CITY OF LOS ANGELES
BOARD OF DEFERRED COMPENSATION ADMINISTRATION

ADOPTED MINUTES
REGULAR MEETING OF AUGUST 18, 2009 – 9:00 A.M.
700 E. TEMPLE STREET, ROOM 350

BOARD MEMBERS:
Present:
Eugene Canzano, Chairperson
Richard Kraus, Vice-Chairperson
Shelley Smith, First Provisional Chair
Margaret Whelan, Third Provisional Chair
Cliff Cannon
Michael Perez

Staff:

Personnel:	Alex Basquez Steven Montagna JoAnn Dominguez
City Attorney:	Anita Parys Vicky Williams

1. CALL TO ORDER

Eugene Canzano called the meeting to order at 9:08 a.m. He noted that he had attended the retirement dinner for staff member JoAnn Dominguez and acknowledged the large attendance and her service to Plan participants.

2. PUBLIC COMMENTS

None.

3. MINUTES

Mr. Kraus noted some typographical errors and omissions to the minutes, which staff indicated would be corrected. Mr. Perez indicated that in the minutes he had noticed a comment made by Ms. Whelan about annual review of the Great-West contract and asked for some clarification. Mr. Montagna replied that he believed this comment was in reference to building in an annual review in the next Request for Proposals/contract for a third party administrator. **A motion was then made by Shelley Smith, seconded by Richard Kraus, to approve the minutes of July 21, 2009, as amended; the motion was unanimously adopted.**

4. INVESTMENT PROVIDER PRESENTATION: VANGUARD

Ed McGettigan, Vanguard Relationship Manager, and David Wilson of Vanguard's Portfolio Review Group, were present to review performance for the Vanguard Institutional Index Fund, the Mid-Cap Index Fund, and the Total Bond Market Index Fund. Mr. McGettigan began with a brief overview of the firm, indicating Vanguard's emphasis on low fees. He stated that the average expense ratio across all of its funds was 0.20%. Richard Kraus asked if that number was weighted by assets, and Mr. McGettigan indicated it was. Mr. McGettigan further indicated that cash flow for the firm had been very strong the past few years.

Mr. Kraus asked how the firm handled voting of proxy shares for its institutional clients since the funds were not held as mutual funds. Mr. McGettigan indicated that Vanguard encouraged proxy voting for all its share classes, including its institutional funds. Mr. Kraus asked staff if the City's Plan voted its share classes. Mr. Montagna replied that the Plan had not historically voted its shares because of the problem of identifying share ownership, indicating that the Plan Administrator maintained the individual account records, not Vanguard. Mr. Cannon asked how other institutional clients handled the voting of their shares. Mr. McGettigan replied that defined benefit plans typically voted their shares, while defined contribution plans typically did not. Ms. Smith indicated that this was an issue that should be reviewed in greater detail and brought back to the Board for discussion.

Mr. Wilson then began his portfolio review. He stated that performance for the Vanguard Institutional Index was slightly ahead of its benchmark index for all periods and had a current expense ratio of .025%. He indicated that with respect to management changes, the firm had added an individual to head its Quantitative Analysis team with over 20 years of experience. He stated that the turnover rate for the Fund was 6.3% and that this was the result of changes to the composition of the index.

Mr. Wilson next discussed residual error, or the difference between the return of the index vs. the return of the fund. He indicated that the fund was slightly ahead for several reasons. He stated that, first, the timing of certain intra-day rebalancing trades often provided opportunities to make purchases at more favorable prices. He indicated that another factor was securities lending, which allowed the firm to lend out shares, invest the proceeds and then capture the interest. He stated that Vanguard's securities lending program was very conservative and explained how certain other firms had gotten into trouble with securities lending by gradually increasing the level of risk in their reinvestment portfolios. He stated that, by contrast, Vanguard invested the funds in the safest way possible, using money market instruments only. He indicated that securities lending added approximately .03%, which effectively covered the management cost of the fund.

Ms. Smith asked how much discretion Vanguard was permitted in its rebalancing trades. Mr. Wilson replied that it was very little, and that these trades typically occurred on an intra-day basis. Mr. Perez asked how the fund's performance would compare to enhanced index fund managers, and how Vanguard would define enhanced index management relative to its own strategies. Mr. Wilson replied that he wasn't sure, given that enhanced index managers straddled the line between active and passive management.

