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FALL 2016

The Future of **Natural Resources** Exposure

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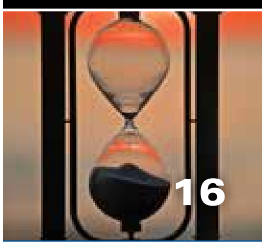

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Ashley Dunning is Co-Chair of the Public Pension and Investments Practice Group, a member of the Litigation Practice Group, and a partner at the national law firm Nossaman LLP. She has provided fiduciary and outside general counsel services, and/or litigation representation, to the majority of the over 30 public retirement systems in California for nearly two decades, including CalPERS, CalSTRS, 16 of the 20 CERL systems, and the independent city retirement systems in San Francisco, San Diego and Los Angeles.

DAVID KAPLAN

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David Kaplan's practice is focused on complex litigation, including securities class actions, individual "opt out" actions, and international securities matters. Mr. Kaplan has over a decade of experience in the field of shareholder and securities litigation. For his outstanding work advising and representing institutional investors, Mr. Kaplan has been recognized for several years as one of San Diego's "Rising Stars" by Super Lawyers.

NICOLE LAVALLEE

Partner, Berman DeValerio

Nicole Lavallee, the Managing Partner for the San Francisco Office, focuses her practice on securities litigation. She is an integral member of the firm's New Case Investigations Team, which scrutinizes potential securities law violations to determine whether a case meets the firm's exacting standards. Ms. Lavallee is also a member of the Firm's executive committee.

DAN McALLISTER

SACRS President and San Diego County Treasurer-Tax Collector

Dan McAllister was elected San Diego County's Treasurer- Tax Collector in November 2002 and re-elected to his fourth term in June 2014 by an overwhelming 99% majority of the vote. Not only is he responsible for the collection of more than $5.5 billion in property taxes each year, but his office also manages the Investment Pool, which reached an all- time high of $10.1 billion in April of 2016, ensuring that these funds are wisely invested and safeguarded for entities such as the school districts and cities in the County.

Mr. McAllister also serves as a member of the San Diego County Employees Retirement Association, which manages more than $10 billion of investments. Additionally, he is a former chairman of the Board of Directors of the internationally recognized San Diego Convention Center Corporation. Prior to his election as San Diego County Treasurer-Tax Collector, Dan was a successful financial consultant and investment broker.

NAPIERPARK
GLOBAL CAPITAL

NAPIER PARK GLOBAL CAPITAL

Napier Park Global Capital is an independent alternative asset management firm that manages approximately USD 6.8 billion as of June 1, 2016. The firm offers a diversified product mix including credit funds, bespoke client solutions, private investments, CLOs, and structured credit to large, sophisticated institutional investors. Napier Park Global Capital has offices in New York, London and Switzerland. For more information, visit: www.napierparkglobal.com

BLAIR NICHOLAS

Senior partner, Bernstein Litowitz Berger & Grossmann LLP

Blair Nicholas is a senior and managing partner of Bernstein Litowitz Berger & Grossmann LLP and widely recognized as one of the leading securities litigators in the country. He has extensive experience representing prominent private and public institutional investors in high-stakes actions involving federal and state securities laws, accountants' liability, market manipulation, and corporate governance matters. Mr. Nicholas has recovered billions of dollars in courts throughout the nation on behalf of some of the largest mutual funds, investment managers, insurance companies, public pension plans, sovereign wealth funds, and hedge funds in North America and Europe.

NOEL O'HALLORAN

Director, Chief Investment Officer, KBI Global Investors (North America) Ltd.

Noel O'Halloran joined KBI Global Investors Ltd. in 1992, was promoted to Head of Equities in 1996, and appointed Chief Investment Officer in 2002. In 2000, he was one of the key architects that formulated KBI's Resource Solutions investment philosophy and process to extract the investment potential resulting from the supply and demand imbalances for the essential resources of Water, Energy and Food.

Mr. O'Halloran is an engineer by profession having graduated with 1st Class honors degree from University College Cork. He is a member of the CFA Institute and the UK Society of Investment Professionals.

MICHAEL ROBSON

Edelstein, Gilbert, Robson & Smith llc

Michael R. Robson has worked since 1990 in California politics and has been lobbying since 2001 when he joined the firm. Prior to joining the firm, he began a successful career with Senator Dede Alpert as a legislative aide soon after she was elected to the Assembly in 1990. He became staff director/chief of staff in 1998, while the Senator served in the position of Chair of the Senate Appropriations Committee. He is experienced in all public policy areas with particular expertise in environmental safety, utilities, revenue and taxation, local government finance, education, and the budget.

GABRIEL RODRIGUES

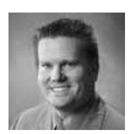
SACRS Vice President and Program Committee Chairperson and a Deputy Sheriff with the Contra Costa County Office of the Sheriff

Gabe Rodrigues is a Deputy Sheriff with the Contra Costa County Office of the Sheriff. Gabe spent over two decades in the Food and Drug Industry prior to entering Law Enforcement. His titles included Financial Analyst, Database Analyst, Marketing Manager, and Account Executive. At the age of 48, Gabe followed his lifelong dream of becoming a Peace Officer. His work in Law Enforcement provides him with the satisfaction of helping the community that he is sworn to protect. Gabe earned his BA in Management from Saint Mary's College at Moraga, California and his MBA in Marketing Management from California State University, Hayward.

JUSTIN N. SAIF

Associate, Berman DeValerio

Justin Saif is an Associate at Berman DeValerio and focuses his practice on securities litigation. Mr. Saif has successfully litigated several securities class actions in federal court, resulting in meaningful settlements for defrauded investors.



TRENT E. SMITH

Edelstein, Gilbert, Robson & Smith llc

Trent E. Smith worked for over 12 years in the State Capitol prior to joining the firm. He started his career in 1990 working for the well-respected late Senate Republican Leader Ken Maddy. He was later awarded one of 16 positions in the prestigious Senate Fellowship Program. Upon completion, he started working in various positions in the State Assembly. He worked as a Chief of Staff to Assembly Member Tom Woods of Redding and later to Orange County Assembly Member, Patricia Bates, who served as Vice Chair of the Assembly Appropriations Committee. In this position, he gained a unique and valuable knowledge of the State budget and related fiscal policy matters. In addition, he has extensive experience in numerous policy areas.

MICHAEL TOUMANOFF

Of Counsel, Nossaman LLP

Michael Toumanoff has specialized, for more than 25 years, in the law affecting public retirement system fiduciaries, and has represented and advised several California public pension systems, including KCERA, LACERA, SBCERA, SDCERS, and the Pasadena Fire & Police Retirement System, on a variety of issues.

SACRS Provides Members with Tools and Skills to Succeed

As we prepare to meet at the Fall SACRS Conference on Nov. 8, I ask that you consider how our public pension systems fit in America's retirement landscape. Did you know in California, our twenty '37 Act pension systems serve more than 500,000 active and retired employees? Or when combined, the assets under management for our plans represent more than $135 billion?

Today in America, 84 percent of state and local workers have a defined benefit pension plan. With increased media scrutiny on public pension plans, it's more important than ever that we recognize the responsibility we have to our current and future beneficiaries. As your SACRS President, I will continue to support this organization's goals of education and legislation.

Thanks to the tireless work of our Board of Directors, our Spring and Fall Conferences offer a chance for public pension leaders to share best practices, warn against potential pitfalls and learn about the latest trends in investments and fiduciary responsibility.

I want to recognize SACRS Vice President Gabe Rodrigues, Secretary Art Goulet, Treasurer Larry Walker, Immediate Past President Yves Chery and Affiliate Chair Michael Bowman for putting together excellent programming for the 2016 Fall Conference in Indian Wells.

Looking ahead to next year, SACRS is again partnering with the UC Berkeley Center for Executive Education to hold its Public Pension Investment Management Program 2017. This certificate program aligns with our continued efforts to give our members the tools and skills they need to successfully manage pensions. We are proud of the fact our program is held in exceptionally high esteem by all who attend it. UC Berkeley is one of the finest educational institutions in the world, and we encourage more systems and trustees to send their participants next year.

As President, I want to bring our organization into an era of innovation, while continuing to capture the essence of our mission and goals. Modern infrastructure and design will bring a new energy to the ways our members interact with SACRS. Our board is working together to rebrand the organization with a modern look and feel, especially on our website. SACRS.org will soon become more user-friendly, a place where our members can easily find any information they are seeking. We are working now to make sure the product we roll out is the best it can be, and we hope to unveil the rebranded website and support materials at our Spring Conference next May.

We are also exploring the idea of holding more webinars for our many trustees, wherever they are, to provide educational opportunities. A webinar series could give members timely lessons covering a wide variety of topics in the public pension world.

During the Fall Conference, I hope you will join me in contemplating how we can advance the progress of SACRS and of public pension systems across California.

See you in the desert on November 8-11.

***Dan McAllister**, President of SACRS & SDCERA Trustee*

FROM THE EDITOR

A Key Conference Ingredient: Networking

As this edition goes to print, we are just a few weeks away from what promises to be another value-packed SACRS Conference. Our backdrop is a beautiful location, at the picturesque Renaissance Indian Wells Resort & Spa, in the heart of the Coachella Valley.

This conference is highly regarded for its learning opportunities, but I also hear a lot about the many benefits of networking from attendees. We strive to make our networking sessions engaging, fun, and productive for our members to get to know each other. While some may call networking time "hardly working" in reality we are "working hard" to gain valuable connections and build relationships with colleagues that may not have otherwise had the chance to happen.

Indian Wells networking time will be particularly memorable as we gather on Election Eve, November 8 for our *SACRS Election Central – It's Red, White, Blue and You!* evening reception. Together we will watch live results from multiple media outlets, while enjoying (or not, depending on your politics!) the historic, exciting election night together.

In addition, we have seven daytime meals that can be excellent places to meet new people or re-connect with others. If you are sporty, or if you aspire to be, attendees can also get their conference day off to a healthy start with either a Wednesday morning yoga session or the Thursday morning SACRS 5K Fun Run/Walk. On Thursday evening there is yet another reception to meet, greet, and get caught up on what's new.

