CITY OF LOS ANGELES
BOARD OF DEFERRED COMPENSATION ADMINISTRATION

ADOPTED MINUTES
REGULAR MEETING APRIL 21, 2015 - 9:00 A.M.
700 E. TEMPLE STREET, ROOM 350

BOARD MEMBERS:

| **Present:** | **Not Present:** |
|---|---|
| John R. Mumma, Chairperson | Michael Amerian, Vice-Chairperson |
| Cliff Cannon, First Provisional Chair | Robert Schoonover |
| Tom Moutes, Second Provisional Chair | Linda P. Le |
| Ray Ciranna, Third Provisional Chair | |
| Wendy G. Macy | |

Staff:

| | | |
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| Personnel: | Alejandrina Basquez | Paul Makowski |
| | Steven Montagna | Matthew Vong |
| | Alexandra Castillo | |

City Attorney: Curt Kidder

1. CALL TO ORDER

John Mumma called the meeting to order at 9:02 a.m.

2. PUBLIC COMMENTS

Steven Montagna introduced Alexandra Castillo as the new Plan Manager for the Deferred Compensation Plan.

Mr. Mumma, having been elected as the new Chairperson at the previous month's meeting, thanked the Board members for the nomination and election. He also stated committee assignments would be made after all Board member seats are filled following the results of the upcoming Board Elections.

3. MINUTES

**A motion was made by Tom Moutes, seconded by Wendy Macy, to approve the March 17, 2015 Regular Meeting minutes; the motion was unanimously adopted.**

4. BOARD REPORT 15-20: STABLE VALUE FUND PROVIDER SELECTIONS

Mr. Montagna presented staff's recommendation to select Galliard Capital Management as the Stable Value Fund manager for the Deferred Compensation Plan. He stated the contract would begin on July 1, 2015 for a five (5) year term. He indicated this investment option manages approximately one billion dollars in total Plan assets. He stated the Stable Value Fund RFP was released at the end of 2014 and received responses from six firms. He indicated staff worked with the Plan's Consultant, Mercer, on reviewing the responses. He then turned the presentation over to Devon Muir from Mercer Investments Consulting to review the evaluation process and explain the methodology behind the ranking of the firms.

Mr. Muir presented background regarding the Stable Value Fund. He explained the intent of the Stable Value option was to be a capital preservation vehicle that provides more favorable return than other alternative capital preservation vehicles. He noted Stable Value funds started with an insurance guarantee in that investors would place money with an insurance company and receive an IOU, which was backed by the full faith and credit in that company. He indicated that due to the significant amount of credit risk involved, the market over time has migrated away from favoring solely insurance backed products to ones that were more diversified. He indicated the market migrated, as did the Plan, to the idea of having a more diversified bond portfolio consisting of short to intermediate securities. He stated the portfolio had a guaranteed book value treatment of 100 cents to the dollar, which was provided by utilizing various "wrap" providers. He explained that "wrap" providers were financial institutions that charge a fee to stable value products in order to guarantee that a participant contributing money to the fund will be able to get money out at full value when they choose to distribute.

Mr. Muir stated that stable value best practices guided Mercer in evaluating candidates, which included a well-managed Stable Value fund consisting of a diversified bond portfolio, having multiple managers and sub-advisors managing the portfolio providing diversification, and having various wrap providers insuring the portfolio. He noted that Mercer views the Stable Value fund as a long-term capital preservation vehicle and thus was not necessarily looking only at top performance. He stated the evaluation considered the ways in which portfolios were constructed and whether risk taken was reasonably justified in the level of return.

He reviewed the scoring breakdown and noted that Galliard scored highest. He stated they tended to rank well due to the continuity of its organization and because they have primarily managed Stable Value assets for close to twenty years, since the inception of the firm. He noted their senior personnel had very little turnover. He stated it was advantageous to hold a significant level of stable value assets as Galliard does, as it enables a firm to negotiate more favorable terms with both external managers and wrap providers. He indicated Galliard had a very conservative approach to its investment style and would be able to insulate themselves fairly well from a rise in interest rates and redeploy assets more quickly than the other candidates. He stated Galliard's performance was above median and its fees were second lowest.

Mr. Muir reviewed the different rating factors that were approved by the Board which consisted of organization strength, continuity, investment experience, investment approach and process, performance, portfolio transition, administrative reporting and fees. He stated Mercer looked to see if the respondents' organizational structures were sound, whether their firms were committed to stable value management, and if they demonstrated having significant level of stability in personnel at its investment ranks as well as its senior levels.

