

POLICE AND FIRE RETIREMENT PLAN

Investment Committee Summary

THURSDAY

SAN JOSE, CALIFORNIA

August 20, 2009

Present:

Committee Members

David Bacigalupi
Scott Johnson
Keith Keesling

Also Present:

Russell Crosby	-Secretary/Director	Allan Martin	-NEPC
Carmen Racy-Choy	-Staff	Christopher Levell	-NEPC
Ali Amiry	-Staff	Dan LeBeau	-NEPC
Ron Kumar	-Staff	Carolyn Smith	-NEPC
Ceara O'Fallon	-Staff	Aaron Prince	-WAMCO
Conrad Taylor	-Trustee	Thomas McMahon	-WAMCO

MEETING SUMMARY

RECOMMENDATIONS

1. Approval of NEPC's recommendation to grant WAMCO an investment policy exception to increase the range of the downgraded securities from 2% to 10% temporarily for 6 months.
2. Approval to accept the Boston Company's 5% fee reduction for three years, effective July 1, 2009.
3. Approval to accept INTECH's request for an investment policy exception to limit their security variation to no more than 2.5% of the security's weight in the benchmark.

ITEMS

1. Approval of Investment Committee Summary.
 - a. July 16, 2009.
2. Discussion on Scheduling Future Investment Committee Meetings.

The Secretary noted that the next committee meeting is scheduled for September 15. It was requested that meetings be held on Thursdays, versus Tuesdays, which are Council meeting days. The following dates were scheduled:

- a. Thursday, October 29, 2009, 9:00 a.m.
- b. Friday, November 13, 2009, Investment Committee meeting at 9:00 a.m.; followed by the Committee of the Whole meeting at 10:00 a.m.
- c. Thursday, December 17, 2009, Investment Committee meeting at 9:00 a.m., followed by the Real Estate Committee meeting at 10:00 a.m.

3. Discussion and Action Regarding the Asset Liability Modeling Study.

Mr. Martin recalled that when NEPC was first retained in April 2008, they did an asset-only study, resulting in a recommendation that the plan had an over-concentration of risk in equities and that the equity exposure be reduced. He explained that the sole focus of the study was to develop an asset allocation that produced the best possible return against a volatility level in the portfolio. He noted that factors such as inflation and interest rate drive the returns of the assets and also impact the liability structure of the plan. He said that NEPC is examining the liability structure of the plan, making sure it does not result with an asset mix where assets drop significantly while liabilities are increasing as that would create unfunded status and other significant issues of concern.

Member Keesling commented if it could be predicted with accuracy what is necessary to pay out and if that should remain a constant number. Mr. Martin explained that it is not a constant number because there is an inflation factor in the payouts.

Member Keesling asked whether the asset allocations were based on liabilities, and Mr. Martin responded that the study examines the volatility and change in the liability structure and assures that the asset structure is sensitive to those liabilities.

Mr. Levell stated that the Plan had a large drop in assets, and earning 8% a year for the next 10 years is not sufficient to recover the losses that have been incurred over the last year. He explained that the Plan's funded status is expected to decline over a 10 year period even if the assets earn the assumed net investment return of 8.0%, and total cash flows are expected to increase (thru employer/employee contributions) over the next 10 years, covering cash outflows.

Ms. Racy-Choy clarified that NEPC is doing nothing different on salary assumptions than the actuarial assumptions, which is maintained throughout the report. She noted that NEPC's report is different from an actuarial report in that NEPC is examining what can be done from an investment perspective that will allow the Plan to be in a better financial position in the future. She said managing to keep the assets and liabilities in tandem is one way to assure that the Plan doesn't get unfunded liabilities.

Mr. Levell referred to various scenarios, noting that the equity risk dominates the portfolio.

Ms. Racy-Choy reviewed the asset classes described in the report, noting that the Plan

does not contain asset classes in Inflation-Linked Bonds (TIPs), Commodities, and Emerging Market Debt Spreads.

Status: Following discussion, consensus was for NEPC to return next month, respond to questions raised, allow time for staff to address issues, and then present it to the full Board.

4. Discussion and possible action on WAMCO's securities downgrade exception.

Dr. Amiry reported that the performance suffered drastically last year because of excessive allocation to mortgage-backed and other types of securities. WAMCO is requesting to increase the limit of their holdings that have not performed and have been downgraded. WAMCO was invited to explain how they are addressing the issue and to discuss their outlook for long-term in the securities' portfolio.

Mr. Prince noted that one factor which had a significant impact on the portfolio was WAMCO's cash-equivalent program. He explained that the cash-equivalent program is being improved, and that WAMCO has refined the definition of what a cash-equivalent is so that in the next cycle, this problem is not repeated in the portfolio.

Mr. Prince referred to the super senior bond in the portfolio which continues to receive monthly principal payments, and should be paid off in approximately one and a half years. He explained why the bond and other securities were downgraded from AAA to CCC.

Member Bacigalupi asked how much more of the portfolio could be expected to be downgraded, and whether there was a structure in place to start exiting. Mr. Prince responded that he did not anticipate more than 1-1.5% additional downgrading.

Ms. Racy-Choy stated that NEPC had taken a closer look at the portfolio and their recommendation was to grant the 10% increase in allocation with a caveat that it be granted on a temporary basis. WAMCO is to continue holding the assets, work toward reducing the allocations, and report back in six months to discuss the progress of bringing the allocation back to 2%, the current guideline. She commented that the intent is not to push to sell assets at distressed prices.

Committee moved, seconded, and carried: Approval of NEPC's recommendation to grant WAMCO an investment policy exception to increase the range of the downgraded securities from 2% to 10% temporarily for 6 months.

5. Approval to accept the Boston Company's 5% fee reduction for three years effective July 1, 2009.

Ms. Racy-Choy referred to the staff report, which states that at its October 23, 2008, meeting, the Federated City Employees' Retirement System's (Federated) Investment Committee asked that staff and the investment consultant renegotiate the fees paid to The Boston Company due to underperformance.

Staff negotiated a 5% fee reduction for three years effective July 1, 2009, for both the Federated and the Police & Fire plans.

Member Johnson stated he did not recall the performance as it relates to this particular plan. Mr. Kumar responded that for this particular plan, they're within the benchmarks so they are reasonable; however, in the case of Federated, they are below performance.

Member Johnson inquired about the term of the current agreement, and Mr. Kumar responded that the reduction is for the next three years in the middle of the agreement.

Committee moved, seconded, and carried: Approval to accept the Boston Company's 5% fee reduction for three years effective July 1, 2009.

6. Discussion and Action Regarding INTECH's Guideline Expansion.

Dr. Amiry reported that Intech requested a change to the portfolio's investment guideline, which reads, "limit individual security selection to the lesser of 10 times or 2.5% more than the benchmark weight." He explained that the weight in the portfolio cannot be more than 10 times or 2.5% over the benchmark. He stated that Intech wants to simplify the portfolio's structure and only limit it to 2.5% above the benchmark weight, which makes their operation easier and does not have a drastic effect on the portfolio. Staff recommends approval.

Mr. Martin explained that the original guideline has more limitation for smaller stocks on how big they can get in terms of exposure.

Committee moved, second, and carried: Approval to accept INTECH's request for an investment policy exception to limit their security variation to no more than 2.5% of the security's weight in the benchmark.

7. Update on the Securities Lending Pool Defaults.

Noted and filed.

Approved:



RUSSELL U. CROSBY, SECRETARY/DIRECTOR
DIRECTOR