CITY OF LOS ANGELES
BOARD OF DEFERRED COMPENSATION ADMINISTRATION

ADOPTED MINUTES
REGULAR MEETING OF FEBRUARY 17, 2009 – 9:00 A.M.
700 E. TEMPLE STREET, ROOM 350

Board Members:
Present:
Eugene K. Canzano, Chairperson
Sally Choi
Richard Kraus
Michael Perez
Shelley Smith
Kurt A. Stabel

Staff:

Personnel:	Steven Montagna, Personnel Natasha Zuvich, Personnel JoAnn Dominguez, Personnel Steven Hong, City Attorney

1. CALL TO ORDER

Eugene Canzano called the meeting to order at 9:10 a.m., noting that a quorum was not present (Board members Canzano, Kraus, Perez and Stabel were in attendance) but that the meeting could proceed with presentations until such time as a quorum was formed.

2. PUBLIC COMMENTS

None.

4. INVESTMENT PROVIDER PRESENTATION: HARTFORD LIFE INSURANCE

(Note: Item 4 was heard out of order since it was presentation only and a quorum was not required for it to be heard)

Peter Ganey, Director, and Timothy Baker, Director Portfolio Specialist Group, were present to review performance for the three variable funds offered by Hartford Life Insurance. Mr. Ganey began by indicating that he understood that two of these funds had been placed on Watch status and that a report had been provided which presented alternative funds managed by Hartford into which these assets could be matched if the Board was interested in considering this. Mr. Perez asked whether it was appropriate to consider or act on such a proposal since it was not part of the agenda. Mr. Canzano indicated that the information could be presented but that a more optimal approach would be to process it first through staff and the consultant.

Mr. Baker then began his presentation of performance results. He briefly reviewed the management teams for both funds and then indicated that the Hartford Stock Fund and equity portion of the Advisers Fund took a broad approach to investing and were free to invest in any market sector along the investment continuum from deep value currently, for example as was currently being found in the Financial sector, to aggressive growth, such as was being currently being found in companies like Electronic Arts. He reviewed the portfolio characteristics of the funds and where they placed relative to the fund benchmarks. Mr. Canzano asked if the returns were provided net of fees, and Mr. Baker answered affirmatively. With respect to the Hartford Advisers Fund, Mr. Kraus asked whether the current 68% position of the Fund in equities, above the 60% level found in the benchmark, was appropriate and whether the Fund had any governing limitations, and Mr. Baker replied that equity exposure tended to drift up during times of significant equity losses and that there was no strict limit on the degree of equity exposure the Fund could take.

Mr. Baker next reviewed the performance for the Fund, indicating that the Stock Fund had placed in the 89th percentile and the Advisers Fund in the 78th percentile over the past year. Mr. Stabel asked for the source of the under-performance. Mr. Baker replied that it was primarily a case of getting places too early and not anticipating the severity of the downturn particularly in Financials and Information Technology. He stated that risk was not rewarded in 2008 and that, coming in from 2007, the Fund was over-exposed to risk. With respect to the Capital Appreciation Fund, which he stated had performed relatively better, he indicated that it had started the year well by being over-weighted in materials and energy but that this strategy did not work past the mid-point of the year. He indicated that the Fund manager was still heavily invested in energy and believed that the price of oil was under-valued and was likely to drift up to around $65 per barrel. He indicated that in 1998 the Fund had under-performed by 38% and the next year outperformed by 46%, suggesting that years of severe under-performance could be followed by outstanding years.

Mr. Kraus asked whether the willingness of Hartford to offer fund substitutions revealed a lack of confidence in the two funds. Mr. Baker replied that it did not but merely represented an interest of Hartford in providing an opportunity for a different risk strategy. The presentation then concluded.

3. MINUTES

(Note: Item 3 was heard out of order and addressed following establishment of a quorum with the arrival of Shelley Smith at 9:25 a.m.)

Mr. Canzano asked that staff correct the listing of Board members present at the meeting. **A motion was then made by Sally Choi, seconded by Michael Perez, to approve the minutes of January 20, 2009; the motion was unanimously adopted.**

6. HARTFORD FUNDS AND SECURITIES LENDING

(Note: Item 5 was heard out of order since its topic related more immediately to the prior agenda item. Sally Choi arrived at the meeting at 9:35 a.m.)