He stated the firms generally had strong consistency in its personnel, with exceptions at PIMCO, Goldman Sachs and ICMA. He stated Galliard, Goldman Sachs and PIMCO were three of the largest firms in terms of managing separate accounts. He noted the importance of this point, given the Plan's mandate at $1 billion dollars brings about unique considerations. He stated managers without significant separate account management experience would likely find the Plan's Stable Value fund challenging to manage.

Mr. Muir continued his review and reported on the firms' investment approaches and processes. He indicated several of the managers proposed a diversified sub-advisor roster, which is beneficial. He noted the two exceptions were PIMCO and Standish, which elected to manage the assets internally. He stated Mercer also reviewed the level of cash in the portfolio and indicated high levels of cash may be a sign of managers having difficulty obtaining wrap providers. He stated Mercer places strong emphasis on diversity and credit quality of wrap providers. He indicated all respondents generally had favorable levels of diversity in that regard.

Mr. Muir then reported on the investment performance component of the review. He stated that Mercer's approach was not necessarily to favor the top performing strategy but to identify the best risk-managed approach. He indicated Mercer placed their focus on three levels of investment performance, which were overall Stable Value historical performance, overall product, and ranking of the Stable Value composite relative to the peer group. He stated Mercer also assessed each firm's underlying investments and the performance ranking of those strategies to ensure undue levels of risk were not taken relative to their peer groups.

Mr. Muir noted in terms of administrative reporting, one of the critical pieces is the ability to furnish a net asset value on a daily basis. He indicated this was a critical service needed from the current mandate that several proposers were not able to accommodate directly. Mr. Muir reported that fees competitively ranged from 26 to 36.5 basis points with Standish at the low end and PIMCO at the top.

Mr. Muir reviewed the firms' suggested portfolio structures. He stated Mercer wanted to see a level of liquidity that would not overly diminish returns and favored strategies that have more of an open maturity bias. He noted managers like Goldman Sachs and ICMA tended to prescribe a significant level of fixed maturity investments.

Ray Ciranna indicated he was fine with the Plan's selection of Galliard, but stated that while there were major organizational issues at PIMCO, their performance could not be disregarded. He stated that though the PIMCO proposed fees were higher, their performance seemed to have outweighed their fee. Mr. Muir stated that PIMCO's non-selection was more attributable to its current organizational circumstances. He indicated it would likely take time for senior management to stabilize and additionally demonstrate a commitment to Stable Value. He stated changes in senior management and in level of assets managed generally cause a re-evaluation of an organization. He indicated a level of stability within a firm would be desired. He additionally noted that while PIMCO had positive performance on a composite level, its underlying portfolio construction had taken on notable interest rate risk and as such had not attained favorable absolute or risk-adjusted performance. Mr. Mumma asked what the stable value returns were ten years ago. Mr. Montagna stated it was approximately 5%.

Mr. Muir stated Galliard was proposing a new fund management expense of 30.2 basis points. He indicated this would represent an increase of 3 basis points from the current fee. He stated Galliard had, to this point in time, charged an internal management fee only on the portion of the portfolio it was managing, which was 80%. He stated that under the proposed model, Galliard was charging the investment management fee across the entire portfolio upon internal counsel advisement. He indicated the intent of charging the fee across the entire portfolio was to remove any perceived perception that Galliard might improperly adjust the portfolio's Galliard-managed allocation. He stated it was appropriate and reasonable to apply a holistic fee, which was consistent with what other managers were proposing. Mr. Montagna added Galliard had been limited from applying this fee method sooner due to the terms of the current contract with the Plan.

Mr. Muir also stated Galliard was proposing a second level of pricing, which would raise the fees by 1.3 basis points from the current fee structure. He stated Galliard was proposing to increase external management of the portfolio from 20% to 30% percent. He stated Galliard would introduce another manager, Dodge & Cox, as one of the sub-advisors on the fund. He indicated Dodge & Cox was a strong bond manager and the performance generated by their proposed strategy was significantly higher than its peer group as well as the existing portion of the portfolio they were replacing. He indicated that while it would warrant a slightly higher fee, this would further diversify the portfolio. Mr. Montagna stated that this was in line with the industry standard.

