CITY OF LOS ANGELES
BOARD OF DEFERRED COMPENSATION ADMINISTRATION

APPROVED MINUTES
REGULAR MEETING OF JUNE 15, 2010 – 9:00 A.M.
700 E. TEMPLE STREET, ROOM 350

BOARD MEMBERS:

Present:	**Not Present:**
Eugene K. Canzano, Chairperson	Sangeeta Bhatia
Richard Kraus, Vice-Chairperson	
Sally Choi, First Provisional Chair	
Cliff Cannon, Second Provisional Chair	
Maggie Whelan, Third Provisional Chair	
John R. Mumma	
Michael Perez	

Staff:

Personnel:	Alejandrina Basquez Steven Montagna Natasha Gameroz Claudia Guevara
City Attorney:	None

1. CALL TO ORDER

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

2. PUBLIC COMMENTS

None.

3. MINUTES

Mr. Kraus noted several corrections to the minutes (regarding a description he provided under the Investment Menu agenda item, the notation of when a Board member entered the meeting, a word choice made by a comment from Ms. Whelan under the Annual Report discussion, and a statistic used under the Quarter Report discussion). **A motion was then made by Richard Kraus, seconded by Mike Perez, to adopt the minutes of the 05/18/10 Board meeting, as amended; the motion was unanimously adopted.**

4. INVESTMENT PROVIDER PRESENTATION: HARTFORD LIFE INSURANCE

Peter Ganey and Tim Baker, both with Hartford Life Insurance, were present to review performance for the Hartford Capital Appreciation Fund. Mr. Ganey began by indicating that Hartford has a 30-year relationship with Wellington Management to sub-advise Hartford funds. He stated that Wellington manages $562 billion, with $70 billion managed in Hartford variable annuity and non-annuity products.

Mr. Baker then discussed the Capital Appreciation Fund. He indicated the management structure of the Fund lends itself to building and retaining experienced personnel, with 17 out of 113 of its analysts currently partners in the Fund. He stated that Saul Pannell is the portfolio manager and manages 51% of assets, with the balance spread out in sleeves over a fluctuating range of other managers. Mr. Perez asked for additional description of the sleeve system. Mr. Baker replied that these other managers have expertise in particular areas such as mid-cap stocks, large company value stocks, and international stocks, and that a portfolio manager is responsible for assigning assets within these sleeves, and the number of sleeves can vary.

Mr. Baker went on to indicate that Wellington takes a bottom-up approach, conducting over 5,000 manager meetings per year. He stated the Fund's focus is on finding value opportunities with a target for price appreciation of at least 25% above the current market price. He indicated if a given stock is not able to provide that kind of opportunity it will not be purchased and that managers are less concerned with risk than upside potential, but there's an inherent risk hedge built in with this disciplined focus on value. He further indicated the Fund is designed to outperform in any environment, but that it does better in strong economic periods. He stated 70% of the Fund's holdings are in large-cap stocks and compared fund sector weightings with the benchmark S&P 500, noting higher weightings in consumer discretionary items, health and technology, and lower weightings in consumer staples/energy. He stated the Fund's average P/E ratio was below the benchmark, and its 5-year projected growth was above the benchmark.

Mr. Kraus asked if the Fund was always fully invested. Mr. Baker replied that the Fund, by its prospectus, could go as high as 10% cash but that typically it was below 5% and currently was at approximately 2-3%. Mr. Kraus asked about the percentage that could be devoted to international stocks. Mr. Baker replied that the Fund could invest up to 35% of its holdings in international companies. He further stated that the Fund reached 34% in 2008 before pulling back, that it fell to 27% in 2009 and was presently back up to 30%. He indicated that the view of the team was that they were agnostic on the issue of nation of origin but were simply looking for the best companies.

Mr. Baker next discussed the Fund's top 10 holdings, indicating that Ford, Wells Fargo, and Apple were some of the prominent names. He discussed performance returns, indicating the Fund had outperformed its benchmark in virtually all time periods reviewed, lagging the benchmark only once in the past ten years. He stated that over 3-

year or longer time periods the Fund had been in the top quartile or better, and that exposure to international stocks had hurt with the second phase of the credit crisis.

