CITY OF LOS ANGELES
BOARD OF DEFERRED COMPENSATION ADMINISTRATION

ADOPTED MINUTES
REGULAR MEETING OF DECEMBER 19, 2006 – 9:00 A.M.
700 E. TEMPLE STREET, ROOM 350

Board Members:
Present:
Maggie Whelan, Chairperson
Bill Stein, Vice-Chairperson
Eugene Canzano
Richard Kraus
Rick Rogers

Staff:
Personnel: Maryanne Keehn, Personnel
Steven Montagna, Personnel
Bryan Cowitz, Personnel
Natasha Zuvich, Personnel
Richard Bobb, City Attorney

1. CALL TO ORDER

Maggie Whelan called the meeting to order at 9:05 a.m.

2. PUBLIC COMMENTS

None.

3. MINUTES

A motion was made by Richard Kraus, seconded by Bill Stein, to approve the minutes of November 21, 2006; the motion was unanimously adopted.

4. INVESTMENT PROVIDER PRESENTATION: WASHINGTON MUTUAL BANK

Milt Bledsoe of Washington Mutual Bank was present to review performance for the Washington Mutual Liquid Account and Certificates of Deposit (CDs). Mr. Bledsoe began by providing an overview of the Bank and its assets under management. He stated that the Bank worked with approximately 300 employer-sponsored plans and over $1.3 billion in assets with those employers. He further stated that as of April 1, 2006 FDIC insurance on individual accounts had been increased to $250,000.

Mr. Bledsoe then discussed the growth in the Bank's Deferred Compensation Plan assets since 2000, noting that they had grown sharply in the last year due to the increase in short-term rates of return. He then reviewed the rates for 2006 and noted the impact of the inverted yield curve. He reviewed some of the statistics concerning the accounts, including the fact that almost 10% of all Deferred Compensation Plan assets are held in the Washington Mutual accounts, that 11.5% of Plan participants contributed to their products, and that in the last year those products were the top two in terms of net cash flow.

Mr. Bledsoe next reviewed information regarding Washington Mutual's corporate philosophy and returning funds to the communities they serve. Mr. Canzano complimented Mr. Bledsoe on the strong evidence of Washington Mutual's progressive policies and corporate giving. Rick Rogers asked how decisions are made regarding where corporate giving is directed. Mr. Bledsoe responded that those decisions are made by regional managers who have more direct knowledge of local communities, and cited as an example a program in the Los Angeles area where the Bank provides zero or low-interest check-advance services to certain qualified individuals to help relieve them from the trap of interest-rate gouging by check-advance firms. Mr. Rogers asked why so much of the Bank's resources appeared to be directed to Los Angeles, and Mr. Bledsoe responded that much of the Bank's business comes from the large Los Angeles population.

The presentation then concluded.

5. BOARD REPORT 06-40: INTEREST EARNING OPTIONS REVIEW

Steven Montagna, along with Marina Batliwalla and Laurel Cochennet of Mercer Investment Consulting, presented their review of the Plan's interest earning options. Mr. Montagna introduced the discussion by reviewing the primary issues raised at previous Board meetings: whether the Plan's interest earning options were providing competitive rates of return and fully disclosed fees, and how the consolidation of the Plan's Hartford General Account and Galliard Stable Value Fund would be communicated. Mr. Montagna indicated that the broader question concerned identifying the appropriate mix of interest-earning choices which would allow the Board to achieve the highest rates of return in a variety of interest rate environments.

Ms. Batliwalla then compared some of the product differences of the various options. Mr. Montagna indicated that the options could be grouped into two general types, with the Washington Mutual Savings Account and Certificates of Deposit representing one class of offerings and the Galliard and Hartford funds offering another class. Ms. Batliwalla and Mr. Montagna both indicated that each product had different underlying investments and different rate-of-return expectations given different interest rate environments. They both referred to the current inverted yield curve as representing an atypical interest rate environment. Mr. Stein asked if there was an expectation as to how long the inverted yield curve would continue. Ms. Batliwalla and Mr. Montagna indicated that this was difficult to predict, but would likely be resolved once questions were resolved about the future course of the U.S. economy.

Ms. Batliwalla next reviewed current rates of return on each product. She noted that both the Washington Mutual Liquid Account as well as Certificates of Deposit compared favorably with rates obtained for other banks. She stated that the Galliard Stable Value Fund also compared favorably with other stable value products, but that a comparison of the Hartford General Account rate was not possible because no universe of meaningful comparisons exists for that product.

Ms. Batliwalla next turned to reviewing product fees. She noted that the only product for which a fee was known was the Galliard Fund. Mr. Montagna noted that the reason for this was that the Stable Value Fund was a separate account exclusively owned by the City and for which a specific investment management fee had been negotiated. He stated that by contrast the other three products represented investment pools in which the City was but one participant, and the providers of those products did not disclose their margin or profit on the asset pool as a whole. Ms. Batiwalla indicated that one of the benefits of utilizing a separate account as opposed to participating in a pooled fund was the transparency of fees.