Susan Dalton of Mercer Investment Consulting was present to review her report regarding the Hartford Funds. Ms. Dalton first noted that a press release had been issued that morning indicating that Mercer was acquiring Callan Associates and that more details regarding this acquisition would be presented at a future meeting.

Ms. Dalton next began her discussion of the Hartford Funds and the sub-advisory firm of Wellington Management Company. She noted that these two funds had been placed on Watch effective the prior Board meeting and the Board could take action to discontinue the funds at its next quarterly review should the two funds continue to under-perform and be on Watch status. Mr. Perez asked for the distinction between Monitor and Watch. Ms. Dalton replied that Watch was considered to be more serious situation than Monitor. Ms. Choi asked at what point being on Monitor status would result in a Fund moving to Watch status. Mr. Montagna replied that being on Monitor status did not automatically result in moving to Watch status, and that it would be more useful to think of the two categories as representing degrees of under-performance, with more serious under-performance over longer time periods leading to being placed on Watch status which could then result in termination.

Ms. Choi and Mr. Stabel asked for additional clarification, wondering why the funds had not been eliminated earlier. Ms. Dalton replied that in prior reviews the severe under-performance over the time periods under review would not have been present as it is now, but that as time has gone on and under-performance worsened the case for placing the Funds on Watch became more apparent. Ms. Smith stated that the issue was one of perspective at any particular time, and that what appeared clearly now as severe under-performance would not have been as clear in prior time periods. She further noted that the Board was not in the practice of eliminating funds for shorter periods of under-performance since it was expected that most funds would cycle through periods of at least mild under- and out-performance, but that there was a point at which under-performance would be so extreme that it would become apparent that there was no way for the Fund manager to dig out of the whole. Mr. Perez indicated that from his perspective as a pension fund manager, equity managers were typically selected and de-selected at exactly the wrong times, because out-performers were less likely to continue their out-performance and under-performers were less likely to continue under-performing. He further stated that unfortunately there was no viable alternative way to approach the selection process.

Mr. Perez asked if staff could provide the Board with the investment policy. Mr. Montagna indicated that no discrete investment policy document existed and that the policies with respect to Watch and Monitor status were included in each quarterly report. Mr. Perez asked if a copy of the original Board action creating the Watch/Monitor policies could be provided, and Mr. Montagna indicated that it could. Mr. Kraus asked if staff could build in a separate presentation regarding this policy, and Mr. Montagna indicated that this might not be possible for the next meeting given that he anticipated a very full agenda.

Following this discussion, Ms. Dalton then reviewed her report in detail. She indicated that Mercer does not cover the Hartford Stock Fund and Advisers Funds because these products are present in only 4-5 other plans for which Mercer provides reviews. Regarding the sub-advisor Wellington, she stated that the firm had recently reduced its work force by 10% but that this reduction had not affected these two funds. She stated that the fees charged in both funds were reasonable compared to other large-cap active fund managers. She noted each fund's recent volatility and then reviewed the charts included in her report, emphasizing that each fund was scoring higher in terms of relative risk but lower in terms of performance, meaning that for the risk the strategies were assuming the returns were not being delivered. With respect to the chart on page 8 of her report, she indicated that the Fund was under-performing for all time periods. She indicated that retaining the funds at this point might not make sense given the Board's ongoing efforts to consolidate the investment menu and eliminate redundancies.

Ms. Smith indicated that she wanted to share some historical perspective with the Board for these funds. She noted that Hartford and another provider had come into the City's Plan in bundled administrative roles at the Plan's inception. She stated that this plan design was eventually determined to be more costly and not in the best interests of participants and the Plan eventually unbundled its recordkeeping and administrative services. She indicated that a number of funds in the Plan were legacy holdings from the prior Plan design and might not make sense to continue in the Plan as the investment menu continued to be refined.

Ms. Choi asked if the fact that funds were being placed on Monitor and Watch was disclosed to participants. Usha Archer of Great-West Retirement Services was present and indicated that this was disclosed in quarterly newsletters. Ms. Choi asked if participants were notified of which of their specific holdings were in funds on Monitor or Watch. Mr. Montagna indicated they were not. Ms. Smith stated she believed the Plan should be cautious with that degree of specificity given that it might encourage participants to think short-term and be reactive at the wrong times, given that all actively managed funds will routinely have cycles of at least moderate under-performance and out-performance.