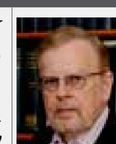
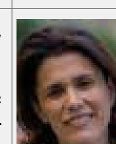
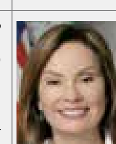
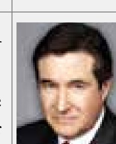
As for me, I am particularly looking forward to Wednesday evening, as our first full conference day comes to a close we will be in the Aloha Spirit with a Hawaiian Style BBQ. This event includes a reception, dinner, and entertainment by a local Polynesian dance group.

If you are not planning on attending the SACRS 2016 Fall Conference, I hope this writing will entice you to consider coming to next year's SACRS Spring Conference. I encourage you to mark your calendar now to join us on May 16-19, 2017 in Napa, California. You can count on a great program, as well as some valuable networking time! Don't miss it.

Sulema H. Peterson

***Sulema H. Peterson**, SACRS Administrator, State Association of County Retirement Systems*

Do you know these distinguished SACRS Fall Conference 2016 presenters? Take the test and see!

	ACCOMPLISHMENT		SACRS PRESENTER	
1	A graduate of Harvard University, this panelist was recently selected by the university as the first Latina in its 380-year history to have a portrait commissioned in her honor. She is the first Treasurer of the United States to have her current portfolio include oversight of the Bureau of Engraving and Printing, the United States Mint, and Fort Knox, as well as Chair the Advanced Counterfeiting Deterrence Steering Committee.	A	**GREGORY R. COPLEY AM, GCHT, FRCGS** *Thursday, November 10 | 10:45 a.m.* **SACRS General Session** *How Can America Dominate an Entirely Transformed World?*	
2	This duel careered panelist is one of America's most respected television journalists, and more recently is an entrepreneur in innovative health care. He is an advisor and board member of Edison Pharmaceuticals, the world leader in the study of mitochondrial disease. He is also a co-founder of Ampere Life Sciences, a newly launched company developing medical and functional foods targeting antioxidant deficiencies.	B	**ALEX WALLACE** *Wednesday, November 9 | 9:00 a.m.* **SACRS General Session Keynote** *2016 Elections*	
3	This SACRS speaker oversaw Nightly News, Meet the Press, and the Washington, D.C. bureau. In conjunction with responsibilities as Senior Vice President, she also served as Executive Producer of Rock Center with Brian Williams from October 2012 to June 2013 and Executive in Charge of Today from November 2012 until January 2014. She is a multi-winning News and Documentary Emmy Award winner and Peabody award recipient.	C	**ROSA "ROSIE" GUMATAOTAO RIOS** *Wednesday, November 9 | 2:00 p.m.* **SACRS General Session** *Outside the Box: The Power of Diversity*	
4	This SACRS panelist is an industrialist, and has owned shipyards and a ship design firm in the UK, a chemicals company in France, and was vice-chairman of Scotland's national airline, Highland Express. He is the author or co-author of 34 books on strategic philosophy, history, geopolitics, psychological strategy and information dominance, energy, aviation, national planning, and poetry.	D	**FORREST SAWYER** *Wednesday, November 9 | 9:00 a.m.* **SACRS General Session Keynote** *2016 Elections*	

Answers: 1.C 2.D 3.B 4.A

Dear SACRS Members,

I hope that 2016 has been a good year for you and your families. I am looking forward to seeing many of you at our upcoming Fall SACRS Conference in Indian Wells. The SACRS Program Committee has put together another outstanding line-up for all of us to enjoy and to benefit from.

This year's conference falls on the week of the most interesting Presidential election of my lifetime and possibly ever in our nation's history. As a reminder, please make sure that you get your absentee ballots in before the conference. To compliment the timing of our conference on Wednesday at 9:00 am, we will be featuring renowned veteran Broadcaster and Journalist Forest Sawyer and former NBC Senior Vice President Alex Wallace who oversaw the Today Show and the NBC Nightly News. They will provide us with some very good insight on what they see as the future of our country with our new U.S. President.

The following session at 10:30 am will feature financier and philanthropist David Rubenstein, co-founder and co-CEO of The Carlyle Group, one of the world's largest private equity firms. Mr. Rubenstein will offer his insight on the impact on the private markets based on the outcome of the election.

A significant change that the Program Committee made for this conference is the introduction of combining the New and Advanced Trustee training to be held on Tuesday at 3:00 pm. We have decided to combine the two groups so that the new Trustees can meet and benefit from the experience of our seasoned Trustees. Out of all the organizations I have been involved with, SACRS by far has the best feeling of a community. All of us can relate to our first SACRS Conference where we felt like an outsider when we observed how close all of the members were with each other. At my first SACRS Conference in 2012, I recall thinking I would never fit in with this group because they knew each other so well. I was pleasantly surprised how welcomed I became as the conference went on. I want us to be able to welcome the new Trustees with the same care and attention that I was fortunate to experience. To help break the ice for our new Trustees, we will be playing the Asset Allocation Game. We will be teaming up the new Trustees and advanced Trustees for a chance to show the competitive side of our personalities.

Lastly, the SACRS Board of Directors will be attending the various breakout sessions so that we can meet with as many members as possible. We encourage you to share any ideas or concerns that you have about SACRS with all of your Board members. SACRS is an organization that belongs to all of us. Its continued success depends on each one of us.

I am looking forward to seeing you in Indian Wells.

Sincerely,

Gabe Rodrigues,

Gabe Rodrigues, *CCCERA Trustee and SACRS VP*

Risks and Opportunities from Challenging Liquidity Conditions in Credit Markets

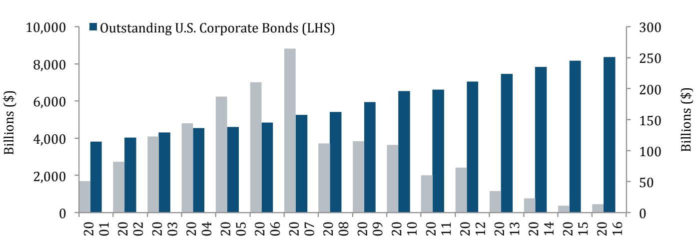
There has been a tremendous amount of focus over the past year or so on the liquidity risks in the corporate debt markets in the media, research reports, and public addresses by high-profile money managers. The combination of significant corporate debt market growth, dramatically lower broker-dealer balance sheet commitment and meaningfully higher participation in the market by daily-liquidity structures (e.g., Mutual Funds and ETFs) has stoked investor concerns over the potential for greater volatility. Credit markets are the focal point for measuring the impact of the structural changes we have seen over the last few years.

Cause and Extent of Liquidity Problems in Credit Markets

Before we can consider liquidity problems, it is important to recall what is meant by 'liquidity', which is commonly agreed to be "the degree to which an asset or security can be bought or sold in the market ***without*** affecting the asset's price."[1] Liquidity is also characterized by a high level of trading activity.

There has been extensive market commentary of liquidity issues facing fixed income markets in general, and credit markets in particular, but it is worth recapping on the key sources of these concerns. The first is the clear statistical evidence of the reduced role of dealers in providing secondary market liquidity. Dealer inventory in the U.S. has shrunk by as much as 95% from the peak in 2007 when it accounted for 5% of outstanding bonds compared to 0.16% of outstanding bonds in 1Q2016:

Outstanding U.S. Corporate Bond Market vs. U.S. Dealer's Inventory



Source: Federal Reserve Bank of New York and SIFMA. Data as of March 31, 2016.

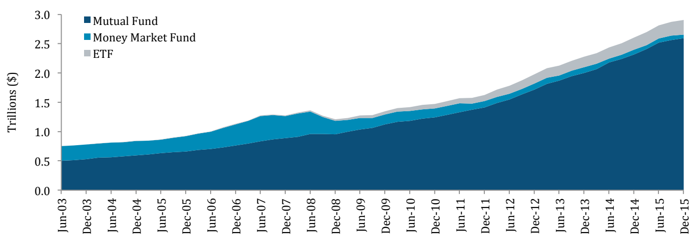
This is a fairly dramatic reduction in liquidity support for the credit markets and clearly removes one potential smoothing mechanism, which might previously have constrained spread volatility during periods of market turmoil. There are a growing number of regulations on large banks in the U.S. and elsewhere, which reduce the attractiveness of both investing and trading in credit securities, and have thereby contributed to this collapse of balance sheet commitment.

The table below summarizes the main regulatory developments in this area:

REGULATION	IMPACT
Dodd-Frank & Volcker Rule	Trading must reflect customer flows, proprietary trading outside of government-backed markets is illegal.
Basel III	Tougher new capital standards, especially for credit intensive assets.
Fundamental Review of Trading Book (FRTB)	Significantly increases capital required to support trading.
Liquidity Coverage Ratio (LCR)	Requires banks to hold liquid assets to cover maximum 30-day outflows. No credit assets are LCR eligible.
Supplementary Leverage Ratio (SLR)	Constrains leverage for large banks with 5% min capital against all assets (including cash) at the bank level, 6% at the holding company, creating significant minimum return hurdles for all assets.
Treatment of Other Comprehensive Income (OCI)	Works with Basel III to inhibit security holdings as changes in value of Available for Sale (AFS) securities now go through Tier 1 capital.

The second key structural change relates to the holders of credit assets, with an explosive growth of mutual fund and Exchange Traded Funds (ETFs) as illustrated by the graph below:

U.S. Corporate Bond Market Developments



Source: Bank for International Settlements. Includes holdings of U.S. corporate and non-U.S. bonds.