Mr. Mumma asked if the benchmark beta is always 1, and Mr. Baker replied that it is, and that the portfolio's beta is higher than the benchmark. Mr. Perez asked if the Fund should consider using a different benchmark, and Mr. Baker replied that the S&P 500 is highly correlative to the Fund. Mr. Mumma asked if the Russell 3000 was a large-cap index, and Mr. Baker replied that it was an all-cap index. Mr. Perez commented that many funds have growing exposure to international stocks. Mr. Baker replied that many international firms derive high percentages of their revenues from the U.S. Mr. Mumma asked about the fees and share class for the City's holdings. Mr. Baker indicated that the City's shares were in the 1A share class, which had the lowest expense ratio.

The presentation then concluded.

5. BOARD REPORT 10-18: INVESTMENT MENU

Steven Montagna indicated that the discussion for this meeting was regarding the Plan's Mid-Cap Core Fund in the re-designed investment menu, and that the International Fund would be addressed next month. Susan Dalton of Mercer Investment Consulting indicated that a portfolio with equal weightings of value and growth was the best option because of long-term benefits related to risk and return. She indicated Mercer was presenting options varying from 100% passive to 100% active management, and that at different times either value or growth would outperform, however both should have similar return characteristics over longer periods. She stated that in that there was not a significant difference as far as return and risk were concerned for the 50% passive vs. 33% passive options, Mercer believed the 50% option made sense as a way to limit management expenses.

Mr. Canzano indicated his view that there was little reason to take on the added risk after comparing the 50% passive vs. 33% passive options, and he supported the former. Ms. Choi indicated she too was in favor of the 50% option due to the level of risk and return being almost identical and fee savings. Ms. Dalton stated that after reviewing fifteen years of data it appeared Mercer tends to produce more value through the addition of growth managers versus value managers, although she had no definitive explanation for this, she suspected that in the value space Mercer tends to favor financials. Mr. Kraus indicated that if he understood everything correctly it was very important to choose the right active manager. Ms. Dalton responded that Mercer and the Board will have to ensure the active manager would have the right characteristics and best blend in order to add value. Mr. Kraus asked whether it was more likely to get funds that are pure in their distinction between value and growth to avoid blurring the two. Ms. Dalton responded affirmatively.

Mr. Mumma asked Ms. Dalton to explain the tracking error on page six. Ms. Dalton responded that tracking error was deviation from the benchmark. Mr. Cannon added that the difference is between the arithmetic versus geometric assessment. Ms. Dalton responded that the geometric analysis would take into consideration the timing and compounding, whereas the arithmetic would indicate the pure return values.

Following this discussion, a motion was made by Michael Perez, seconded by Sally Choi, approving replacement of the Plan's current Mid-Cap investment fund with a new "DCP Mid-Cap Stock Fund" which would be 50% passively managed, 25% active growth and 25% active value; the motion was unanimously adopted.

6. QUARTERLY INVESTMENT PERFORMANCE REVIEW

Susan Dalton of Mercer Investment Consulting presented Mercer's performance review for the period ending March 31, 2010. She indicated she wished to disclose that her firm had recently settled litigation with the State of Alaska. She further stated the State had sought $2.8 billion in damages but Mercer settled for $500 million without admitting wrongdoing and did so out of a determination it was in the best interests of its shareholders. Mr. Mumma asked if the issue was related to a change for the State's employees to a defined contribution system, and Ms. Dalton replied that it did not.

Ms. Dalton then presented her report. She indicated that only one fund was currently receiving a designation of Unsatisfactory. Mr. Perez asked if the Plan's policies for fund removal addressed a situation where a fund was beating its benchmark over one time period but not another. Ms. Dalton replied that Mercer's recommendations in those instances would be more qualitative in nature. Mr. Perez asked whether that policy should be reconsidered. Mr. Montagna indicated that the policy could be revisited with the change to the new investment lineup, with perhaps some efforts made to accelerate the speed with which the Plan acted during periods of under-performance.