Ms. Dalton next discussed that portion of her report regarding securities lending. She stated that this information was produced as a result of Board member Sangeeta Bhatia's question about whether securities lending practices with Northern Trust affected the City's holdings in any way. Ms. Dalton first began by indicating that securities lending is a process by which a fund will lend a security to a broker for a fee. She said this is a fairly normal course of action with passively managed funds and that the fees help to reduce some of the inherent lag between an index and index fund. She stated that problems can occur when shareholder redemptions force managers to sell securities on loan in illiquid environments, and in particular in cases where enhanced cash pool arrangements are being used. She indicated that with Northern Trust as an example its holdings had included Lehman Bros. Paper and forced liquidations resulted in forces losses.

With respect to the City's funds, she indicated that the Vanguard Bond Index Fund has 0.1% of its securities on loan; the Vanguard Institutional Index has 5.9%; the State Street Russell 2000 Fund has 0%; and the DWS EAFE Equity Index Fund has 1.1%. She stated that Vanguard's securities lending program is extremely conservative and in 20 years of doing this has never experienced a loss. She indicated that the type of fund the City holds with State Street has no securities lending, and DWS uses Deutsche Asset Management for its securities lending, not Northern Trust, and only 1.1% is on loan. She indicated that in summary the City did not have any securities lending concerns with its funds.

5. GREAT-WEST QUARTERLY PLAN REVIEW

Gary Robison, Local Account Manager, and Usha Archer, Regional Account Manager, both of Great-West Retirement Services, were present to review Plan statistics for the quarter ending 12/31/08. Mr. Robison began by reviewing Plan asset totals, observing that with another substantial decline in Plan assets a second wave of participant capitulation seemed to have occurred, with many investors giving up and moving to guaranteed assets. He next reviewed asset flows, observing that the largest positive cash flows were to the Plan's savings options but also the Self-Directed Brokerage Option (SDBO). Mr. Kraus pointed out a discrepancy between numbers presented in two different parts of the report, and Mr. Robison replied that he would see that this was corrected.

In reviewing the contributions of new dollars by asset class, Ms. Archer noted that she saw these numbers as more meaningful because they reflected where participants were directing their new money whereas existing assets were more impacted by market fluctuations. She stated that an encouraging trend was that contributions to the Plan's asset allocation funds were now at 16%. Mr. Canzano asked if Plan assets were calculated as net of any amounts on loan, and Ms. Archer responded affirmatively. Mr. Canzano thanked Great-West for the effectiveness of their chart presentations which provided for easy identification of chart segments.

Mr. Robison next reviewed local activity, including participant contacts and group meetings. He stated that conversations with participants were longer than normal as participants wrestled with decisions around transferring assets out of the markets. Mr. Robison then briefly reviewed data regarding distributions and rollovers and the remaining statistics in the report. Mr. Kraus asked whether the group meeting statistics included National Save for Retirement Week, and Ms. Archer indicated that this was included in the table information category.

Mr. Stabel asked what participants needed to do to prevent over-contributions. Mr. Montagna replied that City payroll systems controlled for over-contributions. There was some discussion with Board members then about the Catch-Up contribution limits. Mr. Robison indicated that Great-West had been invited by LACERS to be part of their new financial planning educational module and would be participating in upcoming presentations. Mr. Perez asked for some information regarding what types of security protections were supplied by Great-West's systems, and Ms. Archer indicated that she could address that in a separate and more detailed report given the complexity and depth of the subject matter, but that being the second largest defined contribution recordkeeper nationwide she knew that Great-West utilized ample security precautions in all of its functions.

The presentation then concluded.

7. BOARD REPORT 09-09: AMERICAN FUNDS INSTIUTIONAL CLIENT FORUM

Mr. Montagna indicated that the American Funds was hosting a client forum on March 5th and that staff had provided information about the event as well as information concerning the cost of meals for ethic filing purposes. Mr. Montagna indicated that any Board members interested in attending should contact staff by February 20th.

