

CITY OF LOS ANGELES
BOARD OF DEFERRED COMPENSATION ADMINISTRATION

ADOPTED MINUTES
REGULAR MEETING OF JUNE 16, 2009 – 9:00 A.M.
700 E. TEMPLE STREET, ROOM 350

BOARD MEMBERS:

Present:

Eugene Canzano, Chairperson
Richard Kraus, First Provisional Chair
Margaret Whelan, Third Provisional Chair
Sangeeta Bhatia
Sally Choi
Michael Perez
Shelley Smith

Staff:

Personnel: Alex Basquez
 Steven Montagna
 Natasha Zuvich
 Ashley Stracke

City Attorney: Anita Parys
 Vicky Williams

1. CALL TO ORDER

Eugene Canzano called the meeting to order at 9:10 a.m.

2. PUBLIC COMMENTS

None.

3. MINUTES

Richard Kraus stated that the word “Band” in last paragraph on page four should be changed to “Bank.” He also stated that the reference to Mr. Ruff on page 7 should be changed to Mr. Cannon and that the time the meeting was adjourned should be changed to 11:34 a.m.

Referring to the “Requests for Future Agenda Items” section, Mr. Perez asked staff when the topic of disclosure of market contacts was scheduled to be discussed. Mr.

Montagna explained that the topic was being addressed in the Board By-laws that staff expected to present to the Board at the July meeting. He stated that staff would be recommending that the Board refer the By-laws to the Plan Governance and Administrative Issues Committee for more detailed consideration, but that the Board could decide to discuss the topic of market contact disclosure separately if it wished. **A motion was then made by Richard Kraus, seconded by Shelley Smith, to approve the minutes of May 21, 2009, as amended; the motion was unanimously adopted.**

4. INVESTMENT PROVIDER PRESENTATION: LAZARD ASSET MANAGEMENT

Martin Flood, Portfolio Manager/Analyst with Lazard Asset Management, was present to review performance for the Lazard U.S. Mid Cap Equity Fund. Mr. Flood began by briefly noting some personnel changes with the organization as noted in the firm's written report. He stated that the firm had reduced staff but none of these reductions had been with investment management personnel.

He next indicated that the managers of the U.S. Mid Cap Fund were focused on capitalizing on the relationship between productivity and valuation, looking for firms with strong cash flow, balance sheet strength, and market leadership. He stated that access to the capital markets was also important, particularly in the current economic environment. He stated that in order for money managers to survive in this environment it was important to be forward looking, and that looking at historical results would not necessarily be sufficient given how rapidly conditions were changing.

Mr. Flood discussed the returns of mid-cap company stocks generally, indicating that they had tracked the market generally and participated in the market rally off the February lows. He stated that the firm believed that notwithstanding that rally there still remained many attractively priced stock valuations, although gains over the next six months to several years would probably not be lacking in volatility. He indicated that the firm's focus was defensive.

He reviewed some of the Fund's recent purchases and redemptions, noting that the fund had fewer holdings presently, that its top ten holdings represented 23% of total assets and that this would likely narrow further to 30%. He stated that the Fund's Return on Equity (ROE) was 12.8% vs. 11.4% for the index.

Turning next to performance, he acknowledged that the Firm had under-performed its benchmark since inception but that most of this under-performance was attributable to the fourth quarter of 2007, a period where the market was still rising and the Fund was early in exiting out of positions that subsequently fell sharply in 2008. He indicated that since that quarter the Fund had been closing the gap, notwithstanding its year-to-date under-performance of sixty basis points. He indicated that more recent under-performance was the result of disappointments in three stocks out of approximately sixty holdings. Mr. Flood next reviewed the rolling performance of the Fund, stating that the Fund had been in the first or second quartile of funds 85% of the time. The presentation then concluded.