There is now almost $3 trillion in U.S. funds dedicated to corporate credit risk and offering frequent, often daily, liquidity to investors. This has created serious mismatches between investor liquidity and underlying asset liquidity. This is exacerbated by first-mover advantage and herding among portfolio managers, which "can encourage destabilizing behavior and amplify shocks."[2]

> *"There is little doubt both that liquidity provision has been substantially reduced and that the magnitude of liquidity risks has risen markedly. It is easy to conclude from this that liquidity interruptions, and periods of increased spread volatility associated with them, will be more frequent than in the past."*

The broad concerns about liquidity conditions and risks are perhaps best summarized by the following excerpts from the IMF Global Financial Stability Report published in April 2015, which had a section titled "When market liquidity vanishes":

> "Markets could be increasingly susceptible to episodes in which liquidity suddenly vanishes and volatility spikes."
>
> "Inflows into mutual funds have provided an illusion of liquidity in credit markets, but changes in market structure may exacerbate illiquidity in times of stress."
>
> "Many of the factors responsible for lower market liquidity also appear to be exacerbating risk-on/risk-off market dynamics and increasing cross asset correlations during times of market stress."
>
> "Economic and policy tensions leave global markets vulnerable to bouts of illiquidity that could prove systemic."

So there is little doubt both that liquidity provision has been substantially reduced and that the magnitude of liquidity risks has risen markedly. It is easy to conclude from this that liquidity interruptions, and periods of increased spread volatility associated with them, will be more frequent than in the past. What is less clear is whether the really large moves in spreads will be less frequent by virtue of the fact that previous large holders of credit product, the banks, will have a lesser role in the process and won't exacerbate spread widening by selling large volumes at times of the most acute market stress, something that we have certainly witnessed in the past. It may well be that the politicians and regulators who have been largely responsible for the changes in market structure will be satisfied if they have reduced the risks of catastrophic events even if there are generally more frequent periods of increased volatility or, to put it another way, "the car is safer, but the ride is a lot bumpier."

Investor Risks in Certain Fund Structures

One issue that has received less attention is the impact of these changing liquidity conditions on investor risks in existing structures. Once again, a quick recap on history can be illuminating. The development of tradable credit indices ignited a boom in hedge fund involvement in credit with dramatic growth from 2002-2007. Single-name and index CDS drove corporate (and later, mortgage) credit liquidity and trading levels to new heights and both hedge funds and dealers set up 'correlation trading' teams to trade and manage credit on a proprietary basis. Hedge fund liquidity terms mimicked those of more liquid markets (e.g., interest rates and currencies) and new investors in the form of retail and Hedge Funds of Funds were attracted to this higher-returning, less-correlated, 'liquid' strategy. The ensuing crisis from 2007 to 2009 demonstrated very clearly that too many managers ignored the 'liquidity interruption' risk and asymmetrical risk profile of credit. Many funds used CDS to hedge what was a liquidity event, not a credit event, and found to their detriment that exiting credit derivative trades was a lot harder than putting them on!

It is tempting to ask whether we have collectively learned enough from these past events. As liquidity risk is once again a hot topic, many institutional investors continue to have exposure to shorter locked-up credit hedge funds which are increasing the credit and liquidity risk exposures in their portfolios by mismatching short-dated capital with more complex, less liquid assets, or using meaningful amounts of borrowed money leverage. While there are ways to mitigate this risk (e.g., holding higher cash balances to compensate for liquidity interruption and redemption risk), we have seen ample evidence of ugly mark-to-market drawdowns and subsequent fund redemptions meaningfully impairing investor returns whether as a result of portfolio concentration in binary-outcome risks (e.g., FNMA and FHLMC, Puerto Rico), exposure to 'cheap' market sectors that fall out of favor (e.g., Energy) or high levels of borrowed money to amplify carry. Unfortunately, these liquidity mismatches do not simply result in longer periods for investor redemption requests to be met, since those redemption requests themselves cause further losses as managers force product into an illiquid market and suffer the price consequences of doing so. The herd instinct and first mover advantage referenced by the IMF become all too real in these situations, further deteriorating the outcome and meaning that investors who perceived the liquidity 'option' as a positive thing could not have been more wrong. We believe that the prevalence of funds purporting to offer frequent liquidity in credit markets, from ETFs and mutual funds through to short lock-up hedge funds, could well be the harbinger of the next series of bond and credit fund blow-ups during the next economic downdraft.

Potential development of 'Liquid' Credit Trading Products

Perhaps somewhat perversely, even as available market liquidity has fallen, the growth in retail ownership of corporate bonds, particularly in high yield, has increased the requirement for frequent, often daily, liquidity. Portfolio managers have therefore turned to so-called 'portfolio' products to fund outflows or invest inflows immediately and then seek to execute the necessary single-name bond trades over time. It is worth understanding how this can work and what constraints there will be in the effectiveness of these products acting as a provider of liquidity to individual funds.

Portfolio products include CDX, TRS and ETFs, but while the first of these has experienced the fastest growth it is the last category, ETFs, which have been most prevalent as a potential mechanism for supplying market liquidity. Assuming these ETFs are an effective index of appropriate risk, fund managers can use them as a means of dealing with both redemptions and inflows. However, and this is crucial, it only works if there is another manager experiencing opposite flows who effectively wants to be the other side of the ETF trade - otherwise one is simply transferring the liquidity problem from one fund to another. So for ETFs to be effective contributors to market liquidity, there need to be managers experiencing opposing flows who are both willing to use ETFs as a proxy ahead of single-name bond trades, raising the question as to what proportion of flows offset or may be termed 'diversifiable'. The news here is mixed. In general, based on two years of weekly Lipper data on more than 800 high yield mutual funds, around 50% of flows are diversifiable, suggesting that ETFs are a viable tool for satisfying daily liquidity requirements. The problem is that during the most extreme weeks, i.e. those where we are most likely to be concerned with liquidity issues, this can fall to as low as 5%.[3] So when flows become highly correlated, ETFs will likely be of very limited use in dealing with liquidity issues. As the ETF market continues to develop, along with improved ability to short selective ETFs through better ability to borrow shares, they may well provide a useful tool to take and manage risk in credit, but they are unlikely to provide the solution to the liquidity mismatches which they are themselves exacerbating!

It is always worth remembering that the source of potential illiquidity is the lack of homogeneity in fixed income instruments. This is at the root of the problem, and explains why equity market liquidity is always so much better than bond markets, particularly during crisis periods, even if it is somewhat illogical given their respective positions in the capital structure. This was most apparent during the global financial crisis when equities of even distressed companies remained liquid as bond market liquidity all but disappeared. This fundamental problem is impossible to address without some unforeseen development of standardized, evergreen, debt instruments, and the recent proliferation of cusips has only served to remind us of the more bespoke nature of so much of the credit markets.

Implications of Changing Liquidity Conditions for Credit Investments

It is now time to bring all the above together and give our perspective on what it means for credit markets and credit investors.

Our first conclusion is that we are seeing a sustained bifurcation in the market where on-the-run corporate bonds and indices are broadly held by retail and other investors with short term liquidity needs (even though these may sometimes be difficult to meet) while more credit-intensive and structured investments, which are more prone to liquidity interruption, have fewer investors and trading desks involved. This bifurcation has the capacity to create and even exacerbate very different valuations for the two segments. We are already seeing signs that investors are willing to accept much lower returns for purportedly liquid sources of exposure to credit, particularly high yield credit. This liquidity premium makes the generic parts of the market less interesting to sophisticated investors and supports the logic for focusing on more specialized credit markets where there are far greater opportunities to extract attractive risk-adjusted returns.

Qualified, experienced investors with the ability to analyze, value and risk manage more complex credit investments have an exceptional opportunity to be providers of liquidity on an opportunistic basis to a wide range of sectors where spreads remain highly attractive compared to expected losses and are often at multiples of pre-crisis levels.

For sophisticated institutional investors credit market illiquidity is not something to deter allocations, but rather this illiquidity, particularly in the more specialized credit instruments, is the very source of excess returns. This theme of turning what looks like a problem into an opportunity to extract investment performance, has been central to success in many investment sectors over the generations. The quid pro quo for the harvesting of these returns is an acceptance that liquidity terms need to reflect those of the underlying instruments and that anything else will simply expose investors to greater risks. It can seem counterintuitive that giving up a "feature" such as frequent liquidity rights will actually reduce the risks of an investor's holdings, but we firmly believe this to be the case, and see fund performance providing compelling evidence in support of appropriate liquidity terms. Indeed, it requires longer locked-up fund structures to realize the intrinsic value in many credit markets.

***Napier Park Global Capital**, a global alternative asset management firm, has long been at the forefront of highlighting structural and secular changes to the marketplace for credit investments, and have consistently sought to provide investors with an insight into changing market liquidity and the risks and opportunities this presents. We hope this article will provide further interesting food for thought for investors as they consider the best way to navigate their way through these changing markets.*

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1 Investopedia, July 2015.

2 Source: Barclays – Implications of ETFs on Credit Liquidity – Using ETFs to Mitigate Fund Flows, June 2015.

3 Source: Barclays – Implications of ETFs on Credit Liquidity – Using ETFs to Mitigate Fund Flows, June 2015.

The Future of **Natural Resources** Exposure

In the late 1980s, Japan, it seemed, was taking over the world. It was – by far – the largest component of the world equity market (making up 45% of the MSCI World market cap), and Japanese investors were buying up U.S. assets on a huge scale. To many investors at the time, Japan's position as the largest equity market seemed secure and they invested accordingly.