Mr. Wilson next reviewed the Mid-Cap Fund, indicating that it had an expense ratio of 0.09%. He stated that the turnover on this Fund was substantially higher because companies could leave the index by moving both up and down into large and small cap categories, and because of the exceptional volatility which had occurred over the past year. Mr. Wilson indicated that the Fund nevertheless also had positive tracking error. Mr. Kraus indicated that the outperformance for the Mid-Cap Fund compared to its peers existed but to a smaller degree than with the Vanguard Institutional Index Fund. Mr. Wilson agreed, indicating that the general view is that more thinly traded market segments were less efficient and thus provided more opportunities for knowledge and skill to add to performance. Ms. Smith commented that while this may be the case on the whole, the problem for any individual manager was persistence.

Mr. Kraus asked about the degree to which the S&P 500 was a true large-cap proxy and the degree to which it had overlap with other indices. Mr. Wilson replied that overlap existed but the S&P 500 represented 78% of the broad market.

Mr. Wilson next discussed the Vanguard Bond Market Fund, indicating that it had an expense ratio of 0.08% and that, in contrast to the other two funds, used index sampling rather than direct purchase of the index. He said this was the case because the holdings of the index were so large (8,866 issues) that it would be inefficient to attempt to hold all of them due to lack of liquidity in some issues and other factors. He stated that the Bond Fund held 3,072 issues and that the total number in this group had broadened substantially since 2002.

Ms. Smith asked if Vanguard conducted any independent review of the ratings on the firms given agency-rating flaws. Mr. Wilson replied that Vanguard used a dedicated team to independently conduct such reviews. He stated that Vanguard attempted to add value by buying new bond issues at cheaper relative prices. Mr. Perez asked Mr. Wilson for his thoughts on the strategy of rebalancing within the current economic environment. Mr. Wilson referred the Board to a chart in the booklet which described how this economic recovery could be different than the typical recovery, and that fixed income was likely to do better than equities in a slow-growth environment. He further referred the Board to a table which demonstrated how different asset classes had performed over the past twenty years, indicating that every single asset class had outperformed inflation over that time period. Mr. Canzano indicated his appreciation of the information contained in the table.

5. GREAT-WEST QUARTERLY PLAN REVIEW

Rick Kramer, Director of Government Operations, and Gary Robison, Account Manager, both of Great-West Retirement Services, were present to review Plan performance statistics for the period ending June 30, 2009. Mr. Kramer began by indicating that Plan assets had rebounded substantially from the prior quarter and had now reached $2.4 billion. He stated that Plan participation had grown to a total of 40,473 accounts. Mr. Canzano asked if it was possible to identify how many of the non-contributing participants had separated from City service. Mr. Montagna indicated that it was possible to do this and that the methodology for performing the calculations had been identified as part of refining the eligible voting populations for the recent elections. He indicated that in order to pull all the information together and obtain an accurate number required project management and working with the City Controller and DWP Payroll. Ms. Whelan asked if there was a quicker way to obtain the information through PaySR. Alex Basquez indicated that she would review the matter. Mr. Kramer next indicated that the average bi-weekly contribution rate had dropped to $295 from $349 in the third quarter of 2008.

Mr. Kramer then reviewed net cash flow, indicating that the Washington Mutual CDs Account showed large outflows because the account was frozen. Mr. Canzano asked if it was possible to determine where the outflow from the Conservative Profile Fund had gone to, and Mr. Kramer indicated this information was not available. Mr. Kramer discussed asset allocation by asset class, noting that the Plan's Asset Allocation Funds had risen to 6% of assets. Finally, he noted that the average account balance had risen to $60,727 in the second quarter, a sharp improvement from the first quarter.

Mr. Robison reviewed local account activity, indicating that his staff had increased the number of meetings held with the Animal Services enrollment initiative. Ms. Whelan asked for the results of that initiative, and Mr. Robison indicated that 21 meetings were held and approximately 18-20 people were enrolled, but not all the final numbers were in because some individuals were still holding on to their forms. Natasha Zuvich indicated that the enrollment success rate was approximately 5-10%.