5. CITY ATTORNEY DISCUSSION: BOARD GOVERNANCE/CONTRACTING

Deputy City Attorney Anita Parys indicated that the City Attorney's Office had been asked to respond to the question of what level of discretion the Board had compared to the City's retirement/pension plans. She stated that the City's retirement/pension plan boards had plenary authority as dictated by the State Constitution, but that the Board was treated differently because it was created by City Council ordinance and the Council retained its veto power. She stated that Assistant City Attorney Noreen Vincent was present and would be discussing the Board's options with respect to contracting. She indicated that it was her understanding that the primary concerns of the Board in contracting related to application of rules for Minority and Women Owned Business outreach efforts.

Ms. Smith replied that the Board's concerns were broader than that, and what was being sought was the broadest degree of flexibility possible in order for the Board to meet its fiduciary obligations to participants to provide them with the best products and services. Ms. Vincent indicated that the City Attorney agreed that Board members were fiduciaries with respect to the Plan, but that the Council also had a fiduciary role. She reiterated that the State Constitution provides retirement/pension plans with plenary authority but does not provide that authority to deferred compensation plans. She stated that the City Council could have set up the Plan if it wished to without a Board, and that the Plan was still considered part of the organic City entity.

With respect to contracting, Ms. Vincent stated that State law provides for certain carve-outs of independence for certain bodies in which State law supersedes any requirements that might be set with respect to contracting, providing as one example the authority for treasurers within the State regarding the time and manner of deposits, which can allow them to go around City contracting requirements. She stated that although this was the case, the City Treasurer did adhere to those requirements and did not see them as being in conflict with her fiduciary responsibilities.

Ms. Vincent then reviewed some of the specific components of the City's Standard Provisions and other general contracting requirements, indicating that living wage requirements were now part of the City Charter, and that slavery disclosure documents did not apply to investment contracts. She indicated that if there were specific requirements that were of concern the Board had the ability to go to the City Council to request exclusions.

Ms. Smith indicated that the Board understood that certain of its selection processes were being compromised by the City's general contracting requirements, and that the issue was not simply one that arose when it came time to execute a contract, but could occur much earlier when prospective providers might opt not to participate in a search process given the burdens imposed. She indicated that she was interested in pursuing the option of approaching the City Council about granting certain exemptions. There was discussion among Board members and City Attorney staff that it might be useful to,

as part of approaching Council on this matter, remind them of the duties and obligations assumed by them in taking on fiduciary decisions associated with the Plan.

Mr. Montagna asked the City Attorney representatives if the Board could choose to, on a routine basis, conduct its investment selection processes using an approach it had employed in the past in situations where an RFP process was canceled due to limited response. He stated that in those instances the Board had gone to its consultant to conduct an investment manager review and then asked the consultant to return to the Board with the highest scoring firms, with the Board subsequently making a selection.

Ms. Vincent indicated she was unsure if this was possible if the intent in doing so was to circumvent City contracting rules. Ms. Choi indicated her concern that such a process not limit the candidate pool in any way. Mr. Montagna replied that the intent would not be to circumvent contracting rules, and that in most instances a contract would not be required at the end of the process if the chosen investment vehicle was a mutual fund. He further indicated that in any event the process had been approved by the City Attorney and used by the Board in the past, and that it should provide for a much wider respondent pool since effectively any vendor could be considered, not just those responding to an RFP. Ms. Vincent indicated that there could be additional concerns regarding access to the process if certain vendors were excluded from the consultant's review. Mr. Montagna indicated that this could be addressed by issuing appropriate notifications to the vendor community of their right to be considered in the process, and that this function could be handled by staff and would not be done by the consultant. He further indicated that the Board would set the parameters of how vendors would be considered.