**A motion was made by Mr. Ciranna, seconded by Mr. Moutes, to approve the recommendation from staff and the Board's investment consultant to select Galliard Capital Management as the provider of the DCP Stable Value Fund for a five-year contract term beginning July 1, 2015; the motion was unanimously adopted. A motion was made by Mr. Ciranna, seconded by Cliff Cannon, to instruct staff to draft a proposed contract for the selected provider and authorize the Board Chairperson to execute the contract, subject to agreement between the**

**City and contracted provider as to all applicable terms and conditions; the motion was unanimously adopted.**

Mr. Mumma moved the agenda forward to discuss Item 6.

5. BOARD REPORT 15-21: CORRECTION TO CREDITING RATE FOR FDIC-INSURED SAVINGS OPTION

Mr. Montagna reported on the occurrence of a recordkeeping error during 4th Quarter 2014 in relation to the Deferred Compensation Plan's FDIC-insured Savings Account option. He stated staff had received notice from Mercer in early April regarding the Plan having a negative crediting rate for its FDIC-insured option for 1st Quarter 2015. He indicated staff learned this was a result of an over-crediting of the interest rate during 4th Quarter 2014 and a subsequent correction being applied in 1st Quarter 2015 in the amount of approximately $180,000. He stated it was a small amount relative to the overall asset base of $300 million dollars, but since interest rates were low, the correction actually created a negative rate of return for 1st Quarter 2015.

Mr. Montagna stated staff was particularly concerned they were not notified by Empower Retirement of this error in a timely manner nor were they informed a correction had taken place. He indicated after further investigation of the issue, staff was able provide input on how to rectify the situation. He stated that the approximate 9,000 plan participants were invested in this option would receive a corrected statement for 4th Quarter 2014, coupled with a letter explaining why the error had taken place. He stated participants would subsequently receive a statement for 1st Quarter 2015, which would include the corrected balance from the previous quarter. He stated staff had discussions with Empower regarding steps needed to be taken to prevent such an error from recurring.

Lisa Tilley, National Accounts Director with Empower Retirement, apologized for the error and explained that the products team had not realized the interest rate for 4th Quarter 2014 needed to be changed from an annual rate to a quarterly rate. She stated Empower would be providing additional oversight and any type of future correction would be brought to her as well as the account management team's attention. She indicated her staff would be working more closely with the products team and ensuring the account manager was notified of the rate changes. She stated Empower would also include lower reconciliation approval thresholds for these types of bank products to help bring to light any issues that may occur.

Mr. Ciranna expressed his concern in regards to the delayed notification and lack of communication from Empower to Plan staff, particularly after the discovery of the error in January. He stated he appreciated Ms. Tilley's letter to staff, but the correspondence did not include information regarding how Empower would communicate with Plan staff going forward. Ms. Tilley apologized for the oversight and indicated Empower would ensure communication with Plan staff. She explained that the Empower account manager working on the correction in January had been coordinating with Mercer to make corrections on reporting, but as an oversight the account manager had not informed the City of the error. She noted it was not Mercer's responsibility to inform the City and indicated the mistake and oversight was attributable to Empower. Mr. Moutes echoed Mr. Ciranna's concerns regarding the lack of communication.

Mr. Mumma asked when the corrected 4th Quarter 2014 statements were sent. Ms. Tilley stated the statements were mailed out the previous week. Mr. Mumma asked whether participants that took distributions may have had any adverse impact on their taxes. Ms. Tilley stated that corrections were not applied to participants that took distributions and that there would be no adverse tax consequences for them.

Mr. Cannon expressed his agreement with Mr. Ciranna and Mr. Moutes' concerns regarding the lack of communication. He asked whether there were any inquiries from Plan participants regarding this error. Ms. Tilley stated there had been no inquiries to Empower thus far, but stated they would continue to monitor the situation and report back to the Board with updates.

Mr. Mumma asked Mr. Montagna if there were any inquiries made from participants specifically to City staff. Mr. Montagna indicated there were none and noted that when dividing the $180,000 by the number of participants affected, the individual dollar amounts were very small. Mr. Mumma asked Mr. Montagna whether he thought the communication breakdown had been remedied. Mr. Montagna stated it was, but he noted this issue was something staff would continue to monitor. He stated this was a record keeping error coupled with an internal communication error, which also led to another issue where the Plan had to communicate to its individual members. He stated these issues were important and would be considered when developing and conducting future Third-Party Administrator search processes. Ms. Tilley stated Empower had added more support to the account management team to ensure similar issues would be addressed appropriately.