Ms. Cochennet spoke next, first reviewing the reasons for the consolidation of the Hartford and Galliard products. She indicated that consolidating would reduce the credit risk on the Hartford funds by moving them out of Hartford's General Account and into a separate account. She further noted that consolidation would allow for a transparent investment management fee, greater Board control over the underlying investments, and increased liquidity for Plan participants interested in moving to other Plan investment options. She clarified that the consolidation really represented a two-step process in which Hartford funds would first be moved from the General Account to a separate account managed by Hartford, and the entire pool of assets would be record-kept as a single City of Los Angeles branded investment option which would reduce equity wash limitations, lower costs and be more user-friendly for Plan participants.

Ms. Cochennet then reviewed the communication strategy for informing participants about the change, including educating participants about why the change was being made and reassuring them that the change would not negatively impact them. She reviewed the key components of the education campaign, the timetable for implementation, the various media that would be used and the success factors for evaluating the success of the process.

Following this presentation, Richard Kraus indicated that it was important for participants to understand the reasons for the change and what was happening behind the scenes, as well as how the change would benefit them. He further indicated that it would be helpful to have a sense of what the interest rate impact would be at the time of fund consolidation. Mr. Stein asked again about expectations for a return to a more normal interest rate environment, indicating that his reason for asking was questions he had received from retired Plan participants regarding whether it made sense to move money out of the Galliard or Hartford products into the Washington Mutual products given the rate differentials and the equity wash limitations on direct transfers. Ms. Whelan asked how many participants were invested in the Hartford General Account; staff indicated that it did not have this information but that it could be obtained and disseminated to Board members. Vince Foley, retired from the Department of Water and Power, was present and asked if the minimum rate guarantee currently offered by Hartford would be eliminated once funds were transitioned to a separate account; Ms. Batliwalla indicated that it would go away, but noted that participants were paying for that rate guarantee in the form of higher fees.

6. BOARD REPORT 06-41: QUARTERLY INVESTMENT REVIEW

Marina Batliwalla and Terry Dennison of Mercer Investment Consulting were present to provide the results of Mercer's investment review for the quarter ending 9/30/06. Ms.

Batliwalla began by indicating that after January 1 she would be turning over her projects with the City to Mr. Dennison, as she was taking on a more limited role with Mercer.

Mr. Dennison began by indicating that the City offered a broad array of investment choices to its Plan participants. He directed the Board's attention to the high-level summary on page 6 of the report which indicated whether the City's various offerings were performing at a satisfactory or unsatisfactory level. He noted that two funds, Fidelity Magellan and Lotsoff Small Capital Equity, continued to demonstrate serious performance problems and that Mercer was moving close to issuing a recommendation to terminate those funds.

Mr. Dennison then proceeded to describe why Mercer focused on three- and five-year performance figures and how its compliance table on pages 13-14 should be interpreted. He stated that under-performance was denoted by a red "x" but that this did not indicate the degree of under-performance. Mr. Rogers asked for clarification of Mercer's procedural methodology. Mr. Dennison indicated that Mercer's assessment of whether a fund should be replaced or retained was based on a number of factors including performance, fund management changes and investment process concerns.

Mr. Dennison next discussed each of the City's funds where under-performance was noted. In the process of doing so he explained how the Board should look at the Fund Profile pages for each fund, one of which described the excess return or loss for a fund compared to its benchmark over various time periods, and the other which assessed returns relative to the risk assumed by the fund. Mr. Dennison indicated that the Hartford Advisers Fund, the Capital Guardian U.S. Equity Fund, the Hartford Stock Fund, the American Funds Growth Fund of America and the Fidelity Diversified International Fund all had performance issues which were of modest concern and should be monitored, while the Fidelity Magellan Fund and Lotsoff Small-Cap Equity Fund had more serious long-term performance or investment process issues which might generate a termination recommendation in the near term.

Mr. Dennison's presentation then concluded.

7. BOARD REPORT 06-42: AUTOMATIC ENROLLMENT

Mr. Montagna asked if there were questions or comments regarding the staff report. Mr. Kraus commented that in looking at the issue of which Plan fees should be reduced or eliminated he believed that automatic enrollment strengthened the argument for eliminating the fifty-cent fee, since auto enrollment might otherwise be interpreted to be imposing that fee on employees. Ms. Whelan asked what the fifty-cent fee was used for. Mr. Montagna replied that presently it was used to pay for the Personnel Department's administrative costs as well as consulting fees and travel expenses, but now that the Plan's budget accounts had been consolidated for reporting purposes those expenses could just as easily be paid from surplus funds obtained from the Great-West administrative fee.