Ms. Smith indicated that this issue could be addressed on multiple tracks. Mr. Montagna suggested that Personnel and City Attorney staff work together on drafting a proposed policy that could incorporate an efficient search process with the essential principles that should govern that process and assure an open, merit-drive search. As a result, **a motion was made by Maggie Whelan, seconded by Sally Choi, directing City Attorney and Personnel Department staff to (a) draft a proposed procurement and investment manager search process that would attempt to provide for the broadest pool of candidates for consideration in the most efficient way possible and with appropriate notification to potential candidate firms of their rights to be considered in that process; and (b) develop a plan for addressing both for the short-term and long-term the possibility of certain exemptions to some of the City's general contracting requirements; the motion was unanimously adopted.**

6. FIDUCIARY RESPONSIBILITIES PRESENTATION

Ashley Stracke led a presentation on fiduciary responsibilities. She began by indicating that fiduciaries are defined by their actions and not by their roles. She indicated that it was possible for a governing body to not make any fiduciary decisions, but that generally this was not the case.

She then discussed a variety of actions taken in administering the Plan, distinguishing between those which were fiduciary actions and those that were non-fiduciary actions: examples of the former included interpreting policy, selecting service providers and changing investment options, while examples of the latter included approving distributions, preparing communication materials and enrolling participants. She reviewed the various groups involved in administering the Plan and described the contexts in which they exercised a fiduciary role or did not, pointing out that while the Board mostly engaged in fiduciary decisions, others such as staff did so some of the time, and certain entities such as the City Attorney and consultant never did.

Ms. Stracke next discussed fiduciary duties, indicating that these included carrying out duties with care, skill, prudence and diligence; complying with Plan documents and applicable laws, diversifying Plan investments; and ensuring expenses were reasonable. She indicated that the Employee Retirement Income Security Act (ERISA) did not govern the Plan but provided useful guidance because it was the most comprehensive guide. She stated that the “prudent man” standard indicates that a fiduciary give appropriate consideration to those facts and circumstances that the individual knows or should know are relevant.

Ms. Stracke finally outlined the decision-making process suggested in order to meet the prudent man standard. She reviewed the best practices that were indicators for a Plan having met its fiduciary requirements and noted that the Plan was currently meeting all of them, but could improve by scheduling annual fiduciary review sessions and creating a stand-alone Investment Policy document incorporating previously approved policy positions adopted by the Board.

Mr. Kraus noted a book that provided information regarding the implications of a particular court case as it related to fiduciary duties. Vicky Williams of the City Attorney’s Office indicated that this case had been researched as part of preparing for the presentation. Ms. Smith added that the circumstances and legal framework included in that case were not directly relevant to the City’s Plan.

The presentation then concluded.

7. BOARD REPORT 09-33: FDIC INSURED PROVIDER

Mr. Montagna indicated that at the previous Board meeting, Mercer Investment Consulting identified Bank of America, Wells Fargo, Bank of the West, and City National Bank as institutionally viable. He explained that Mercer and staff had since reviewed each bank in terms of their operational and contracting viability, and that Wells Fargo was not willing to modify its weekly rate-setting schedule and had therefore withdrawn its name from consideration. Mr. Montagna stated that the three remaining firms could meet the City’s general contracting requirements and that staff did not foresee insurmountable obstacles to negotiating contracts with these entities.

The Board recessed at 10:50 a.m. and reconvened with a quorum at 10:55 a.m.

Ms. Dalton reviewed her report and stated that both Mercer and staff were recommending that the Plan select Bank of America, City National Bank, and Bank of the West as providers for the FDIC-Insured Savings Option. Following this discussion, **a motion was made by Sally Choi, seconded by Shelley Smith, to a) approve the selection of Bank of America, City National Bank and Bank of the West as providers for the new City of Los Angeles Deferred Compensation FDIC-Insured Savings Option; (b) instruct staff and the City Attorney to work with the selected providers in developing the necessary contracts; and (c) authorize the Board Chairperson to execute the contracts; the motion was unanimously adopted.**

Mr. Canzano stated that a few Board members had indicated they would need to leave the meeting by a specific time and therefore requested that the Board first discuss the remaining action items on the agenda. The Board agreed to this request.

