CITY OF LOS ANGELES
BOARD OF DEFERRED COMPENSATION ADMINISTRATION

PROPOSED MINUTES
REGULAR MEETING OF AUGUST 19, 2008 – 9:00 A.M.
700 E. TEMPLE STREET, ROOM 350

BOARD MEMBERS:
Present:
Eugene K. Canzano, Chairperson
Bill Stein, Vice-Chairperson
Sangeeta Bhatia
Sally Choi
Richard Kraus
Michael A. Perez

Staff:

Personnel:	Maryanne Keehn Steven Montagna Ashley Stracke JoAnn Dominguez
City Attorney:	Richard Bobb

1. CALL TO ORDER

Eugene Canzano called the meeting to order at 9:13 a.m.

2. PUBLIC COMMENTS

None.

3. MINUTES

Richard Kraus asked if the minutes could note the successful candidates for the two elected positions. Steven Montagna indicated that he would make that addition.

4. INVESTMENT PROVIDER PRESENTATION: VANGUARD

Ed McGettigan, Relationship Manager, and Jeff Johnson, Investment Manager, both of Vanguard, were present to review performance information for the Vanguard Institutional Index Fund and the Vanguard Total Bond Market Index Fund. Mr. McGettigan began by indicating that William McNabb had succeeded

Jack Brennan as Chief Executive Officer of Vanguard, but that Mr. Brennan would remain Chairman of the Board.

Mr. Johnson then began his fund review, first discussing the Vanguard Institutional Index Fund. He stated that the Fund was managed by Donald Butler and had $66.5 billion in assets. He noted that the Fund used a full replication strategy to meet its mandate of representing the S&P 500 index. He compared Fund characteristics with the S&P 500 and stated that both were virtually identical. He indicated that the composition of the S&P 500 had changed over the past 12-18 months, with energy being the second largest component and financials having gone from 21% to 14% compared to one year ago. He indicated that the Fund had minimal tracking error and in fact had done better than the index by two basis points through effective management of cash flows.

Mr. Perez asked how the Fund's international holdings affected performance. Mr. Johnson replied that the Fund did not have foreign holdings, and that this indication under the Fund characteristics was a technical distinction noted for certain U.S. shares with foreign operations.

Turning next to the Vanguard Total Bond Market Index Fund, he stated that the Fund used a sampling strategy, owning 3,410 of the 9,457 issues making up the Lehman Bros. Aggregate Index, but that the characteristics of the holdings were virtually identical. He stated that the sampling strategy attempted to match not only sector holdings of the Index but to match sub-sectors such as insurance, brokerage, etc., as well.

With respect to tracking, he indicated that the Fund was outperforming the benchmark by 21 basis points over the last year. He stated that part of the explanation for this was that some corporate bond issuers were having difficulty finding buyers and therefore had to offer some of their bonds at a discount.

Mr. Kraus asked for an explanation for the Fund's under-performance in 2002. Mr. Johnson replied that this was largely due to the Fund not matching its strategy at the sub-sector level. Mr. Canzano asked if the problems in 2002 were the source of weakness in the 10-year numbers, and Mr. Johnson responded affirmatively. Mr. Perez asked why there were such performance discrepancies with emerging markets, and Mr. Johnson replied that growth continued to be strong in countries such as Russia and Brazil, which derived significant revenue from oil.

Ms. Choi asked what the firm saw as challenges and opportunities going forward. Mr. Johnson replied that it was hard to be optimistic about the economy and that expectations were for single-digit growth. He stated that on the positive side interest rates remained low and stocks may be attractively priced. Mr. Canzano indicated his appreciation for the chart on page 19 indicating changing market leadership and asked for page numbers in future presentation booklets. Ms. Choi asked if the booklets could include biographies of the managers.

5. BOARD REPORT 8-30: PLAN SAVINGS OPTIONS AND RFP FOR STABLE VALUE FUND

Mr. Montagna explained that at the March 2008 meeting, the Investments Committee asked Mercer to review the Washington Mutual Liquid Savings account and Certificates of Deposit. He explained that Mercer had found that only 20% of governmental plans offered an FDIC insured option. Mr. Montagna indicated that staff would not recommend eliminating the Washington Mutual options because 1) the Stable Value fund has not always produced a higher rate of return and 2) the Washington Mutual options provide the added benefit of FDIC insurance. He also indicated that within the next two to three years it was likely that more governmental plans would start offering FDIC insured investment options.

