p.m.

City and County of San Francisco
SFERS Office – 1145 Market Street, 6th Floor Conference Room
San Francisco, CA 94103

RETIREE HEALTH CARE TRUST FUND BOARD MEMBERS

President
Katharine Petrucione

Vice President
David Salem

Members
Pauline Marx

Clare Murphy

Ed Walsh

Trust Administrator
Jay Huish
SFERS Executive Director

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- A sound enhancement system will be available upon request at the meeting.
- Minutes of the meeting are available in alternative formats.

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San Francisco CA 94103-4689
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CALENDAR

Call to Order: 1:07 p.m

Roll Call: Commissioner Katharine Petrucione
Commissioner Pauline Marx
Commissioner Clare Murphy
Commissioner David Salem
Commissioner Ed Walsh

10022017-03 **General Public Comment**

Commissioner Petrucione noted that there were no members of the public present.

Commissioner Petrucione moved Item 4 (Educational Presentation on Asset Allocation) so that it will be discussed after Item 6 (Educational Presentation on Emerging Markets Debt).

10022017-05 Discussion Item **Educational Presentation on Public Equity**

Documents provided to Board prior to meeting: Education Materials on Public Equity from Meketa Investment Group, Investment Consultant.

Mika Malone, of Meketa Investment Group, introduced Paola Nealon, of Meketa Investment Group. Ms. Nealon spoke shortly about her professional experience.

Larry Witt, of Meketa Investment Group, presented an oral and written report on this item.

Bill Coaker, SFERS' Chief Investment Officer, discussed emerging markets in Asia and their recent growth. Mr. Coaker expressed agreement with Meketa's analysis that emerging markets will outperform the rest of the developed markets. He also discussed China's current economic transformation.

Commissioner Ed Walsh asked how an investment in emerging markets would work. Ms. Malone explained that the Board could choose either a broad commingled index fund or consider selecting an active manager in this space.

Commissioner Walsh inquired about excluding investments in particular countries, such as Russia. Mr. Witt explained that depending on the size of the allocation, the Board may be able to have a separate account in which the Board could determine any exclusions it wanted as long as the manager was willing to abide by the guidelines. If the Board went with a commingled fund or index fund, the Board would not be able to request restrictions. Ms. Malone discussed the costs associated with having a separate account and explained that the Fund probably would not be allocating an amount that would warrant a separate account at this time.

Commissioner Clare Murphy explained that once the Fund starts placing investment restrictions, the Board will need to be able to justify its decision. She discussed her experience with excluding specific countries from investment during her tenure at SFERS and the amount of work that entailed.

Commissioner David Salem asked if it was a higher cost to enter these markets and also to exit them, and how the expenses compare to the investments the Fund already has. Ms. Malone explained that in emerging markets, trading costs are higher and cost about twice as much to transact as compared to the U.S. public equities.

Mr. Witt explained the monthly liquidity in these investments and that participants can only invest or withdraw during one period in the month, to limit transaction costs.

Mr. Coaker provided examples of emerging markets companies, including Tencent, Alibaba, Taiwan Semiconductor, China Mobile and Baidu.

Commissioner Salem asked about the effect of the appreciating US dollar on these emerging markets investments.

Ms. Malone explained that currency is factored into their analysis of emerging markets.

Commissioner Salem asked if there were managers that sell futures, or currency futures against their portfolios. Ms. Malone stated that there were some, but it is a minority of managers. Mr. Coaker explained that he doesn't believe these kinds of investments are worth the costs and that currency values don't tend to change too much over 10-20 year periods.

Mr. Coaker added that if the Board engages individual managers, the Board should be evaluating the specific companies they invest in as many of these companies are world class, as opposed to the countries where they operate.

Commissioner Salem asked for further clarification on how currency hedging works. Ms. Malone responded that hedging can be beneficial if you can predict what the trends will be over a long enough period of time.

Commissioner Petrucione asked if, when it comes time for the Board to begin paying benefits, volatility becomes a concern. Ms. Malone stated that volatility is always a concern, but that it will be a greater concern once the Fund starts paying benefits. She explained that it is less a concern than liquidity would be at that point.

Ms. Malone explained that in all the asset allocation scenarios being presented later in the meeting, Public Equity is included.

Proposed Action: This is a discussion item only.

10022017-06 Discussion Item **Educational Presentation on Emerging Markets Debt**

Documents provided to Board prior to meeting: Education Materials on Emerging Markets Debt from Meketa Investment Group, Investment Consultant.

Paola Nealon, of Meketa Investment Group, presented an oral and written report on this item.

Commissioner Marx requested clarification on what Brady bonds are.

Commissioner Salem asked if the credit agencies rating these investments are the same as those that rated investments prior to the Financial Crisis of 2008.

Commissioner Marx asked if debt instruments are another way to diversify in a rising interest rate environment.

Mr. Witt explained that with rates going up, bonds decline; however in riskier investment classes, expectations for defaults go down, and expectations for growth go up.

Ms. Nealon stated that these kinds of investments can exhibit a lot of equity-like characteristics.

Commissioner Marx asked if these instruments are fixed rate.

Commissioner Salem asked about currency risks.

Mr. Witt provided information about hard and local currencies.

Commissioner Petrucione asked if this asset class would be actively managed.

Ms. Nealon said most likely this asset class would be actively managed. Ms. Malone explained that there aren't suitable passive indexes to invest in this asset class at this time.

Commissioner Petrucione asked at what level does the country issue debt: is it always federal or state, county, and local levels as well.

Ms. Malone explained there is some local level debt, but most of it is at the federal level.