10. BOARD REPORT 09-35: THIRD PARTY ADVICE/TRADING – SELF-DIRECTED BROKERAGE OPTION

Mr. Montagna stated that at the January 21, 2009 Board meeting, staff was directed to work with the City Attorney's Office to develop a recommendation regarding the use of Schwab's Advisory Services product and/or authorizing Third-Party trading through the Self Directed Brokerage Option (SDBO) provider, Charles Schwab. He stated that this issue had arisen as a result of participant requests for these services.

Mr. Montagna explained that activating the Schwab Advisory Services would allow participants in the SDBO to grant an independent advisor, who had a relationship with Schwab, the authority to trade on the participant's behalf. He explained that the City Attorney and Mercer both reviewed the power-of-attorney agreement executed by Schwab and determined that the language did not provide indemnification for the Plan sponsor. He further explained that the agreement could not be changed by Schwab, and that it would not be practical for the Plan to administer an independent agreement, so staff and the City Attorney were therefore recommending that the Board not activate Schwab's Advisory service for Plan participants.

In regards to the Third-Party trading option, Mr. Montagna explained that the service would allow participants in the SDBO to select a third-party to trade on the member's behalf. He explained that the power-of-attorney agreement for this option also did not provide indemnification, but that the City Attorney's Office was less concerned with this because it would be difficult to maintain any connection between the Plan sponsor and the individual chosen by the participant to trade the participant's account. He indicated that staff was therefore recommending that the Board approve authorizing Third-Party trading of participant accounts within the SDBO.

Mr. Perez asked if staff had an understanding of participant sentiment in regards to these recommendations. Mr. Montagna indicated that he had spoken with the participants who had contacted the Plan regarding the services and they indicated they

would be satisfied with this option. He further indicated that the advisors they were working with might not be fully satisfied because they would be unable to collect revenue from the participant's Schwab account, although compensation arrangements could of course be made separately.

Mr. Kraus asked if there were other disclosures or acknowledgements required of participants in connection with enrolling in the SDBO. Mr. Montagna stated that there were such disclosures/acknowledgments that participants had to assent to before they could enroll. Following this discussion, **a motion was made by Shelley Smith, seconded by Sally Choi, to (a) decline the option of adding Schwab's Advisory Services program to the Self-Directed Brokerage Option (SDBO); and (b) approve authorizing Third-Party-Trading of participant accounts within the SDBO; the motion was unanimously adopted.**

11. BOARD REPORT 09-36: NAGDCA CONFERENCE

Mr. Montagna indicated that staff was presenting a recommendation for the 2009 NAGDCA Conference that differed somewhat from prior years in that, given current economic conditions, staff believed it was appropriate to limit the number of people attending. He indicated that staff was recommending that Personnel attendance be reduced from six to no more than four attendees, and City Attorney staff attendance reduced from two to no more than one attendee. Board members indicated they agreed with the recommendation. **A motion was then made by Shelley Smith, seconded by Sangeeta Bhatia, to approve the necessary funding for available Board members; four Personnel Department staff; and one City Attorney staff; to attend the 2009 NAGDCA conference in Austin, Texas; the motion was unanimously adopted.**

Mr. Kraus asked if staff believed there would be any difficulty obtaining the Mayor's approval given the current economic conditions. Mr. Montagna stated that in 2008, the Plan received approval without difficulty and assumed this would be the case for 2009.

Ms. Choi asked if there was a way the expenses for travel could be budgeted separately from the Plan's general operating budget. Ms. Whelan explained that the Personnel department would like to do this, however, given the current budgeting structure, it was difficult to do so. After this discussion, Board members Sangeeta Bhatia, Sally Choi, Michael Perez, and Shelley Smith excused themselves from the meeting. The Board did not have a quorum for the remainder of the meeting.