Mr. Stein asked if Mr. Montagna had data regarding the percentage of active versus retired employees who were calling in and voicing concerns about the safety of their assets. Mr. Montagna indicated that he did not have that kind of breakdown, but that generally those questions might be expected to come from retired participants who were more likely to invest in savings options. Mr. Stein also indicated that from his perspective as a retiree, it was important to maintain an FDIC insured account because unlike active employees retirees did not have the ability to make up for catastrophic losses. Richard Kraus remarked that participants may expect an FDIC insured option since the majority of plans which offered FDIC options were located in California. Mr. Canzano indicated that he supported staff's and Mercer's recommendation. **A motion was then made by Bill Stein, seconded by Michael Perez, to reaffirm the Plan's commitment to including an FDIC-insured option or options as part of its core investment menu; the motion was unanimously adopted. A subsequent motion was made by Sally Choi, seconded by Bill Stein, directing staff to draft a Request for Proposal for Plan savings (FDIC-insured) options; the motion was unanimously adopted.**

The discussion then moved into deciding whether the Plan should expand the brokerage window to include the trading of Certificates of Deposit. Mr. Montagna indicated that it might be possible for participants who wanted FDIC protection from multiple banking institutions to use the SDBO to purchase individual CDs. Mr. Montagna stated that staff recommended the Board approve the expansion of trading options under the Plan's SDBO to include the purchase of individual FDIC insured CDs. He further stated that Charles Schwab indicated it would take approximately one month to activate once approval was given. Finally, Mr. Montagna indicated the Board may also want to review whether CDs should be part of the core menu in the future. **A motion was made by Bill Stein,**

seconded by Michael Perez, to refer to the Investments Committee for further review the option of expanding the SDBO to include Certificates of Deposit and whether Certificates of Deposit should continue to be part of the core investment menu; the motion was unanimously adopted.

Mr. Montagna proceeded to the topic of the RFP for a Plan Stable Value Fund provider. He indicated that although the incumbent contracts did not expire for almost a year, due to the complexity of the process Mercer had requested a decision be made by the end of the year to allow six months for implementation. Mr. Kraus asked what "Content Maturity Treasury" on page nine of the RFP was referring to. Ms. Dalton stated that it was a common benchmark used in this type of manager search. Mr. Kraus then asked if the RFP would include a question regarding whether the fees could change with different sizes of assets. Mr. Montagna indicated he would add this. Mr. Stein asked for a timeline for the RFP and Mr. Montagna replied that staff could have the RFP results to the Board as early as November. **A motion was made by Bill Stein, seconded by Eugene Canzano to approve the draft Request for Proposal for the Plan Stable Value Fund provider; the motion was unanimously adopted.**

6. BOARD REPORT 8-31: STOCK AND BOND TRADING

Andrew Ness, Principal with Mercer Investment Consulting, presented Mercer's research on the prevalence of stock and bond trading in defined contribution plans. He stated that typically only a small number of participants have an interest in investing in individual stocks and bonds, but that they are often a vocal group. Mr. Ness indicated that options offered within a Self Directed Brokerage Option (SDBO) included Mutual Funds, Exchange Traded Funds (ETFs), stocks listed on the NYSE or other approved exchange, corporate government bonds, Real Estate Investment Trusts, Covered Calls, and Protected Puts. He also stated that collectibles, commodities, and real property were typically not made available. Mr. Ness further indicated that SDBOs are more prevalent in mature plans. He noted that among mature private sector plans, 33% have SDBOs, while 45% of mature public sector plans offered an SDBO. Mr. Ness stated that only a minority of participants were interested in using SDBOs.