Commissioner Petrucione asked what considerations should the Board be looking at as they determine whether to invest in emerging market equity and emerging market debt.

Ms. Malone explained that emerging market equity would be the riskiest, publicly traded component of the portfolio, and that emerging market debt would be a diversifier for the portfolio.

Commissioner Salem asked about the JP Morgan indexes and their purpose and how good of a reference they are.

Ms. Malone identified the countries that are available for investment in this asset class.

Proposed Action: This is a discussion item only.

10022017-04 Discussion Item **Educational Presentation on Asset Allocation**

Documents provided to Board prior to meeting: Education Materials on Asset Allocation from Meketa Investment Group, Investment Consultant.

Mika Malone, of Meketa Investment Group, presented an oral and written report on this item. She presented six asset allocation options for the RHCTF. Each of these options had a different expected return (7.0%, 7.25%, 7.5%, 7.75%, 8.0%, and 8.0% without private equity), highlighting the risk and return tradeoffs of portfolios with different exposures to risk assets.

Caryn Bortnick, SFERS Deputy Executive Director, clarified that this is not an action item, and that no decisions will be made at this meeting, but that the Board should provide feedback for the next meeting.

Commissioner Petrucione asked for clarification on risk associated with the different options.

Commissioner Walsh requested clarification on private real estate.

Ms. Malone discussed the spectrum of private real estate investments.

Commissioner Salem requested more information regarding private markets including how the Board finds managers and how the Board should invest the Fund.

Mr. Coaker explained that Meketa should make a recommendation on a manager for the Board to hire. He also explained that it will take some time to build up the target allocation and how capital is called in private equity.

Ms. Malone suggested that if the Board decides to add this asset class in a few years, a fund-to-fund approach may work best. She discussed commitment levels and offered to provide analysis on pacing. She stated that it may be beneficial to take more than a few years for the Fund to build up to this allocation.

Commissioner Salem asked if private debt implies real estate.

Mr. Coaker explained what private debt includes and who traditionally invests in this asset class. He suggested that when ready, the Board hire one or two private market managers, who focus on private equity, private debt and private real estate.

Mr. Coaker asked the Board for feedback on their risk tolerance and return expectations.

Commissioner Murphy asked what the impact of the return variances would have on achieving the goal of providing promised health care benefits. She expressed that these investment options will inform the Board's decision-making and that the Board is not yet educated enough to make these choices.

Mr. Coaker asked if the Board needed more data or if they know whether earning 7-8% over the long term is going to meet the health care funding requirements.

Ms. Bortnick reported that staff would look into this and come back to the Board with more information.

Mr. Coaker asked when the cash outflows will start.

Commissioner Walsh explained that the purpose of all of this is to have a fund equal to the liability.

Commissioner Marx stated that the liability is in the billions.

Commissioner Murphy asked how staff and consultant would recommend the Board choose from among the options presented today. She also asked for information on the consequences if they were to revisit the allocation every three years.

Mr. Coaker stated that because cash outflows are a number of years away and the Fund needs to make a meaningful return, the Board can take a meaningful amount of risk in the next 15-year period. He asked the Board to consider leaving the selection of managers to staff and consultants. He suggested that the Board review asset allocation at least every two years.

Ms. Malone also suggested that the Board could take on more risk and a higher expected rate of return. She suggested that the Board review asset allocation every three years.

Commissioner Petrucione asked the other members of the Board to talk about where they are on the range of options presented. She also requested that the Board adopt an asset allocation policy.

Commissioner Walsh stated that he preferred Policy B, that 7.5% is a good target, but that he needs more information.

Commissioner Murphy stated that policies B or C make sense. She stated that the allocation will take time to do. She suggested that the Board look at handing the responsibility to select managers to consultants and staff and asked how that might work. She stated that she doesn't feel comfortable investing in private equity at this time.

Commissioner Salem expressed his belief that private equity is too much for the Board at this time. He stated he preferred policy C over B. He concurred with Ms. Malone that an asset allocation review should be completed every three years. He wants more analysis on the liability issues.

Commissioner Marx stated her preference for policy B, but that she would consider other policies. She expressed that she would like to see an implementation plan and what will get the best return for the Fund more efficiently. She also expressed a preference for an asset allocation review every three years.

Commissioner Murphy suggested that the Board review the investment policy.

Ms. Bortnick stated that the investment policy would be brought before the Board at the next meeting for review.

Mr. Coaker said that staff and consultants would bring an implementation plan before the Board at the next meeting. He said he would look into an asset liability study and its costs.

Ms. Malone offered to bring different options within policies B and C if the Board would like.

Commissioner Petrucione asked the Board if they would be comfortable making a selection at the next meeting or should they defer it to February 2018.

Mr. Coaker stated that liability studies can take a long time.

Ms. Malone suggested making a decision sooner rather than later, but then revisiting the asset allocation when a potential liability study comes back.

Mr. Coaker suggested that if they do a liability study, the Board should select an interim asset allocation so they can start the process and then select a long-term policy when the studies come back. He stated he believes the Board has enough information to take some action at this time.

Commissioner Petrucione requested that some sort of action related to asset allocation be agendized for the next meeting.

Mr. Coaker reiterated that he would being to the next meeting a proposed asset allocation and implementation plan, provide a proposed updated investment policy, and provide the Board with details about an asset liability study, including cost and how long it would take.

The Board decided that the next meeting would be Monday, November 27, 2017 at 1:30 PM.

Proposed Action: This is a discussion item only.

10022017-07 Discussion Item **Good of the Order**

No members of the Board had any items to discuss.

Proposed Action: This is a discussion item only.

Adjourn: 4:06 p.m.