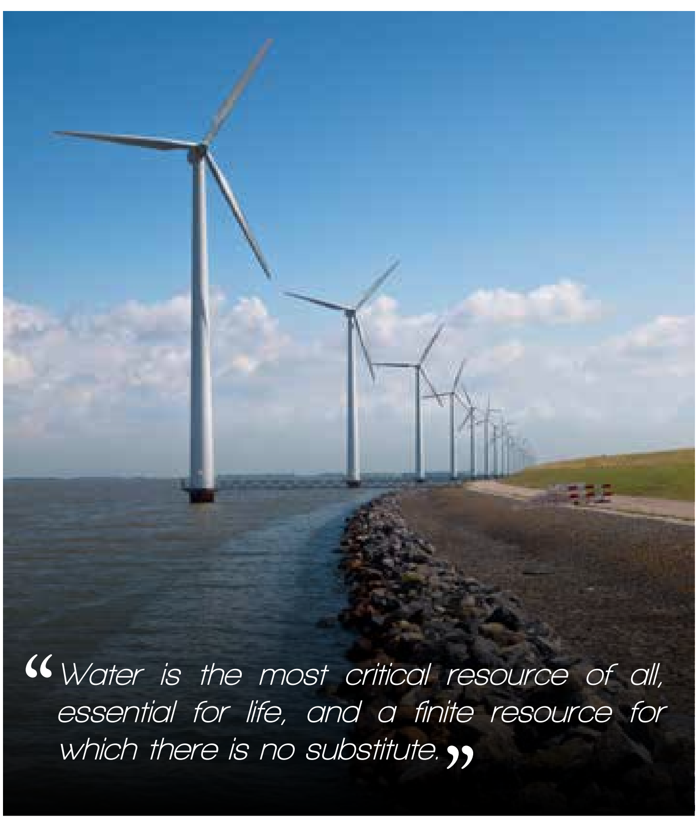
But a stock market index reflects the strength of companies today, and tells us relatively little, if anything, about the future. In Japan's case, its share of the world index is now down to about 8%, and the U.S. is by far the largest market as measured by market cap. Investors, who followed market cap weightings, in the late 1980s, lost a huge amount of their investments.

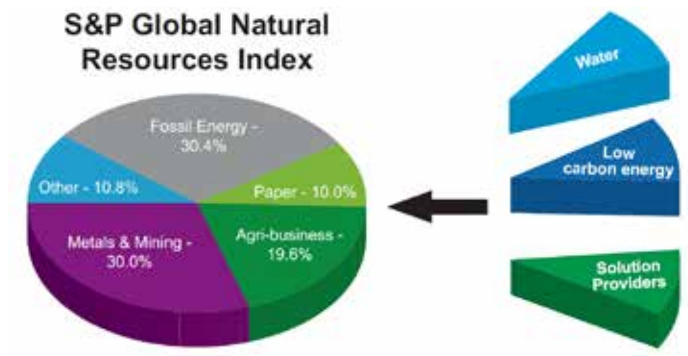
> *"Putting it more broadly, the accepted make up of an investment asset category today may not be representative of the make up of that asset class tomorrow."*

My crude example of the Japanese stock markets fall from grace is really a metaphor for the notion that constituents » that dominate an index today will not necessarily be the main components of the index in the future. Putting it more broadly, the accepted make up of an investment asset category today may not be representative of the make up of that asset class tomorrow.

> "Investors allocate to natural resources in their broader portfolios for three key reasons: to diversify away from the mainstream exposures they have in the other parts of their portfolio, to get some degree of inflation protection, and to gain exposure to and benefit from multi-decade global infrastructure spending."

With this in mind, my team and I have spent considerable time and effort considering the long-term secular investment potential resulting from the supply/demand imbalances in the natural resources space. Investors allocate to natural resources in their broader portfolios for three key reasons: to diversify away from the mainstream exposures they have in the other parts of their portfolio, to get some degree of inflation protection, and to gain exposure to and benefit from multi-decade global infrastructure spending. We looked at traditional natural resource allocations: they were heavily weighted to Energy (dominated by big oil, natural gas and coal), Metals & Mining, Paper & Packaging and more 'traditional' Agricultural exposure. We asked ourselves: Does this typical allocation really address the key reasons why an investor invests in natural resources and is it representative of the future make up of the natural resources space?





In the above graphic, we represent a traditional natural resources allocation using the S&P Global Natural Resources Index, as an (imperfect) proxy for how many investors invest in this space. From our study we identified three key areas that were glaringly absent from a traditional natural resources portfolio.

Our vision is clearly to look to ***future*** key vital natural resources, rather than many that - not unlike the Japan analogy – may have peaked and be oriented more toward the past.

Water

Water is the most critical resource of all, essential for life, and a finite resource for which there is no substitute. Couple this with the fact that historically, water demand has grown at twice the rate of population growth and is expected to grow by more than 40% by 2030. In order to address the challenges of water scarcity, an estimated $12 trillion global investment will be required from 2015 to 2030, which will be the largest component of global infrastructure spending over that time period, more than roads, railroads, seaports, and power combined[i].

Water is critical to global economic well-being as an essential input across a diversified array of industries, including the food processing, semi-conductor production, mining, paper and energy industries. The water opportunity is broader than a single sector, consisting of a collection of less-covered companies with diverse return characteristics that are involved in some specialized aspect of the provision of water. The businesses include more defensive water utilities that manage the infrastructure from source to use and back again, higher growth companies that design, produce or construct water infrastructure and niche water technology companies that produce solutions to manage, conserve and assure water quality.

Water investing is a multi-decade secular growth strategy with exposure to sectors, companies and regions that I believe are poised in the future to deliver growth above the broader market. As such, I believe they are positioned to provide investors with inflation protection. Looking at all of the above points, the infrastructure spend, the diversification benefits and the growth prospects, it is strange, in my view, that an investor would not have water exposure in their natural resources portfolio.

Low Carbon Energy Solutions

The second key area that we have identified as overlooked is the contribution of low carbon energy solutions to the energy portion of a traditional natural resources allocation. The traditional energy component of a natural resources portfolio is dominated by coal, oil and natural gas and all those large cap energy names that – unfortunately from a diversification point of view - you will probably also find in your U.S. or International equity portfolio.

We are all aware of the supply/demand dynamics impacting the energy sector. We all know that fossil fuels are finite and that alternative solutions need to be found to address shortfalls now and in the future. We have all heard of climate change and we also are all aware of the various government initiatives in place to reduce CO_2 emissions and achieve 'energy security'. It is indisputable that low carbon energy solutions are vital to address these issues.

Significant price declines in solar and wind technologies that have occurred in recent years have made installing these renewable energy sources mainstream as many are now cost competitive versus traditional power generation sources (even discounting the shale oil and gas revolution, and government subsidies). However, renewables are not the only solution. Much of the solution for the supply/demand imbalance (and targeted CO_2 reduction) will come from the *energy efficiency* sector through investment in grid infrastructure to improve capacity, reliability, and flexibility in power transmission and distribution, and from improved transport and building efficiency (everything from electric vehicles to designing and building residential and commercial buildings that use less energy).

There is major infrastructure investment in low carbon energy solutions. And there is a broad and diversified opportunity set of renewable energy and energy efficiency companies - which you probably do not hold in other parts of your portfolio - available for investment. Low carbon energy solutions are poised for multi decade growth in the years ahead supported by multiple longer-term drivers (supply/demand imbalance for energy, wind and solar are cost competitive, supportive regulations, technological advancement). All of these factors are supportive of investment in low carbon energy solutions as part of your natural resources exposure.

Another important consideration for investors when allocating within their natural resources portfolio is the fact that asset owners and stakeholder are increasingly concerned about the long-term implications of investing in extractive industries, including coal mining and oil extraction. They see two difficulties with this – firstly the perceived impact of such activity on the environment, and secondly the risk that the valuation of companies engaged in these activities could be overstated, if the substantial fossil fuel reserves that they own fall in value due to new regulatory or taxation measures. By diversify or substituting some or all of this extractive industries exposure through an allocation to water or low carbon energy, asset owners can potentially reduce these environmental, investment and reputational risks.

Solution Providers

Finally, our study of the natural resources space clearly indicates that when you look at the companies that make up a traditional natural resources portfolio there is a lack of exposure to technologies and methodologies that have been or are being developed to solve the problems of the future supply and demand requirements for resources.

A good example is the agribusiness component of a traditional allocation. The stocks and commodities within a standard agribusiness portfolio may give little exposure to technological innovation. Consider agribusiness companies that increase the supply of food through the use of precision agriculture techniques. The driver to develop these innovative techniques is the supply/demand imbalance for food and the fact that there is only a finite amount of arable land available for growing crops. Thus a solution is 'yield maximization'; ensuring every inch of the field is used to maximize output with as little wastage as possible. It is described by some as 'big data' on the farm. It covers sowing, seed usage, fertilizer usage, how to apply water most effectively etc. Any agribusiness component of a natural resources allocation should consider solution-providing companies that integrate GPS positioning systems and software focused on automated farm machinery enabling more precise and efficient application of fertilizers and seeds which enable farmers to eliminate waste and improve farm productivity.

I firmly believe that any natural resources allocation must have exposures to the new and emerging technologies being employed to address the supply and demand imbalances in the natural resources space.

In the words of the young, but wise American poet Mattie J.T. Stepanek, 'Even though the future seems far away, it is actually beginning right now'. An allocation today to Water companies, the low carbon energy sector, and solution providers, will provide investors with a far more representative exposure to the current and future investment potential offered by the natural resources space.

Noel O'Halloran *joined KBI Global Investors Ltd. in 1992, was promoted to Head of Equities in 1996, and appointed Chief Investment Officer in 2002. KBI Global Investors Ltd is an institutional asset manager headquartered in Dublin, Ireland with sales offices in New York and Boston. KBI Global Investors was formed in 1980 and has a global client base managing mandates in the UK, Europe, North America and Asia. This material is provided for informational purposes only. Kleinwort Benson Investors International Ltd. is a registered investment adviser with the SEC and regulated by the Central Bank of Ireland.*

[i] McKinsey Global Institute, Resource Revolution: meeting the world's energy, materials, food, and water needs, November 2011; and McKinsey & Co "Infrastructure productivity", 2013

Gaining on Glaucoma: Detection and Treatment

Alan Cohen, O.D., has seen a lot of patients during his 47-plus years in practice. Here, the Collingdale, Pa. VSP doctor shares some facts about the sight-stealing condition, glaucoma. Dr. Cohen has treated hundreds of glaucoma patients during his career, and knows what to watch out for.

Q. What is glaucoma, and how many people have it?

A. It's an eye disorder that is caused by too much pressure in the eye. It can damage the retina, optic nerve or both, and cause vision loss and blindness. About 3 million Americans have it, and around 120,000 are legally blind because of glaucoma. It's important to catch it and treat it early, because it can lead to blindness in three to 15 years.

