



Retiree Health Care Trust Fund Board

BOARD MEETING MINUTES

Monday, November 27, 2017

1:30 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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- American Sign Language interpreters will be available upon request.
- 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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Sunshine Ordinance Task Force
City Hall
1 Dr. Carlton B. Goodlett Place, Room 244
San Francisco CA 94103-4689
(415) 554-7724
by fax at (415) 554-7854
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CALENDAR

Roll Call: **Call to Order: 1:36 p.m.**

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

11272017-03 **General Public Comment**

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

11272017-04 Action Item **Approve the Minutes of the August 7, 2017 Board Meeting**

Documents provided to Board prior to meeting: August 7, 2017 Draft Minutes

Action: Moved by Commissioner Marx, seconded by Commissioner Walsh to approve minutes of the August 7, 2017 Retiree Health Care Trust Fund Board Meeting.

Ayes: Marx, Murphy, Petrucione, Salem, Walsh. Nays: None.

11272017-05 Action Item **Approve the Minutes of the October 2, 2017 Special Board Meeting**

Documents provided to Board prior to meeting: October 2, 2017 Draft Minutes

Commissioner Salem requested an amendment to the minutes.

Action: Moved by Commissioner Murphy, seconded by Commissioner Marx to approve the minutes as amended of the October 2, 2017 Retiree Health Care Trust Fund Board Meeting, which corrects a reference to the Asian Financial Crisis to the Global Financial Crisis.

Ayes: Marx, Murphy, Petrucione, Salem, Walsh. Nays: None.

11272017-06 Action Item **Approve Recommended Asset Allocation and Implementation Plan**

Documents provided to Board prior to meeting: Staff Memorandum; Asset Allocation Recommendation and Implementation Plan from Meketa Investment Group, Investment Consultant

Mika Malone, of Meketa Investment Group, reviewed the corrections that were made to the materials provided by Meketa prior to the meeting.

Ms. Malone then presented a written and oral report on this item. Based on conversations with the Board at the October meeting, and subsequent discussions with Staff regarding the appropriate risk tolerance and return for the Plan, Meketa selected Option C from the October meeting as the recommended policy. The expected return of the portfolio increases to 7.75%. As expected, the risk level (as defined by standard deviation) increases as the expected return increases. However, the Sharpe Ratio, a measure to calculate return per unit of risk, improves.

The recommended policy expands on existing asset class structure to include new allocations to TIPS, high yield bond/bank loans, emerging market debt, and emerging market equity in order to further diversify the RHCTF. US Equity exposure marginally increases from 37% to 41% of the total portfolio. Developed Market Equity is reduced (37% to 20%) to allow for an allocation to Emerging Market Equity. Investment Grade Bonds is reduced by roughly 2/3rd of its current weight to redeploy assets into additional debt instruments; namely bank loans/high yield loans, emerging market debt and TIPS.

The portfolio moves from a 100% passive structure to include active managers in areas of the market where there is an advantage to considering active investment.

Commissioner Salem inquired as to how the new asset classes would be funded. Ms. Malone explained that it would require a manager search, which would be the next steps.

Commissioner Marx asked what the peer group for this kind of asset allocation is. Ms. Malone stated that similarly sized public funds under \$500 million would be peers. Commissioner Marx requested to see some of the peers' asset allocations.

Bill Coaker, SFERS' Chief Investment Officer, explained that relative to a pension plan, the RHCTF asset allocation will be very different. He stated that he does not believe there is a universe of any meaningful size that is relevant to the RHCTF.

Commissioner Murphy raised concerns that the City could use the new expected rate of return to expect the fund to be fully funded sooner and try to change the Charter to adjust the employer contributions to the Fund. She urged the RHCTF to use careful description in how this is presented and that this is an investment world perspective and that it is hedged significantly.

Mr. Coaker stated that this document was to give the Board guidance as to what the expected investment return is, but is not meant to imply anything about actuarial or city fiscal considerations.

Commissioner Murphy expressed belief that the Board will spend the foreseeable future looking at the universe of returns and how the RHCTF measures against other kinds of funds investing similar amounts in different categories, performance at the asset element level as opposed to the aggregate. Mr. Coaker stated that the characteristics of the fund will change over time, and once outflows start, there will be a peer universe of some size to compare the fund to.

Ms. Malone suggested that if the allocation is approved, that they draft a memorandum highlighting the estimates return over twenty years, and adding in the expected return over 10 years.

Commissioner Petrucione asked what tools will be used to benchmark the Fund.

Ms. Malone said that others trying to achieve the same return would be a reasonable group to compare the Fund to, but there is no data aggregation set available based on expected portfolio returns. She stated that peer groups at the same fund level and asset class level will allow Meketa to put some parentheses around each category of the Fund.