**A motion was made by Mr. Cannon, seconded by Ms. Macy, to receive and file staff's report regarding a correction made to the crediting rate for the Deferred Compensation Plan FDIC-Insured Savings Account Option; the motion was unanimously adopted.**

Mr. Mumma moved forward on the agenda to discuss Item 7.

## 6. BOARD REPORT 15-22: DEFERRED COMPENSATION PLAN 2014 ANNUAL REPORT

Mr. Montagna presented the proposed draft of the 2014 Deferred Compensation Plan Annual report. Mr. Mumma suggested several minor edits and asked that historical asset data be added. Mr. Montagna stated staff would review the report to see if that could be done. Mr. Ciranna stated the Annual Report represented statistics from the

2014 calendar year and asked whether there was a way to provide a snapshot of the organizational makeup of the Board members that served during that year. Mr. Montagna stated the consensus approach established by the Board in the past was to display the organizational makeup of the Board as it currently existed during the date of the report's issuance with inclusion of a footnote indicating the changes to Board members that occurred in the previous year.

**A motion was made by Mr. Ciranna, seconded by Ms. Macy, to approve the current draft of the 2014 Deferred Compensation Plan Annual Report, as amended; the motion was unanimously adopted.**

Mr. Mumma moved the agenda forward to discuss Item 8.

7. BOARD REPORT 15-23: NATIONAL ASSOCIATION OF GOVERNMENT DEFINED CONTRIBUTION ADMINISTRATORS (NAGDCA) CONFERENCE SITE LOCATION

Mr. Montagna updated the Board on an issue which arose in the past month regarding recently passed legislation from the State of Indiana. He indicated there was perception or concern on the part of some that the legislation was either intended or may have had the impact of promoting discrimination by private businesses on the basis of sexual orientation. He noted this year's NAGDCA Conference would be taking place in Indiana and indicated the controversy created an issue for the NAGDCA Board as they became aware that a number of state and local entities had banned travel to the state in response to the legislation. He indicated that in response to the backlash, Indiana legislators made changes to the law. He stated most of the entities that instituted travel bans had lifted them once the legislation was amended. He stated that while the NAGDCA Board had made the decision to move forward and not make any change to its conference location, he felt the Board be informed of the issue. Mr. Montagna concluded his report by stating that no known action was taken by the State of California or the Los Angeles City Council in reference to this issue.

Mr. Moutes stated he appreciated the NAGDCA Board's proactive approach in addressing this issue.

**A motion was made by Mr. Moutes, seconded by Mr. Ciranna, to receive and file the report regarding the 2015 Annual NAGDCA Conference as it relates to the conference location site of Indianapolis, Indiana; the motion was unanimously adopted.**

Mr. Mumma moved the forward on the agenda to discuss to item 9.

8. BOARD REPORT 15-24: PROPOSED TARGETED ENROLLMENT INITIATIVE

Mr. Montagna reported staff had been working on a benchmarking project, of which the initial highlights would be presented to the Board with the 1st Quarter 2015 report. He indicated in conjunction with Plan benchmarking, staff was also participating in a Personnel Department metrics project where a monthly report is presented to management pertaining to metrics for certain functions happening within its divisions. He noted one of the focuses in those discussions was reporting and analyzing the number of participants in the plan.

Mr. Montagna stated the Plan had constructed a well thought out way of looking at the question of achieving retirement income security. He indicated that having a long career, having a defined benefit, and participating in the Deferred Compensation Plan helps City employees meet that objective. He indicated staff wanted to apply a more disciplined approach when looking at enrollment and set an overall goal for the Plan to increase net enrollment by 3% in 2015. He reviewed the Plan's past net enrollment trends and stated setting an ambitious goal was beneficial and helped focus attention on what the Plan was trying to achieve. He then referenced a targeted enrollment initiative recently conducted by Empower Retirement for the County of Los Angeles where a postcard was sent to its participants to call attention to the benefits of enrolling in their plan. He indicated the County's campaign resulted in a 3% response rate. He stated staff proposed a more enhanced "multi-touch" campaign on a pilot basis which would not only include a postcard mailing, but also employee engagement from Empower Retirement representatives and labor organizations. He stated staff intends to target the Department of Transportation's crossing guards and traffic officers. He stated staff would like to receive approval from the Board before embarking on the proposed initiative.