Q. Who's at greatest risk?

A. Like a lot of vision conditions, it typically happens to older people. Most often, people over 40. If there's a family history of glaucoma, risk goes up. Also, people who are very nearsighted or diabetic have a higher risk. Race can also play a role. Some research has shown that black Americans are about seven times more likely to develop glaucoma. In fact, it's the leading cause of blindness among black Americans. Hispanic people also are at higher risk.

Q. What causes glaucoma?

A. As part of normal functioning, your eyes produce an internal fluid to help the eyeball keep its shape. The fluid drains out of the eye all the time, but sometimes the drain "backs up" – and that's what usually happens with glaucoma. When this happens, the pressure from the fluid starts building up inside the eye and damages sensitive nerve tissues. In most cases what you get is chronic glaucoma that slowly worsens over time. There's also a type of glaucoma in which damage occurs without elevated pressure, but it's very rare.

Q. What are the symptoms of glaucoma?

A. The tricky part is that early stages of glaucoma are usually symptom-free. That's why an annual eye exam is a must. A glaucoma "puff test" is a standard part of a comprehensive eye exam. There's also an acute form of glaucoma in which the "drain" shuts down rapidly. This condition is rare but extremely painful, so there's no mistaking it. Acute glaucoma requires immediate attention in a hospital emergency room.

Q. Is there hope for glaucoma patients?

A. Yes – to an extent. There have been quite a few powerful new medications developed in recent years. They can be very effective at slowing or even halting the progression of glaucoma. Laser surgery, with medications, also helps make drainage in the eye better, which reduces the dangerous pressure. While it's not curable, glaucoma is often very treatable – the earlier, the better.

Q. How do your patients feel when you detect their glaucoma early and save their eyesight with treatment?

A. Often, relieved. For example, a good friend told me a few years ago her eyes felt funny. I gave her a thorough eye exam, found she had low-pressure glaucoma and sent her to a specialist. She hasn't lost any additional vision at all, and her eyesight has improved thanks to medication and surgery.

Get yearly eye exams to increase your odds of early detection of eye diseases like glaucoma that could potentially cause future problems.

With Courts Split on Class Action Tolling, Time Can Fly for Individual Claims

Stock fraud, accounting scandals, and predatory behavior by investment banks have long plagued our nation's financial markets. Fortunately, for over 40 years, investors' individual claims for recovery of damages under the U.S. securities laws have been protected and preserved by the filing of a securities class action, which "tolled," or stopped the running of statutes of limitations and repose on investors' individual claims. In 2013, however, a split emerged among the federal circuits regarding the scope of this class action "tolling" rule. That split, which recently deepened, has created great uncertainty and imposed heavy burdens on the institutional investor community.

This timeliness issue – which impacts not only securities cases, but virtually all class actions involving claims governed by statutes of limitation and statutes of repose – will likely be taken up by the U.S. Supreme Court in the near future.

Background

The Supreme Court laid down the class action tolling doctrine over 40 years ago in the landmark case of *American Pipe & Construction Company. v. Utah*. Under *American Pipe* and its progeny, an unnamed member of a prospective investor class has been able to rely on the commencement of a securities class action to protect and preserve the timeliness of its individual damages claims until the court decides whether to grant the case class action status or the investor decides to opt out and assert its claims in an individual action.

For four decades, it has been understood nationwide that the *American Pipe* rule applied to both the statute of limitations and the statute of repose governing claims brought under the federal securities laws. In particular, this includes the 3-year repose period applicable to strict liability claims under Section 11 of the Securities Act of 1933 for material misrepresentations in public offerings, and the 5-year repose period applicable to claims under Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 for fraud in connection with open market purchases.

In 2013, the U.S. Court of Appeals for the Second Circuit upset this settled law by holding in *Police and Fire Ret. Sys. of the City of Detroit v. IndyMac MBS ("IndyMac")* that the *American Pipe* rule does not apply to the 3-year repose period applicable to claims under Section 11 of the Securities Act. In May 2016, the Sixth Circuit extended *IndyMac* in holding that *American Pipe* also does not apply to the 5-year repose period applicable to antifraud claims under Section 10(b) of the Exchange Act in *Stein v. Regions Morgan Keegan*. (The Second Circuit reached the same conclusion just recently in *SRM Global Master Fund v. The Bear Stearns Cos.)*

Consequently, there is now an even 2-2 split among the federal circuits on this critical timeliness issue as the Tenth Circuit (*Joseph v. Wiles*) and the Federal Circuit (*Bright v. United States*) line up on the other side and take the long-accepted view that class action tolling applies to both the statute of limitation *and* the statute of repose. (The Third Circuit is set to break this 2-2 tie in the case of *North Sound Capital v. Merck & Co.* (*"North Sound"*)). Notably, in *North Sound*, the institutional investor community spoke loudly in expressing its strong support for broad application of the *American Pipe* rule. In a "friend of the court" brief, 55 pension funds with over $1.5 trillion in assets under management detailed the severe adverse consequences to institutional investors of overturning the established class action tolling doctrine, the importance of private securities class actions to the interests of long-term institutional investors, and the importance of the class action tolling rule to the court system as a whole.

> *"This timeliness issue – which impacts not only securities cases, but virtually all class actions involving claims governed by statutes of limitation and statutes of repose – will likely be taken up by the U.S. Supreme Court in the near future."*

What's at Stake for Investors

As detailed in the institutional investor amicus brief, the practical effect of limiting the *American Pipe* rule to the statute of limitations would be to impose heavy burdens on investors. The Second Circuit's *IndyMac* decision and the Sixth Circuit's recent *Stein* decision have taken an exceedingly narrow and impractical view of the *American Pipe* rule. In these Circuits

– which cover New York, Connecticut, New Hampshire, Michigan, Ohio, Kentucky, and Tennessee – institutional investors must incur the costs and burdens of extensively monitoring dozens of active securities class actions and, in any case in which the fund has a material financial interest, deciding whether to intervene or file opt-out actions to prevent their individual claims from lapsing under the statute of repose.

Just keeping track of the applicable repose periods can be highly burdensome, as the periods are generally measured from the date of each alleged misrepresentation or material omission, and a single case may involve dozens of them. Those misstatement and omission dates must then be cross-referenced against the investor's individual trading history to determine whether the expiration of each repose period is financially important, and thus whether litigation is warranted, and at what point in time.

Highlighting how extensively such monitoring procedures must be applied, a study by nine leading civil procedure and securities law professors shows that certification decisions are often not issued until well after repose periods have expired. According to the professors' study:

- The Securities Act's 3-year repose period for Section 11 and 12 claims would have expired prior to an order on certification in roughly 50% of all filed cases, and in over 80% of cases that actually reached a certification order; and

- The Exchange Act's 5-year repose period for Section 10(b) claims would have required investors to take protective action in 25% of all filed cases, and in 75% of cases that reached a class certification order.

As a practical matter, these figures likely understate the number of cases requiring proactive monitoring. First, certification battles have grown increasingly complex in light of recent federal jurisprudence, including the Supreme Court's decisions in *Dukes*, *Comcast*, and *Halliburton II*. Moreover, even if certification is granted within all applicable repose periods, courts can revisit certification at any time, which requires investors to consider taking proactive measures to protect against potential *decertification* of a class after repose periods have lapsed.

Furthermore, under a narrow reading of *American Pipe*, investors must protect against *any* defect potentially fatal to the class action, including (i) dismissal based on technical grounds such as standing, (ii) curable defects in the class pleadings such as failure to adequately allege the defendants' state of mind, and (iii) failure of the class plaintiffs to proffer adequate expert testimony, such as accurately apportioning price movements among fraud and non-fraud related factors.

In cases where institutional investors deem it wise to take affirmative action to protect potentially valuable securities claims, they must incur the time and cost of retaining outside counsel to prepare and actively litigate protective intervention motions and new individual actions. Investors must often make this decision on an incomplete discovery record and long before it is clear whether the class action will be successful—or even be certified. Investors' protective suits may involve an array of subsequent procedural motions and other court-clogging motions – all of which are unnecessary, wasteful, and discouraged under the traditional *American Pipe* rule that protected plaintiffs and the court system as a whole from such litigious activity.

This "parade of horribles" is no scare tactic or exaggeration. We have seen this trend play out in practice in many recent cases, where institutional investors have filed opt out actions at or very near the commencement of a securities class action to ensure their individual claims for recovery were protected. A prime example is the Petrobras securities litigation pending in the Southern District of New York, which arises out of the largest corruption scandal in Brazil's history. In Petrobras, nearly 500 individual plaintiffs have opted out early in the litigation (and continue to opt out), with their individual damages claims pending alongside the class action case, and a joint trial scheduled for this September.

Finally, it bears emphasis that because of the present national uncertainty regarding the scope of the class action tolling rule, institutional investors cannot limit these extensive monitoring procedures and proactive litigation measures to cases filed in the Second and Sixth Circuits. Instead, because the majority of federal Circuits have not weighed in on the issue, fiduciaries should be careful to ensure that best practices are in place to safeguard claims for recovery of damages in *all* securities class actions nationwide that are identified as meritorious and in which the investor (or its clients) has significant losses.

In sum, the constant monitoring, protective filings, and litigation activity that would be required if investors lost the full benefit of *American Pipe* would place a substantial burden on the court system, taxpayers, and investors, and adversely affect the retirement benefits of millions of state and local employees. A narrow application of the *American Pipe* doctrine would also undermine the purpose of the class action device by eviscerating class members' ability to rely on a class action to protect their interests, and encourage the filing of individual actions to guard against the loss claims to the statute of repose. The end result would be "[a] needless multiplicity of actions—precisely the situation that Federal Rule of Civil Procedure 23 . . . [was] designed to avoid." *Crown, Cork & Seal Co., v. Parker*

Supreme Court Resolution?

The Supreme Court was set to resolve the critical statute of repose issue less than two years ago in an appeal from the Second Circuit's decision in *Indymac*. However, just days before oral argument, the Court dismissed *certiorari* as "improvidently granted" after a substantial settlement of the underlying case. Now that the Circuit split has widened, the High Court should have an even greater interest in resolving the issue. The institutional investor community would greatly benefit from such clarity.