He indicated that given the City Plan's size, data from state 457 plans is comparable. He noted that of state 457 plans, 25 offered SDBOs and of those state plans that offer SDBOs, 12 offered access to stocks, bonds, and or ETFs. Mr. Ness stated that New Mexico was unique in that it allowed only ETFs and Mutual Funds. He further stated that Mercer and staff contacted the plans that allow trading of stocks and bonds and found that participation in such trading is at around 1-2% of total Plan participants.

Mr. Ness indicated that the State of Texas had commented that some participants had suffered significant losses, but none of these participants faulted the plan. Mr. Ness further indicated that he believed if the City's Plan properly disclosed information regarding investment risks and secured participant acknowledgement of their responsibilities, the Plan would be well insulated. Mr. Ness concluded by stating that if the City did decide to offer stock and bond trading, it would take approximately sixty days to implement.

Mr. Ness stated that some plans required a minimum amount in the core options which was usually around $2,500 or $5,000 and was generally used to collect an administrative fee on the account. Mr. Montagna commented that some of the participants during the bear market in 2000-2002 largely wiped out their accounts using mutual funds and that larger losses might occur if the Plan allowed the trading of stocks and bonds.

Corina Lee, Director with the Police Protective League, then requested to speak. She stated that the first cycle of DROP was ending soon and that these participants had investment experience and wanted to take advantage of the potential returns that stock and bond trading may provide. Mr. Canzano acknowledged that there were outside money managers who tried to take participants out of the City's Plan and that the Board wanted to provide those participants with a competitive alternative. Mr. Canzano also stated that he did not want any problems with potential lawsuits and did not want to jeopardize the majority of participants because of lawsuits from the minority. Mr. Bobb responded that California law did provide some fiduciary relief for public plans regarding this matter as long as they exercised a prudent process in selecting a provider. Mr. Kraus suggested that the plan also consider allowing participants to trade treasury notes in order to cater to more conservative investors.

Mr. Canzano asked how long it would take to implement the trading of stocks and bonds. Mr. Montagna stated that Mercer had indicated it would take thirty to sixty days to start. Ms. Bhatia asked how many participants currently used the SDBO. Ms. Dalton replied that it was around 4%. Ms. Bhatia then asked what type of administrative issues would be involved for stock and bond trading. Mr. Montagna answered that there were currently no limitations other than for participants to keep $2,500 in the core options. Mr. Ness commented that if the Plan were to choose a higher limit such as 50% of funds, this would be deviating from what most plans require. Ms. Bhatia stated that since the Plan was voluntary, apart from regulatory issues, she was not in favor of higher restrictions and that it should be the participant who decides how to invest. Mr. Canzano stated that since participants already have to take an action to be part of the SDBO he was in favor of providing stock and bond trading to those who wanted it.

Ms. Bhatia asked if plan participants who did not use the SDBO would have to bear any costs if stock and bond trading were implemented. Mr. Montagna stated that they would not because any costs would be only paid by those who used the SDBO. Mr. Kraus asked if there would be any indirect cost due to depletion of assets in the core options. Mr. Montagna responded that given the asset base was so large, he would not expect this. Mr. Montagna then indicated that he believed that allowing ETFs only might be a reasonable interim approach because he believed that one reason people were attracted to stock and bond trading was for the experience of trading more often. Mr. Perez indicated that he believed that participants should make their own decisions regarding how they invested their money. **After some additional discussion, a motion was made by Sally Choi, seconded by Michael Perez, to open the SDBO to include trading of individual securities; the motion was unanimously adopted.**

Board members indicated they would like to review the implementation plan and communication materials associated with introduction of stock and bond trading. Mr. Montagna asked if the Board wanted to approve those materials prior to scheduling implementation of the expanded training, or whether staff was being directed to proceed with issuance of the materials and implementation. Mr. Canzano indicated that he believed staff could draft the plan and communication materials, distribute them to the Board, and proceed with implementation unless Board members indicated an interest in changes to the materials. Mr. Montagna indicated he would provide materials to Board members prior to the next Board meeting and, if one or more Board members wished to discuss them, implementation would not move forward until the Board had an opportunity to discuss the materials at a future meeting.