Mr. Canzano indicated that he was interested in further exploring the possibility of an auto enrollment program which utilized a percent of pay rather than a specified dollar amount. Mr. Kraus similarly indicated that he wasn't sure whether a flat dollar amount could address the needs of employees hired at various salary levels, meaning that more highly compensated employees might need a higher contribution amount to have mandatory enrollment provide a meaningful benefit. Mr. Montagna indicated that the $25 example included in the staff report was only illustrative, and that the Board would need to determine a contribution level with which it was comfortable and balanced the needs of different groups of participants.

The Board's legal counsel, Richard Bobb, indicated that with respect to the recommendation in the report regarding securing a legal opinion from the City Attorney's Office on auto enrollment, this was likely to take months given the process involved in generating a formal legal opinion from his office. He indicated that in the interim he would be conducting research with other resources to see if he could at least provide some preliminary information to the Board in the near term.

Following this discussion, **a motion was made by Bill Stein, seconded by Gene Canzano, (a) endorsing establishment of an auto enrollment program for the City's Deferred Compensation Plan; (b) requesting a response from the Office of the City Attorney regarding the question of what barriers exist in State law to the City being able to offer auto enrollment; and (c) once a response is received from the City Attorney, directing staff to return to the Board with recommendations for follow-up action; the motion was unanimously adopted**.

8. BOARD REPORT 06-43: BUDGET STATUS REPORT-09/30/06

Mr. Montagna indicated that the Plan's surplus had grown to $2.5 million, and that further discussion on the topic of fee reductions would take place in the Plan Governance and Administrative Issues Committee meeting scheduled in January. **A motion was then made by Rick Rogers, seconded by Bill Stein, (a) receiving and filing the status report on Deferred Compensation Plan budget accounts for the quarter ending 9/30/06; and (b) approving reimbursement from the Deferred Compensation Plan Trust Fund #896 to the Personnel Department for $55,516.61 for the quarter ending 9/30/06; the motion was unanimously adopted.**

9. BOARD REPORT 06-44: STAFF REPORT

Mr. Montagna asked if there were questions regarding the various items identified in the report. Hearing none, the item was noted as having been received and filed.

10. HARDSHIP APPLICATIONS

The Board first considered those hardship applications recommended for approval. **A motion was made by Bill Stein, seconded by Gene Canzano, to approve a full hardship withdrawal in Case No. 06-52 and partial withdrawal of $4,583 (net) in Case No. 06-58; the motion was unanimously adopted.**

The Board next considered Case No. 06-53. The applicant was present. Board members debated whether the applicant's family emergency could be approved for hardship given the travel and related expenses incurred by the applicant's spouse. **A motion was made by Bill Stein, seconded by Gene Canzano, to approve a full withdrawal in Case No. 06-53; the motion was unanimously adopted.**

The Board next considered Case No. 06-54. The applicant was present. Board members debated the question of whether the ending of a non-spouse relationship could be considered an unforeseen event. **A motion was then made by Gene Canzano, seconded by Rick Rogers, to approve a withdrawal sufficient for the applicant to keep current on his mortgage payment; the motion was adopted by a vote of 4-1 (Canzano, Kraus, Rogers, and Whelan in favor; Stein opposed).**

The Board next considered Case No. 06-56. The applicant was present. Board members debated whether the applicant having allowed her car insurance to lapse negated the consequences of her car accident. Staff clarified for the Board that the applicant had received a previous hardship withdrawal and been reimbursed for income loss she'd suffered as a result of a disability. **A motion was made by Richard Kraus, seconded by Gene Canzano, approving a partial hardship withdrawal in the amount of $7,395.70; the motion was adopted by a vote of 4-1 (Canzano, Kraus, Rogers, and Whelan in favor; Stein opposed).**

The Board next considered Case No. 06-57. The applicant was present. Staff indicated that the case raised the possibility of a community property interest claim on the part of the applicant's spouse, who was not living with him. Mr. Bobb was asked whether the Board could approve a hardship withdrawal in these circumstances. Mr. Bobb replied that given the applicant had apparently filed divorce proceedings, something from the court would need to be received indicating that the wife was waiving her community property interest. Given the inability to form consensus around an action, Mr. Montagna suggested that the matter be held over one month to provide the applicant with an opportunity to obtain the necessary court documents and for staff to obtain more information. **A motion was made by Bill Stein, seconded by Rick Rogers, to defer consideration of Case No. 06-57 until the Board's January 16, 2007 meeting; the motion was unanimously adopted.**

The Board next considered Case No. 06-55. The applicant was not present. **A motion was made by Bill Stein, seconded by Richard Kraus, to deny the application in Case No. 06-55; the motion was unanimously adopted.**

11. REQUESTS FOR FUTURE AGENDA ITEMS

Gene Canzano asked about the possibility of allowing Plan participants to sign up to have their Plan contributions adjusted automatically to each year's applicable annual limit. Mr. Montagna indicated that Great-West was working on automatic increase functionality but that he would ask that they produce a report for the next Board meeting.

12. NEXT MEETING DATE – JANUARY 16, 2007

12. ADJOURNMENT

The meeting adjourned at 12:15 p.m.

* Minutes prepared by staff member Steven Montagna