***Blair Nicholas** is a senior partner and **David Kaplan** is a senior associate at Bernstein Litowitz Berger & Grossmann LLP.*

The SEC—and Warren Buffett—Scrutinize Non-GAAP Accounting

As investors know, Generally Accepted Accounting Principles, or GAAP, are the standards and procedures that companies follow when compiling their financial results for public reporting. However, in addition to providing investors with GAAP-compliant financial results, public companies increasingly provide non-GAAP accounting as well. By one account, 334 of the 500 companies in the S&P 500 Index provided separate non-GAAP metrics in 2014, up from 232 in 2009. This uptick in the use of non-GAAP metrics is causing concern among some, as they can be used to present results in not just a more favorable light, but a more misleading one as well.

Earlier this year, in his annual letter to company investors, Berkshire Hathaway Inc. Chairman Warren Buffett explained how the use of non-GAAP metrics can be misleading. According to Buffett, "the most egregious example" of providing misleading information through the common use of non-GAAP metrics is when companies tell investors "to ignore certain expense items that are all too real," such as stock-based compensation.

> *"While companies are allowed under SEC rules to provide non-GAAP metrics as long as they also report GAAP results and do not give non-GAAP measures greater prominence, the SEC has recently taken steps to rein in some of the most aggressive uses of non-GAAP accounting."*

Presenting investors with non-GAAP figures that exclude stock-based compensation is particularly prevalent among technology companies, where such compensation is in high use. In Buffett's view, compensation is a real and recurring expense that management should include in the calculation of earnings. And a look at the 2015 reporting of both GAAP and non-GAAP metrics by Twitter, Inc., the well-known social media platform, starkly demonstrates why. Twitter reported a $521 million loss under GAAP, as opposed to a $277 million non-GAAP profit. As Buffett warned, the non-GAAP measure excludes $682 million of stock-based compensation. Tesla Motors, Inc. similarly reported significantly different GAAP and non-GAAP numbers in 2015, with a GAAP net loss of $889 million on $4 billion in revenue as compared to a non-GAAP net loss of $295 million on $5.3 billion in revenue.

Mary Jo White, Chair of the United States Securities and Exchange Commission (SEC or Commission), has raised concerns that the use of non-GAAP metrics can mislead investors. In her keynote address at the 2015 National Conference of the American Institute of Certified Public Accountants, she noted the prevalence of such measures in analyst reports and press coverage. While companies are allowed under SEC rules to provide non-GAAP metrics as long as they also report GAAP results and do not give non-GAAP measures greater prominence, the SEC has recently taken steps to rein in some of the most aggressive uses of non-GAAP accounting. In May, the Commission released new guidance on the usage of non-GAAP reporting and described usages that it finds objectionable. SEC Chief Accountant Mark Kronforst said that the SEC was "sending a message;" he encouraged companies to "self-correct" if they were using non-GAAP metrics in ways that were inconsistent with the new guidance.

One action taken by the SEC on this front involved Conoco Phillips Co. In its 2014 annual report, ConocoPhillips provided GAAP and non-GAAP results, including non-GAAP metrics based on much higher 2013 prices for oil and related commodities, including natural gas. The use of these older prices, while not in accordance with GAAP, made the company's financials appear much rosier in light of the steep fall in the price of oil, increasing earnings by $755 million. While the company claimed that this disclosure showed its results controlled for oil price swings, the SEC pushed ConocoPhillips to stop using such potentially misleading non-GAAP metrics. A skeptic might wonder how likely the company would have been to report its results using a similar non-GAAP metric if oil prices had dramatically increased.

A recent analysis conducted by consulting firm Audit Analytics highlights another potential concern regarding the use of non-GAAP measures. On August 3, 2016, *The Wall Street Journal* reported that Audit Analytics found that companies that rely heavily on non-GAAP income metrics are more likely to face certain accounting issues, such as a restatement or a material weakness in internal controls.

While non-GAAP accounting may serve a purpose when used properly to inform investors about company results excluding one-time non-recurring expenses, investors should follow the lead of the SEC and Buffett and cautiously scrutinize non-GAAP disclosures. When used improperly, such disclosures could obscure a company's true health and mislead investors, and their use may indicate an increased risk of other accounting issues.

Nicole Lavallee *is Managing Partner of Berman DeValerio's San Francisco office and* ***Justin Saif*** *is an Associate in the Boston office. Berman DeValerio represents investors, including public pension funds, in securities fraud litigation.*

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DAN MCALLISTER | President

Dan McAllister was elected San Diego County's Treasurer-Tax Collector in November 2002 and re-elected to his fourth term in June 2014 by an overwhelming 99% majority of the vote. Not only is he responsible for the collection of more than $5.5 billion in property taxes each year, but his office also manages the Investment Pool, which reached an all- time high of $10.1 billion in April of 2016, ensuring that these funds are wisely invested and safeguarded for entities such as the school districts and cities in the County.

Dan also serves as a member of the San Diego County Employees Retirement Association, which manages more than $10 billion of investments. Additionally, he is a former chairman of the Board of Directors of the internationally recognized San Diego Convention Center Corporation. Prior to his election as San Diego County Treasurer-Tax Collector, Dan was a successful financial consultant and investment broker.

GABE RODRIGUEZ | Vice President

Gabe Rodrigues is a Deputy Sheriff with the Contra Costa County Office of the Sheriff. Gabe spent over two decades in the Food and Drug Industry prior to entering Law Enforcement. His titles included Financial Analyst, Database Analyst, Marketing Manager, and Account Executive. He spent the majority of this part of his career with two Fortune 500 companies before moving to a start-up company, ending his career as the Director of Sales for an international food manufacturing company. At the age of 48, Gabe followed his lifelong dream of becoming a Peace Officer. His work in Law Enforcement provides him with the satisfaction of helping the community that he is sworn to protect.

Gabe chose to become a Retirement Board Trustee, allowing him the opportunity to use his business experience to protect and grow the assets of the pension plan that his fellow Contra Costa County employees depend on for their retirement.

LARRY WALKER | Treasurer

Larry Walker serves as Alternate Ex-Officio Representative on the SBCERA Board of Trustees, by appointment of Oscar Valdez, the San Bernardino County Auditor-Controller/Treasurer/Tax Collector. He has been on the board since 2010, having previously served as Ex-Officio Representative. He has twice served as Managing Trustee during vacancies in the CEO position.

Larry recently retired from San Bernardino County, having served as an elected county leader from 1986 to 2016. During that time, he served as County Supervisor, Chair of the Board of Supervisors, Auditor-Controller, Recorder, County Clerk, Treasurer, Tax Collector, and Director of Central Collections. He had previously served as elected Mayor of Chino from 1980 to 1986, and as a City Council member from 1978 to 1980.

Larry has been a member of SACRS Legislative Committee since 2015.

ART GOULET | Secretary

Art has been the Retiree Member Trustee of the Ventura County Employees' Retirement Association since 2005. He is also the Immediate Past President of the Retired Employees Association of Ventura County (REAVC), after serving as President for more than 10 years. He also serves as the Legislative Chair for the California Retired County Employees Association (CRCEA). He has lengthy public service at the state, city, and county levels. He retired from the position of Director of the Public Works Agency of Ventura County in 2000, after more than 22 years in that position.

Art is a member of the SACRS Legislative and Audit Committees.

YVES CHERY | Immediate Past President

Yves Chery is a Deputy Probation Officer II with Los Angeles County Probation Department and serves in the Residential Treatment Bureau. His experience includes helping at-risk youths, along with nearly a quarter century of advocacy for working families as a labor leader. Recently, Yves was appointed vice chair of LACERA's Operations and Oversight Committee. Yves is a strong supporter of LACERA's Outreach Programs and was instrumental in equipping Outreach Specialists at County worksite counseling seminars with LACERA's retirement calculators.

MICHAEL A. BOWMAN | Affiliate Chair, Advisor to the Board (Non-voting Position)

Michael A. Bowman is a relationship manager at Capital Group. He has 23 years of investment industry experience and has been with Capital Group for four years. Prior to joining Capital, he was a senior director at Invesco responsible for client service and marketing of institutional strategies. Previous to that, he was a managing director for Advent Capital Management. Michael is based in San Francisco.

What's Next After First District Court of Appeals' Vested Rights Decision in *MAPE v. MarinCERA*?

> "Specifically, the Court held that prospective exclusions of standby type payments and in-kind conversions from retirement allowance calculations were constitutional both on their face and as interpreted and applied by the Board of Retirement of the Marin County Employees' Retirement Association (MarinCERA)."

On August 17, 2016, Division Two of the First District Court of Appeal issued a unanimous published decision in *MAPE et al. v. MarinCERA*, et al. (Aug. 17, 2016, A139610) upholding the constitutionality of certain aspects of the Legislature's Public Employees' Pension Reform Act of 2013 ("PEPRA") that apply to legacy, as opposed to new, members of California's 20 county retirement systems that operate under the County Employees Retirement Law of 1937 (CERL).

Specifically, the Court held that prospective exclusions of standby type payments and in-kind conversions from retirement allowance calculations were constitutional both on their face and as interpreted and applied by the Board of Retirement of the Marin County Employees' Retirement Association (MarinCERA). That result should not have been a surprise. These specific exclusions were consistent with both the statutory "plan in effect" and the most recent case law prior to those amendments, as MarinCERA had argued, so the specific limitations on such inclusions to delineate the scope of the prior general statute did not impair the vested rights of MarinCERA members when the MarinCERA Board implemented those amendments as to post-January 1, 2013 time periods only.

However, the Court took a much more critical view of the plaintiff/appellants' arguments about the scope of vested rights law in California than had either the retirement system and board defendant/respondents or the State of California, which had intervened in the case to defend the constitutionality of the statute through the Attorney General. »

It is this ruling that has caught the attention of the press and others nationally, with Moody's Investor Service calling the ruling "a positive credit development not only for Marin County, but for the State of California (Aa3 stable) and its local governments."