7. BOARD REPORT 8-32: CONSULTANT RFP REVIEW PANELS

Mr. Montagna indicated that the Plan had received a smaller response to the RFP than expected and that the originally proposed interviewing complexity was no longer needed. As a result, Mr. Montagna recommended that Maryanne Keehn and he be designated as the members of the review committee for the consulting RFP. **A motion was made by Eugene Canzano, seconded by Bill Stein, to designate Personnel Department staff members Steven Montagna and Maryanne Keehn as members of the review committee for the Board's Request for Proposal for the Deferred Compensation Plan/Pension Savings Plan Consulting Services; the motion was unanimously adopted.**

Mr. Montagna next discussed the investment management services RFP. Mr. Montagna recommended that the Board allow staff to reissue the Russell 2000 Index Fund RFP given that none of the respondents to the RFP passed the Standard Provisions requirements, including the incumbent. Similarly, none of the candidates had passed the Standard Provisions Requirements for the Mid-Cap Index RFP. Mr. Montagna therefore further recommended that the Board allow Mercer to provide a provider review in lieu of an RFP given the small number of potential providers and that a contract with a provider was probably not required.

Mr. Stein asked whether it was staff's intent to select a single firm that would manage both the Russell 2000 index Fund and the Mid-Cap Index Fund. Mr. Montagna stated that there was no intent to do this. Mr. Montagna indicated that he believed that reissuing the Russell 2000 Index Fund RFP was a prudent action to take before approaching the City Council about extending the current contract. In response to a question from Ms. Choi regarding applicability of the Standard Provisions to provider contracts, Mr. Bobb indicated that these contracts were indeed subject. **A motion was made by Bill Stein, seconded by Michael Perez, approving reissuance of an Investment Management Services RFP for the Russell 2000 Index Fund and directing Mercer Investment Consulting to conduct a Mid-Cap Index Fund provider search and return to the Board with its findings; the motion was unanimously adopted. A subsequent motion was made by Richard Kraus, seconded by Sally Choi, to designate Steven Montagna, of Staff, and Principal Consultant, Susan A. Dalton, of Mercer Investment Consulting as members of the review committee for the Board's Request for Proposal for the Deferred Compensation Plan Investment Management Services; the motion was unanimously adopted.**

8. BOARD REPORT 8-33: STAFF REPORT

Mr. Montagna indicated that staff was preparing a response to a City Council motion instructing the Personnel Department to report on the status of the investments and financial condition of the City's Deferred Compensation Plan, in particular the Washington Mutual products. He indicated this response would come from the Chair and Vice-Chair of the Board.

Mr. Montagna proceeded onto the topic of the NAGDCA conference. He stated that staff was currently developing materials regarding the conference and would distribute them to Board members shortly. Discussion then moved on to the topic of hardship activity. Mr. Canzano stated that he wanted to recognize Great West for their work on the hardships and stated that Great West was able to serve the Plan's participants more quickly than the Board had been able to do.

Mr. Kraus asked Great West to comment on the distribution of Fidelity Magellan fees to Vangard investors. Gary Robison of Great West Retirement Services indicated that the Fidelity Magellan fund was terminated before participants could receive the last fee reimbursement, and that Great West distributed this fee reimbursement to all investors in the Vanguard Institutional Index Fund instead of only to those participants who invested in the Fidelity Magellan fund. Mr. Robison indicated that Great West was rectifying the matter and the process would be complete in a few weeks.

9. COMMITTEE MEMBERSHIPS

Following some discussion, Mr. Canzano stated that the Investments Committee would be composed of Sally Choi, Michael Perez, Kurt Stabel, and Sangeeta Bhatia, with Richard Kraus as Chair. Mr. Canzano then stated that the Plan Governance and Administrative Issues Committee would be composed of himself, Maggie Whelan, and Sangeeta Bhatia, with Bill Stein as chair.

10. REQUEST FOR FUTURE AGENDA ITEMS

None.

11. NEXT MEETING DATE- OCTOBER 21, 2008

12. ADJOURNMENT

A motion was made by Bill Stein, seconded by Richard Kraus, to adjourn the meeting; the motion was unanimously adopted. The meeting adjourned at 11:19 a.m.

Minutes prepared by staff members Steven Montagna and Ashley Stracke.