Mr. Montagna stated the target populations would consist of employees who were contributing to LACERS and were eligible to participate in the Plan. Mr. Ciranna asked whether more demographic information could be obtained on the target groups. Mr. Montagna stated that could be done. Mr. Ciranna asked if staff had envisioned additional targeted efforts that would follow this pilot campaign. Mr. Montagna stated that if this targeted effort is approved and implemented, it was in the Plan's interest to know what was achieved and learned from these targeted initiatives. He also noted the importance of the ability to network with department gatekeepers as well as labor organizations to gain access to employees. Ms. Macy added that this campaign would allow for lessons learned regarding ways to engage specific employee populations that are challenging to reach and provide ideas for best practices for reaching out to larger groups in the future.

**A motion was made by Mr. Moutes, seconded by Mr. Ciranna, to approve staff's recommendation to develop a targeted enrollment initiative to increase the Deferred Compensation Plan's active employee participation rate, with a targeted goal for increasing net participation by 3% in 2015; the motion was unanimously adopted.**

Mr. Mumma reverted back to discuss item 5.

9. BOARD REPORT 15-25: PLAN PROJECTS & ACTIVITIES REPORT

Paul Makowski updated the Board on the status of Plan projects. He stated the DCP Small-Cap Fund change was completed on March 20th and indicated staff was in the process of completing the DCP International Fund change. He stated letters were being sent to all participants invested in the fund and noted the 1st Quarter newsletter contained an article regarding the fund change.

He stated in addition to the error already discussed regarding the FDIC-Insured Savings account, the Plan had recently become aware of fraudulent activity on an account that the Bank of the West services. He indicated staff was currently working with Bank of the West and the Plan recordkeeper to ensure that the Plan's transactions were protected. He stated staff had recently returned from a site visit to Empower Retirement headquarters in Colorado where they observed operations and discussed potential improvements to Plan processes. He noted staff became aware of interesting system improvements they hoped would be realized in the following year.

Mr. Makowski updated the board on the status of pending contracts. He stated the consulting services RFP was currently in the evaluation stage and indicated three firms submitted responses: Mercer, RVK, and Segal. He stated Mercer and Segal submitted proposals for all three components of the consulting contract: plan administration, investments, and communications consulting, while RVK submitted for the administration and investments components only. He stated all evaluations would be completed and recommendations would be presented to the Board at the next meeting.

He indicated staff continued to work on metrics, and a draft of the revamped quarterly report would be presented at the next meeting. He then updated the Board on the status of the CAP rate project and indicated staff was still working with the Controller's Office and the Administrative Services Division to develop a recommendation on how to address CAP rates for the Plan in the future. He noted no additional Plan budget reimbursements would be processed until this was resolved.

Mr. Makowski reported on the upcoming Board Elections and stated there were two candidates running for the Retired Participant Representative seat, Cliff Cannon and Eugene Kent Canzano. He indicated the sole person running for the DWP Active Participant seat was Don Thomas. He stated the election results would be reported to the Board at its June meeting. He concluded his report by stating Alexandra Castillo would be filling the vacant Senior Personnel Analyst II position for the Plan.

Mr. Mumma asked whether the occurrence of fraudulent activity with Bank of the West was an internal problem or an external hack. Mr. Makowski stated he believed it was an outside issue related to an individual fraudulently writing a check against an account.

Mr. Mumma asked if there were any comments from participants regarding the DCP Small-Cap Fund change. Mr. Makowski stated that out of approximately 9,000 participants, staff believed about 20 or so participants actually commented through formal communication or through discussions with a Plan representative. He stated most of the discussions involved the change in fees and indicated there were only a few escalated complaints. Mr. Montagna indicated staff fully addressed those complaints through written correspondence. He noted confusion generally stemmed from the participants not realizing that the fee increase was attributable to the fact that active management was now part of the overall portfolio construction. He indicated staff's correspondence also explained the potential benefits of incorporating active management in that it creates opportunities for the fund to outperform the benchmark.

**A motion was made by Mr. Cannon, seconded by Ms. Macy, to receive and file staff's update on Plan projects and activities during March 2015; the motion was unanimously adopted.**

## 10. REQUESTS FOR FUTURE AGENDA ITEMS

None.

## 11. FUTURE MEETING DATES – May 19, 2015

## 12. CLOSED SESSION

A brief closed session was convened. Following the closed session, Curtis Kidder stated there were no final decisions made on the matter by the Board during the session.

## 13. ADJOURNMENT

**A motion was made by Mr. Cannon, seconded by Mr. Moutes, to adjourn the meeting; the motion was unanimously adopted.** *The meeting adjourned at 10:32 a.m.*