Why so? Perhaps because the Court directly challenged the plaintiff/appellants' assertions that the prior inclusions were vested as to current employees in perpetuity and that in order for PEPRA to have been constitutional, a "comparable new benefit" was required to be provided to any disadvantaged legacy members. The Court first examined the numerous California Supreme Court and Court of Appeal cases on which appellants' relied and concluded that the correct statement of law on the comparable new benefit point was that a reasonable modification to a member's pension rights bearing a material relation to the theory of a pension system and its successful operation was constitutionally permissible, and that a comparable new benefit merely "should," rather than "must," be provided, if an impairment was found.

Further, the Court concluded that in the context of MarinCERA's implementation of PEPRA the legislative modification of the statutory definition of compensation earnable in order to curtail "pension spiking" did not qualify as a "substantial impairment of plaintiffs' contracts of employment with its right to a 'reasonable' and 'substantial' pension," and that a "new benefit" was in fact provided in any event because the newly specified exclusions from compensation earnable rules applied to future time periods as to current employees only and would result in decreased contributions and thus more monthly cash in hand for the affected members:

> The change in policy adopted by [MarinCERA]—which is not an employer of any individual plaintiff or of persons employed by other governmental entities—is not alleged to have changed [sic made a change] in the way compensation is calculated by those entities. Thus, for all we know, employees who prior to [MarinCERA] changing its policy in December 2012 collected any of the items or payments at issue . . . continued to have those items or payments included in their monthly compensation. However, due to MCERA's change in policy, each of those employees' paychecks is no longer being reduced by deductions to cover those sums in funding the employee's retirement. Put simply, the new benefit is an increase in the employee's net monthly compensation. Put even more simply, it is more cash in hand every month.

Also of note, the Court rejected plaintiff/appellants' estoppel arguments against the statutory changes because "Any promises or representations made to plaintiffs could have no validity if contrary to plain statutory language forbidding what plaintiffs wish to have recognized." If taken literally, this statement would appear to prevent any common law equitable estoppel principles from impeding a specifically mandated legislative change that operated only prospectively regardless of how reasonable any expectations of legislative constancy may have been.

Finally, and perhaps most significantly from the perspective of potential future legal developments, the Court included a long discussion of the inherent implied authority of a legislature to make "reasonable" "alterations, changes, and modifications," in retirement benefit plans that result in "reducing or eliminating" certain aspects of a retirement benefit, so long as they apply to *active*, not retired or deferred, employees, and so long as they do not "destroy" an employee's "anticipated pension." The Court stated that neither the United States Constitution nor the California Constitution prohibit such legislative actions, nor by extension would they prohibit such actions by either public employers or retirement boards within each of their respective areas of authority, presumably if also authorized by legislation. The Court did characterize the legislative changes that it was approving in this case to be limited, pointing out, "The extent of the new rule of [CERL] section 31461 is quite modest, as is the scope of the parties' disagreement." Moreover, as the Court discussed at length, an apparent legislative motivation to curb pension spiking is fully consistent with the theory of a pension system and its successful operation as is required even under the cases relied upon in its decision.

However, the potential reach of the reserved legislative power to modify future accruals of ongoing pension benefits and related rights for current public employees found in the decision's open ended discussion is certain to be the source of future disputes, and even continuing ones as plaintiff/appellants have now stated publicly that they will petition for review of the decision by the California Supreme Court.

The most immediate question this newest development raises for some in the California public retirement arena is what impact a grant of review of the *MAPE* Decision may have on the other pending court proceeding challenging the constitutionality of CERL section 31461. That proceeding involves the CERL retirement systems in Alameda, Contra Costa and Merced, which were all consolidated before the Contra Costa County Superior Court in mid-2013 ("Consolidated PEPRA Cases"). The Consolidated PEPRA Cases involve consideration of the same standby-type payments discussed in the *MAPE* Decision, as well as of cash received in lieu of accrued leave in excess of that which is earned and payable during each 12-month period during a final average salary period ("leave cash out" issue). The leave cash out issue had not been directly raised in the *MAPE* case because the MarinCERA Board excluded such excess payments several years before PEPRA was enacted and had not been challenged as a result of those pre-PEPRA exclusions.

In a procedural aside, MarinCERA had defended itself against attempts to consolidate the *MAPE* proceeding into the Consolidated PEPRA Cases on the ground that one superior court had no jurisdiction to order a superior court from a different county to surrender its jurisdiction over a matter originally brought before it. The jurisdictional question arose because the parties in the Contra Costa County Superior Court actions had stipulated that the cases to be consolidated were not "complex" and hence the judicial council's authority to order consolidation of complex cases brought in different counties was not invoked. The Court of Appeal agreed with MarinCERA on this point in a prior unpublished decision issued by the First District Court of Appeal ("DCA") in response to a petition for an alternative writ of mandate seeking enforcement of the consolidation order and the consequent voiding of the Marin County Superior Court's judgment in favor of MarinCERA (*MAPE v. Superior Court,* Case No. A139621).

In May 2014, the Contra Costa County Superior Court issued a Final Statement of Decision in the Consolidated Cases ("Consolidated Cases Decision"), in which that court also held that the legislative amendments to section 31461 were constitutional as to all of the items of pay at issue in the Consolidated Cases, and must be implemented, with the following two important caveats.

First, although the Superior Court held invalid those class action settlement agreements entered into by public retirement systems that provide retirement system members with benefits that are not authorized by statute, it nevertheless also held that the concept of "equitable estoppel" was an appropriate basis upon which to find that in both the Contra Costa County and Merced County retirement systems, members within a certain class of active members who accrued leave prior to January 1, 2013 had a right to have leave cash outs in excess of the amounts specifically authorized by section 31461 included in post-PEPRA retirement allowance calculations, notwithstanding PEPRA's amendments to that statute forbidding that practice prospectively. As noted above, the *MAPE* Decision is directly to the contrary on this estoppel point.

Second, in the Consolidated Cases Decision, the Superior Court held that as to standby-type payments, section 31461 previously had contained an ambiguity as to the pensionability of these types of compensation, at least where the responsibility for which it is paid is "regularly required." The Court concluded that "the issue of whether or not legacy employees have become 'vested' in the prior practice will depend upon the question of whether, for each particular circumstance, the practice was allowable, i.e., in conformance with the requirement that it be within the inclusion of 'days ordinarily worked.'" On this basis, the Court directed such boards:

> to make a factual determination, individually as to such retirees, including such pay in 'compensation earnable' in those limited circumstances where the pay category was previously included <u>and</u> the amount to be included was both earned and required of the employee during his or her final compensation period. This exception, providing inclusion for such 'vested' employees, only applies where regularly applicable to the class of employees and not to employees who receive such compensation, or any part thereof, to 'enhance' the pension.

(Emphasis in original.) The Attorney General, having intervened in all of the pending PEPRA cases to defend the constitutionality of PEPRA, appealed the Consolidated Cases' Decision, challenging the use of equitable estoppel as a basis upon which to order public retirement systems to pay benefits in excess of those that section 31461 permits. The original petitioners then cross-appealed to the extent that the Superior Court had upheld the new prospective statutory exclusions for legacy members not within the smaller group benefitted by the estoppel.

The Consolidated Cases' appeal was assigned to Division Four of the First DCA (Case No. A141913); the same DCA, but a different Division than Division Two, which issued the *MAPE* Decision. The Consolidated Cases' Appeal has been fully briefed since January 2016, and the parties are now waiting for oral argument to be set.

On August 26, 2016, the Attorney General submitted a copy of the *MAPE* Decision to the panel that has been assigned to the Consolidated PEPRA Cases (Hon, Ruvolo, Hon. Rivera, and Hon. Reardon), and noted its applicability to the Consolidated PEPRA Cases. However, Division Four of the First DCA is not bound to follow the *MAPE* Decision, if it disagrees with the manner in which that Division interpreted California Supreme Court and other appellate precedent regarding the scope of vested rights law of California. In light of these developments Division Four is faced with some interesting considerations about how best to proceed.

One threshold question is whether the Consolidated Cases will even be set for oral argument once the petitioners file their petition for review of the *MAPE* Decision. We suspect Division Four is most likely to wait to see if that petition is granted before setting the Consolidated PEPRA Cases for oral argument. We further suspect that if the Supreme Court does grant review of the Division Two *MAPE* Decision, then Division Four may well wait until after the Supreme Court rules before setting the Consolidated PEPRA Cases for oral argument so that it may then render its own decision within the bounds set by additional Supreme Court guidance on these topics. Thus, continued uncertainty in the potential outcomes is a given until the California Supreme Court either denies or grants the expected petition for review, and possibly until it decides the issues raised by the earlier decision if it does grant the petition for review.

What we do know for certain is that litigation over the constitutionality of PEPRA as applied to legacy members is not over, and, depending upon the actions taken by the Supreme Court, may have only just begun.