Paola Nealon, of Meketa Investment Group, presented a written and oral report on the implementation timeline for the new asset allocation. Phase I would add exposure to Emerging Market Equity and Emerging Market Debt, using Developed Market Equity as a source of funds. This would be done in several tranches. Add Emerging Market Equity in three tranches, with cash flows ranging in size between \$10-\$12M, to be completed and fully funded by second quarter 2018. Meketa expects to bring a manager search document and discussion to the February 2018 meeting. Add Emerging Market Debt in two tranches of \$4M each, to be

completed and fully funded by second quarter 2018. Meketa expects to bring a manager search document and discussion to the February 2018 meeting.

Phase II would begin to add exposure to credit sensitive and rate sensitive strategies within Fixed Income, using Investment Grade Bonds as a source of cash. The new 6% allocation to High Yield/ Bank Loans would be completed in two, \$6M tranches, before the end of third quarter. This would be done through an actively managed fund. Meketa expects to bring a manager search document to the February 2018 meeting. The new 5% allocation to TIPS would be completed in two \$5M tranches before the end of third quarter. This would be done through a new passively managed TIPS mandate, as Meketa doesn't recommend active management in this space due to the limited number of issues in the marketplace, and the reduced possibilities to add alpha.

Commissioner Salem asked for the rationale behind doing the implementation in these tranches. Ms. Malone explained that the rationale is to equalize risk while the new asset allocation is being implemented.

Commissioner Petrucione asked if there was any thought to minimizing fees during the implementation process. Ms. Malone assured the Board that that is a priority, but that fees will increase with the addition of active strategies.

Action: Moved by Commissioner Walsh, seconded by Commissioner Murphy to approve the recommended Asset Allocation and Implementation Plan.

Ayes: Marx, Murphy, Petrucione, Salem, Walsh. Nays: None.

□ 11272017-07 Action Item **Approve Updated Investment Policy Statement**

Documents provided to Board prior to meeting: Staff Memorandum; Draft Investment Policy Statement

Mika Malone, of Meketa Investment Group, presented an oral report on the Updated Investment Policy Statement.

Commissioner Marx asked the intent to the changes to the Investment Service Provider Review section allowing staff to move assets. Paola Nealon, of Meketa Investment Group, explained that this was to cover events that may happen where staff would need to act immediately and not have time to get the Board approval.

Commissioner Murphy stated that it was her understanding that if a manager was to be fired, the Board would be doing it. But that staff could pull or freeze funds in an emergency. Ms. Malone said that there are two options for the Board, either they do the hiring and firing or they delegate to staff and consultant to do so.

Mr. Coaker clarified that the sentence gave staff authority to move funds in emergency situations to asset allocations already approved by the Board.

Commissioner Murphy suggested that they handle these kinds of situations with special meetings.

Caryn Bortnick, SFERS' Deputy Executive Director, suggested adding a clause that makes it clear that staff does not have the authority to terminate, but in exigent circumstance staff may move the assets.

Commissioner Marx requested that there be notification to the Board, and explaining this is only allowed under certain circumstances.

Ms. Malone suggested that the entire section be prefaced with a sentence stating that the Board has final say in all hiring and termination decisions.

Mr. Coaker suggested that language be modified further to clarify this would occur only when there is an imminent need.

Commissioner Petrucione said that she would prefer that the circumstances under which assets could be moved by staff without Board approval be clarified in the statement.

Commissioner Murphy requested information on how SFERS handles these kinds of situations and for a copy of the SFERS Investment Policy Statement.

Commissioner Petrucione suggested that language be added that allows some amount of leeway for staff, but that the Board would commit to meet within some specified period of time.

Commissioner Marx noted that because the asset class will most likely have only one manager at this time, there won't be the ability to move funds within that class.

Mr. Coaker suggested that the Investment Policy Statement be modified and brought back to the Board.

Commissioner Murphy requested that notice to the Board be expressly noted in the document.

Commissioner Marx requested clarification under "Duties and Responsibilities" on the terms "input" and "recommendation". Ms. Malone clarified that "input" is meant to signify that the consultant would be receiving comments from staff, and vice versa, and with respect to the Board, that staff would be reporting to them.

Commissioner Marx said that her expectation that staff would have a point of view and share that with the Board. Mr. Coaker suggested changing language to read "staff is responsible for providing recommendations to the Board."

Ms. Malone cautioned against making the IPS too detailed, as it would complicate decision making.

Commissioner Murphy explained that she expects a documentation process that allows the Board to hold accountable consultant and staff. She also requested that if there are 2 or 3 good manager prospects, that all be presented to the Board. She requested that Board and consultant think like a Board member when they present these kinds of policy documents.