8. BOARD REPORT 09-10: ELECTION POLICY REVISION

Mr. Montagna indicated that staff, working together with Steven Hong of the City Attorney's Office, had drafted a revised statement for the Board's Elections Policy concerning the issue of third-party contributions to candidates for elected seats on the Board. Mr. Montagna indicated that the goal of the statement was to help advise candidates that the issue existed but not in an interpretive way, and rather direct them to other resources to acquire information. He further stated that this issue had been discussed at the two prior Board meetings at length and that this represented the last part of revising the policy.

Ms. Choi indicated that she had not been present at the prior discussions and asked for some background. Mr. Montagna indicated that as a result of questions raised by Board member Richard Kraus, the Board's Plan Governance and Administrative Issues Committee had reviewed the question of whether third-party support of a candidate for a seat on the Board might be a reportable event under State ethics rules. He indicated that it appeared that it could be reportable to the extent that there was coordination between the candidate and the third party. He stated that there was a belief on the part of Committee members that candidates should be made aware of this in some fashion, but the original language drafted by the Committee had made some other Board members uncomfortable.

Ms. Smith indicated that she was one of the Board members concerned with the prior language. She stated that she did not believe that any reference to this issue should be included in the Board's policy, but that in the interest of forming a consensus decision she had supported the compromise fashioned at the prior Board meeting and believed that the language drafted by staff and the City Attorney fully reflected that compromise.

Mr. Kraus asked why candidates were not referred to the State's Fair Political Practices Commission (FPPC). Mr. Hong replied that he had done this deliberately because of concerns about their ability to provide an interpretive role. Ms. Choi asked what the reference to third party included, and Ms. Smith indicated that it could be any third party support although the situation that apparently raised the issue concerned union support. Mr. Perez asked for clarification of what gift limits applied, and if that limit was always $100. Mr. Montagna replied that the limits did differ depending upon the entity, and that for unions it was over $400.

Following this discussion, **a motion was made by Richard Kraus, seconded by Kurt Stabel , to amend the Board's Elections Policies and Procedures to add a new Section E as identified in the staff report; the motion was unanimously adopted**.

9. BOARD REPORT 09-11: STAFF REPORT

Mr. Montagna reviewed the items in the staff report, indicating that Mercer would be presenting its review of Stable Value Fund RFP results at the next meeting and that responses to the RFP for an FDIC-Insured Savings Option were due March 2. He stated that contracts for consulting and the Russell 2000 Index fund were pending with the City Attorney, and that the Investments Committee had met on February 13th and would be making a recommendation to the Board with respect to a Mid-Cap Index Fund offering at the next regular Board meeting.

He next indicated that staff was continuing to work with the City Attorney on a presentation concerning Fiduciary Responsibility. Ms. Choi indicated that she would like for this presentation to address the topic of the Board's plenary authority and degree of autonomy from the City Council. Mr. Montagna indicated that this related to issues raised in the 2004 lawsuit by Nationwide Retirement Services against the City of Los Angeles which challenged the authority of the City Council to veto the Board's selection of Nationwide. Ms. Smith indicated that she did not believe the court ever resolved that question and that the case had been dismissed for other reasons. Mr. Montagna indicated that a more complete background on this matter could be added into the presentation.

Following discussion of the staff report, Mr. Canzano indicated that he had attended the Pensions & Investments Conference and found the event to be extremely informative. He shared with the Board the award won by the City for its outstanding achievements in communications. Mr. Montagna indicated that the City had also won three awards from an organization called MarCom which recognized outstanding achievements in marketing and communications, and that he viewed this award as one of the most significant because the competition was much broader and included the public and private sector. Mr. Kraus suggested that information about the awards be included on the website and in newsletters, and Mr. Montagna indicated that this was an excellent idea and staff would work on it.

10. REQUESTS FOR FUTURE AGENDA ITEMS

None.

11. NEXT MEETING DATE – MARCH 17, 2009

12. ADJOURNMENT

A motion was made by Sally Choi, seconded by Michael Perez, to adjourn the meeting; the motion was unanimously adopted. The meeting adjourned at 11:16 a.m.

Minutes prepared by staff member Steven Montagna.