AUTHOR'S NOTE: *On September 26, 2016, plaintiffs/appellants filed a Petition for Review with the California Supreme Court. Numerous groups have filed amicus briefs in support of that Petition, and the defendants/respondents' Answers to that Petition are due in mid-October. The last day for the Supreme Court to order review of the decision is November 28, 2016.*

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*Co-Authors **Ashley Dunning**, Partner, and **Michael Toumanoff**, Of Counsel, are Co-Chair and Member, respectively, of the Public Pensions & Investments Practice Group at the national law firm Nossaman LLP. Ms. Dunning and Mr. Toumanoff provide fiduciary and/or litigation services to many of the public retirement systems in California, and they regularly present nationally on legal issues pertinent to such systems.*

STATE ASSOCIATION OF COUNTY RETIREMENT SYSTEMS LEGISLATIVE REPORT

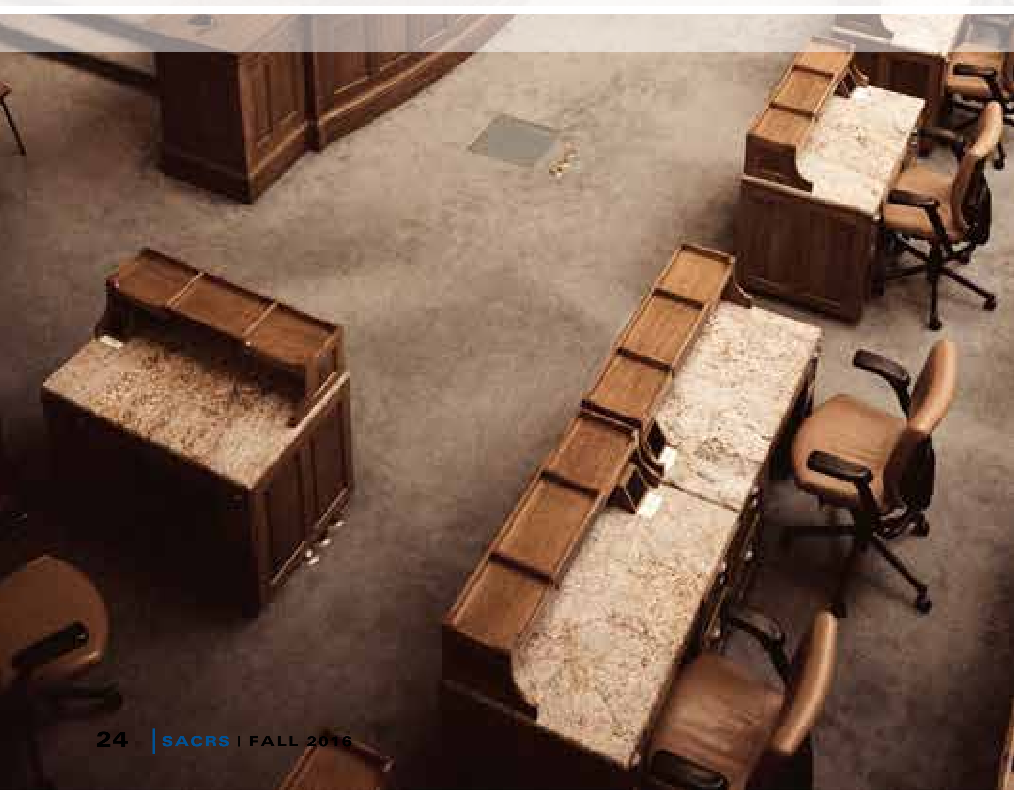
At the time of this writing, the Legislature is in the final month of the 2015-2016 Legislative Session. The final month of legislative activity is typically fast and somewhat frenzied due to the finality of all things. Many deals are consummated, many more possible deals fall apart. There are lots of last-minute committee hearings and legislative sessions that typically run long into the night in order to vote on the thousand-plus bills that eventually pass to the Governor.

The following is an update on the two SACRS-sponsored measures introduced in the 2016 Legislative Session and a preview of the 2016 election.

AB 1853 (Cooper) -- Modernize Retirement System Operating Structure

AB 1853 is the SACRS-sponsored bill by Assemblyman Jim Cooper that would give the 1937 Act retirement boards the optional authority to vote to be the direct employer of personnel working for the system based on one of three existing statutory frameworks already approved for use by the Legislature. The three model frameworks would be the Orange County Employee Retirement System (OCERS), San Bernardino County Employee Retirement Association (SBCERA), and the Contra Costa County Employee Retirement Association (CCERA).

County retirement systems are much larger and more complex than when they were established in the years following



passage of the 1937 Act. Unfortunately, the legacy operating authority structure under the 1937 Act has largely failed to keep up with these developments. Over time, key personnel at the retirement system were designated as employees of the system, with the retirement board setting the terms and conditions of employment, but the implementation of those decisions continues to require action by the Board of Supervisors. Similarly, broader decisions regarding staffing levels, staff structure, job descriptions and duties, and compensation made in the first instance by the retirement board continue to require implementation by the Board of Supervisors. In some cases, this has resulted in the fiduciary decisions of the retirement board not being implemented, complicating the ability of the retirement system to carry out its duties.

Given this situation, individual 1937 Act systems began efforts to gain a more modernized operating authority structure via individual legislative bills to allow their systems to be the direct employer of its employees.

AB 1853 removes the need for pursuing ongoing piecemeal modernization of operating authority by putting in place a standing mechanism for systems to adopt. The bill would continue to protect the rights of the retirement personnel that would shift from county employment to system employment and the governing structure of the boards would not change. This bill will bring a needed level of system autonomy, while maintaining all transparency, budgeting accountability, and fiduciary responsibility required of retirement boards.

At the time of this writing, AB 1853 is awaiting a vote on the Senate Floor. It had previously passed the Assembly on a 45-21 vote.

AB 2376 -- (Assembly Committee on PERSS)

AB 2376 is the Assembly PERSS Committee Omnibus bill involving the County Employee Retirement Law (CERL). At this time, it is a three-part bill dealing with what are considered technical, non-controversial changes to the CERL, including a SACRS sponsored provision pertaining to sworn statements.

Currently, the law requires regulations of every board to include a provision for the filing of a sworn statement by every person who is or becomes a member, showing date of birth, nature and duration of employment with the county, compensation received, and such other information as required by the board.

Historically, 1937 Act systems have utilized a signed, hard copy document as the sworn statement. However, with advances in technology, some systems are now obtaining the same information via an electronic payroll feed from the participating employer. For those systems that do this, having to collect a signed, hard copy document from the member can be viewed as duplicative, unnecessary, and an inefficient use of resources. At the same time, however, there are some systems that view the continued collection of a signed document as valuable, for example, in a situation where there is a dispute regarding the age of the member.

AB 2376 would accommodate both approaches by allowing each system to designate whether it will collect the pertinent information via the traditional sworn statement or via some other format, including electronically from the employer.

AB 2376 is currently awaiting vote on the Assembly Floor to concur with amendments adopted in the Senate. It is expected to go to the Governor for consideration soon after the Legislature reconvenes in August.

November Election Preview

Of course the big political news is the upcoming November election and most eyes and interest are on the Presidential election between Hillary Clinton and Donald Trump. However, the down-ticket legislative races have a more direct impact on county retirement systems.

There are several things to watch in the November election:

How does the Trump candidacy affect down-ticket Republicans in California?

In many parts of the country, down-ticket Republicans are embracing Trump at the top of the Republican ticket. To date, that has not yet been the case in California. Trump has not polled as strongly in California as elsewhere in the country and several prominent Republican legislators have not endorsed him, including Assembly Republican Leader Chad Mayes. There are many who look to the June primary results as indicative that Trump will depress the Republican vote in California and harm those Republicans running in down-ticket races.

Will the lengthy list of Propositions enhance voter turnout?

While some experts believe that the 17 initiatives on the ballot discourage voters from voting on all the measures, many others believe that high-profile measures, such as marijuana legalization, will bring voters to the polls that otherwise would stay home. Will people who show up to vote for marijuana, vote in the Congressional and legislative races? Are they partisan voters?

Is a two-thirds Supermajority of Democrats Inevitable?

While it is much too early to tell, results from the June primary show that several Democrats running against incumbent Republicans in Assembly races ran stronger than initially expected. If the June primary is a guide, it is conceivable that Assembly Democrats could increase their membership beyond the two-third Supermajority threshold of 54 members. The Senate Democrats already enjoy a two-third supermajority, the question is whether they will build upon that by adding new seats.

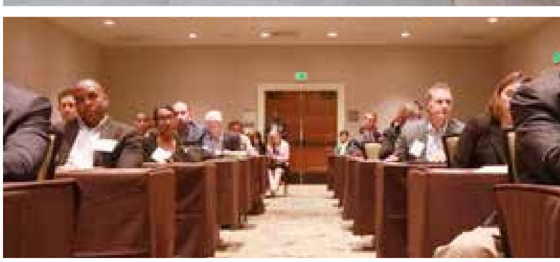
By the time this article goes to print, the fate of AB 2376 and AB 1853 will be decided. To learn more about these bills and other bills of interest to county retirement systems, and to hear an update to the above election preview, please attend the SACRS legislative presentation in Indian Wells as part of the SACRS Fall Conference beginning Tuesday, November 8.

__Michael Robson__ and __Trent Smith__ of Edelstein, Gilbert, Robson & Smith LLC

2016 SACRS SPRING CONFERENCE

COSTA MESA CALIFORNIA

The SACRS 2016 Spring Conference, held May 10-13, 2016 at The Westin South Coast Plaza, included presentations, training sessions, relevant breakout sessions, and concurrent sessions covering a variety of topics. In total, there were nine general sessions, 12 breakout sessions and five concurrent sessions. As was the case in previous conferences, many participants viewed the Spring 2016 conference as "outstanding" and "well executed."









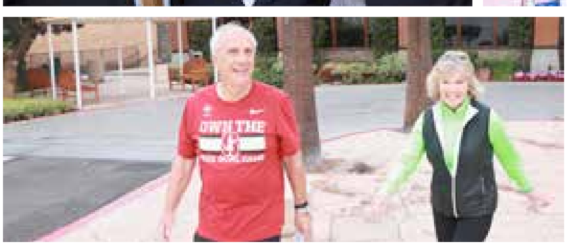



JIM BARRETT
JIM FAILOR
SONOMA COUNTY
ROD JUNE
LOS ANGELES









STATE ASSOCIATION OF COUNTY RETIREMENT SYSTEMS

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UPCOMING CONFERENCE SCHEDULE

SPRING 2017

May 16-19, 2017
Napa Valley Marriott Hotel & Spa
Napa, CA

SPRING 2018

May 15-19, 2018
Anaheim Marriott
Anaheim, CA

SPRING 2019

May 7-10, 2019
Resort at Squaw Creek
Lake Tahoe, CA

FALL 2017

November 14-17, 2017
Hyatt Regency
San Francisco Airport
Burlingame, CA

FALL 2018

November 13-16, 2018
Renaissance Esmeralda
Resort & Spa
Indian Wells, CA

FALL 2019

November 12-15, 2019
Hyatt Regency Monterey
Hotel & Spa
Monterey, CA