8. QUARTERLY INVESTMENT PERFORMANCE REVIEW

Ms. Dalton began her presentation by indicating that the Plan had seventeen investment options but that the number of options would decline over the coming months with the elimination of two underperforming funds and the consolidation of the Stable Value Fund. She then discussed the three-year and five-year performance returns of the Plan's options. She explained that three funds in the first quarter were unsatisfactory. She stated that two of the funds were being terminated with the assets

mapped to other investments and the third, Lazard Mid Cap, had been on monitor status since 2007. She explained that Mercer had an onsite visit scheduled with Lazard for the month of July and stated that Mercer recommended that Lazard remain on monitor status.

Ms. Dalton stated that Plan assets had declined 2.6% from the previous quarter and that the number of participants had risen slightly to 40,539. She explained that in terms of the Plan's asset allocation, assets in the Stable Value fund rose from 25% in the fourth quarter of 2008 to 28% in the first quarter of 2009. She indicated that this was at the expense of large cap and international equities, similar to a trend seen in other plans. She indicated that the stable value and money market options equaled approximately 44% of Plan assets.

Ms. Dalton next discussed the expense ratios of the Plan. She stated that, as explained in previous quarterly investment reports, the Plan's expenses were below the industry average. She stated that total plan fees were 39 basis points excluding Washington Mutual and the Hartford General account.

Ms. Dalton indicated that the Hartford Advisers HLS IA would be terminated and mapped to the moderate profile portfolio and the Hartford Stock would be terminated and mapped to the vanguard institutional index. She also stated that Lazard had experienced periods of underperformance due to their strategy and what was going on in the marketplace. She also indicated that they had recently made personnel changes and that this was the reason for Mercer's onsite visit in July.

Ms. Dalton stated Galliard would become the sole Stable Value Fund provider on July 1, 2009. She also indicated that the Hartford General Life Account assets would be liquidated and moved into Galliard on July 2, 2009. Mr. Montagna also confirmed that the Plan received notification from Hartford that the assets would be moved on July 2, 2009 and that Mercer and staff were not expecting any negative market adjustment as a result of the transfer. He commented that Hartford had until August to move the assets, but was moving them sooner because they could realize a positive market value adjustment.

Mr. Kraus asked what benchmark would be used when the Stable Value Fund transfer was completed. Ms. Dalton stated that the 3-year CMT + 50 basis points and the 91-Day T-Bill +150 basis points would be used as benchmarks for the fund.

Ms. Dalton stated that the profile funds were performing well. She indicated that the Ultra Aggressive Profile had performed slightly below the custom index. She explained that this was because the DWS EAFE Equity Index Institutional Fund had performed below the MSCI EAFE index, which was a result of fair value accounting.

Ms. Dalton indicated that Capital Group had recently announced 800 layoffs, which was approximately 9% of its current staff. She stated that this was following another 500 layoffs from earlier in the year and 50 layoffs in December of 2008. She indicated that

in most cases the layoffs had not been investment professionals. She stated that Mercer would be monitoring this.

Ms. Dalton concluded her presentation by stating that the Fidelity Diversified International Fund was being monitored since it had recently been reopened. She stated that the fund was considered large in size with approximately \$28 million in assets, which caused concerns that if the fund becomes too large it cannot be managed effectively.

Mr. Kraus asked for Ms. Dalton's comments regarding how Mercer's analysis of Lazard comported with their self-assessment. Ms. Dalton replied that Lazard's explanation of their under-performance was largely accurate and that they had been impacted in recent quarters by poor stock selection. She indicated that the fund has a slight value tilt which has not helped, but that over time the fund has been a solid performer.

Mr. Montagna stated that since the remaining agenda items were not urgent, staff recommended that the Chairperson adjourn the meeting and reschedule the remaining items for the next Board meeting. The Chairperson agreed to reschedule the remaining agenda items.

12. REQUESTS FOR FUTURE AGENDA ITEMS

None.

13. NEXT MEETING DATE – JULY 21, 2009

14. ADJOURNMENT

The meeting adjourned at 11:38 a.m.

Minutes prepared by staff members Steven Montagna and Ashley Stracke.