Ms. Bortnick stated that this language would be refined to address the Board, staff and consultant's duties and responsibilities going forward.

Commissioner Petrucione said that she was looking for staff to actively manage the consultant, which it seems like is happening. She would like this relationship to be characterized correctly in the Investment Policy Statement, with more proactive language.

Mr. Coaker explained that because of the growth of the fund, the Board will need more resources down the road and that there are plans for that.

Jay Huish, Executive Director of SFERS, stated that there needs to be more clarification in the Investment Policy Statement on the Board's role in approving the selection and termination of managers. He also confirmed that the language about hiring investment consultants should reflect that this is a duty and responsibility of the Board.

Commissioner Petrucione confirmed that staff and consultant will bring back the item in February.

Mika Malone, of Meketa Investment Group, presented on how the future manager searches would happen. She explained that electing strong and appropriate investment managers is a key determinant of the overall success of the Fund. Investment managers are expected to operate within a client's investment guidelines and are given a large degree of latitude to achieve the investment objectives.

Manager selection is a nuanced process and requires extensive due diligence. When selecting prospective active managers, Meketa Investment Group evaluates the following areas:

- Organization
- Investment team
- Investment philosophy
- Investment process
- Investment performance
- Management fees
- In addition, all managers are evaluated within the context of the Fund's overall investment policy.

Commissioner Petrucione asked if the RHCTF had to use the RFP process to hire managers.

Tran Ly, Deputy City Attorney, stated that she believed the RHCTF did not have to formally follow the City's requirements for an RFP, but that it's a best practice to do so.

Commissioner Petrucione asked if the Charter exempts the RHCTF from the Administrative Code provisions.

Ms. Ly explained that the RHCTF does not fall under Chapter 21, and that using the RFP process would be a policy decision for the Board.

Mr. Huish suggested that the RHCTF Board could follow SFERS' approach by using an RFI.

Commissioner Murphy asked that Meketa or SFERS provide them with samples of RFI questions in order to be educated on the process.

At 3:35 PM – the Board took a 5 minute recess.

At 3:40 PM – the meeting resumed.

Ms. Malone continued the presentation on the manager selection process.

Commissioner Marx said that she would like to see more than one manager to see how consultant and staff came to their recommended manager.

Commissioner Salem asked what policies Meketa has in place that provides assurance that there is no compensation by the manager to Meketa for the introductions.

Ms. Malone explained that Meketa only accepts fees from clients, not managers.

Commissioner Salem raised the issue of "soft dollars".

Ms. Malone reported that the State of California has very stringent disclosure laws and Meketa staff must report out on this annually.

Action: Moved by Commissioner Murphy, seconded by Commissioner Salem to continue the Updated Investment Policy Statement to the next Board meeting.

Ayes: Marx, Murphy, Petrucione, Salem, Walsh. Nays: None.

- 11272017-08 Action Item **Revise Memorandum of Understanding Between SFERS and RHCTF**

Documents provided to Board prior to meeting: Staff Memorandum; Revised MOU between SFERS and RHCTF

Moved by Commissioner Marx, seconded by Commissioner Murphy to continue the Revised Memorandum of Understanding Between SFERS and RHCTF to the next Board meeting.

Ayes: Marx, Murphy, Petrucione, Salem, Walsh. Nays: None.

- 11272017-09 Discussion Item **Q3 2017 Investment Report**

Documents provided to Board prior to meeting: Fund Evaluation Report from Meketa Investment Group, Investment Consultant

Paola Nealon, of Meketa Investment Group, presented the Q3 2017 Investment Report.

Action: This is a discussion item only.

- 11272017-10 Discussion Item **Trust Administrator Report**

Documents provided to Board prior to meeting: Staff Memorandum

Caryn Bortnick, SFERS Deputy Executive Director, presented the Trust Administrator Report.

Commissioner Murphy requested a status update on the outstanding contracts.

Ms. Bortnick confirmed this would be an item on the next meeting's agenda.

Action: This is a discussion item only.

- 11272017-11 Discussion Item **Board Educational Opportunities**

Documents provided to Board prior to meeting: List of Educational and Training Opportunities from Cortex Applied Research

Caryn Bortnick, SFERS Deputy Executive Director, presented the Board Educational Opportunities.

Action: This is a discussion item only.

- 11272017-12 Discussion item **Good of the Order**

RHCTF Board members may request that any matter be calendared at a future meeting. All such requests shall be calendared in a reasonable time. (RHCTF Board Operations Policy ¶17.) The Board will not discuss any items requested to be calendared until a subsequent meeting when the matter is included on the agenda with the required public notice.

Action: This is a discussion item only

□ **Meeting Adjourned at 4:15 PM**