Mr. Cannon asked what topics were included under the retirement seminars. Mr. Robison replied that the session would cover distribution options and maximizing retirement income.

Mr. Robison then turned to a separate report detailing activity within the Plan's Self-Directed Brokerage Option (SDBO). He referred the Board to charts indicating that 59% of SDBO assets were held in mutual funds, 25% in cash, and 15% in equities. He indicated that of the equity portion, approximately 34% was held in Exchange-Traded-Funds, which he found surprising given that these were essentially index funds and the Plan had much cheaper alternatives in its core options. He noted that the average number of trades was fairly small, and that most of these trades were conducted using the website.

6. BOARD REPORT 09-34: PRE-AUDIT CONTRIBUTIONS LIMIT TESTING

Ms. Zuvich presented the staff report regarding pre-audit testing. She indicated that staff had initiated this testing effort as a means of preparing the Plan for the possibility of an IRS audit. She stated that although the City's Plan was unlikely to be high on the list of audit targets because of its relatively simple structure, staff wanted to be proactive in searching for ways to improve its processes.

She indicated that the focus of staff's testing was on Catch-Up contributions, since this was a process more prone to errors given its complexity. She stated that Catch-Up can lead to errors because the amount each participant can catch-up on is unique, the applicable limits can change from year-to-year, and participants are able to change their deferrals throughout their eligibility period. She indicated that for testing purposes staff reviewed all Catch-Up forms and contributions for calendar year 2008. She indicated that 12% of the forms had incorrect retirement age designations, and that this was the result of an internal process error which had since been corrected.

Ms. Zuvich stated that eight over-contributions were identified and corrected, and to better prepare the Plan for audit a new filing system had been created to better document the resolution of each case. She further indicated that staff had audited current Catch-Up participants on the payroll system to determine if any of those individuals should have already been deleted; twelve individuals were identified as having been removed, but none of them had over-contributed.

Board members discussed the possibility of notifying participants when they become eligible for Catch-Up. Mr. Montagna indicated this could be researched. Mr. Kraus asked if it was possible to use the consultant to perform some of the audit testing work. Mr. Montagna replied that this was possible, but given the number of hours required on this project he expected that the costs for such a project would be prohibitive, and it was important to note that even in the event of an audit, if the IRS discovered errors the Plan would be given time to correct them.

Following this discussion, **a motion was made by Shelley Smith, seconded by Richard Kraus, to receive and file the staff report; the motion was unanimously adopted**.

7. BOARD REPORT 09-44: ANNUITY DISTRIBUTIONS

Mr. Perez indicated he was prepared to make a motion. Mr. Kraus asked if participants would continue to be eligible to participate in the LACERS Larger Annuity Program. Mr. Montagna indicated they would. **A motion was made by Mike Perez, seconded by Shelley Smith, to approve eliminating annuity distributions from the menu of distribution options provided by the Plan, and to amend the Plan Document in accordance with the modifications recommended in the staff report; the motion was unanimously adopted**.

8. BOARD REPORT 09-45: STAFF REPORT

Mr. Montagna asked if there were questions on any of the items provided in the staff report. Mr. Perez asked if reports to City Council were typically sent only through the

Board Chairperson or the Board as a whole. Mr. Montagna indicated that the practice in the past had been to work with the Chairperson. Mr. Perez indicated this might be a topic for the Plan Governance Committee. Mr. Kraus asked if more detail could be provided with respect to the reasons for denial of hardship requests. Ms. Zuvich replied that this information could be provided. Mr. Cannon asked if some type of identification badge could be issued to him for the building. Ms. Basquez indicated she would look into this.

9. REQUESTS FOR FUTURE AGENDA ITEMS

Mr. Canzano noted the three projects that had been previously discussed: Proxy Share Voting, Refinement of Non-Contributing Participant Statistics, and Catch-Up Eligibility Notification.

10. NEXT MEETING DATE – AUGUST 18, 2009

Mr. Canzano indicated that the Board's September meeting would be canceled because of the NAGDCA Conference, so the next regular meeting would be in October.

11. ADJOURNMENT

The meeting adjourned at 11:17 a.m.

Minutes prepared by staff member Steven Montagna.