Ms. Dalton next reviewed Plan asset holdings and a comparison of fees vs. industry averages. She indicated that Vanguard Bond Index holdings had qualified for a lower expense ratio, from eight to five basis points, on June 7th. Mr. Mumma asked what triggered the lower expense ratio. Ms. Dalton replied the appreciation of the holdings to a certain level of assets. Mr. Mumma asked if the Plan now had the lowest expense ratio. Ms. Dalton replied that she believed it did.

Ms. Dalton next proceeded to review each of the City's funds, noting that Investment Company of America had experienced some near-term under-performance, falling from the 10th decile to 99th, but that this was viewed as an anomaly, and that Growth Fund of America had also under-performed near-term. She stated that all of the Plan's asset allocation funds were performing as expected. Mr. Kraus questioned whether some of the numbers listed on page 24 should be in red to indicate having under-performed the benchmark and universal median. Ms. Dalton indicated they should, although David Luo, also of Mercer Investment Consulting and who was attending the meeting, subsequently indicated that Mercer's practice was to use red only if the under-performance was at a certain level or higher. Mr. Kraus also asked if footnotes could be added.

Ms. Dalton next discussed the Lazard Mid-Cap Fund. She indicated the Fund tended to under-perform during low-quality rallies, one of which had occurred over the past year. She stated that its more recent performance had improved as higher quality stocks were coming back into focus and could be better positioned in future quarters if the market's emphasis shifted back to quality stocks. She stated the Plan should search for a lower-cost EAFE index fund in conjunction with its changes to the core investment menu. Mr. Kraus asked if it was possible to generate a measurement of alpha relative to a fund's expense ratio. Ms. Dalton indicated that this could be reviewed.

7. BOARD REPORT 10-19: THIRD-PARTY ADMINISTRATOR REQUEST FOR PROPOSAL

Mr. Montagna indicated staff was proposing a calendar of events for development and consideration of a Request for Proposal (RFP) for third-party-administration of the City's Deferred Compensation Plan. He stated the first action item in the calendar was a discussion of disclosure and conflict of interest issues, which would take place the following month. Ms. Choi indicated there would probably be some level of disclosure necessary with communications between the Board members and potential vendors.

Mr. Perez indicated he did not know what the last RFP process consisted of but understood there was some level of controversy. He stated he would like to know whether the Board as a whole was satisfied with the work from the current third-party administrator, and if that was the case whether a Request for Information (RFI) might be a possible alternate process. He indicated Pensions had done something similar with its Custodian Bank, but if there was sufficient reason he would be comfortable conducting a full-fledged RFP.

Ms. Choi asked how often the Plan must issue an RFP. Mr. Montagna responded that in the past contracts for the third-party administrator have been written for five years and that the current five-year contract expired December 2011. He stated that any extension beyond five years would need Council approval. Mr. Canzano indicated the Plan did not have any controversy during the 2006 RFP process, but rather the 2004 process. Mr. Cannon indicated he recalled that the City Council mandated review of the contract. Mr. Montagna responded that the typical City personal services contract is three years unless Council gives authority to exceed that term. He further indicated that the Board went to Council in 2004-05 to request a blanket authority to write all Plan contracts for five years, and that Council granted this authority for investment management contracts but Councilmember Parks had reservations applying this to the third party administrator contract, so that contract was omitted. Mr. Montagna stated staff would only be able to issue a three-year contract unless Council approved authority for five years. He added that due to the complexity associated with these services and the resources required in issuing an RFP, the Board had typically issued this contract for a five-year term.

Ms. Whelan indicated she believed the Board should have more independence given the Plan did not use City funds, and asked about the possibilities of asking the City Attorney about using an RFI. Mr. Montagna indicated this could be done but did not believe the City Attorney would find that the Board had unilateral authority to extend the current contract. Ms. Choi asked if the Board could issue two three-year contracts instead of one five-year contract, whereby the Board could decide after three years whether the contract should be extended an additional three years, a practice utilized by LACERS. Mr. Montagna responded that to his understanding a department can write an RFP with an option to renew for an additional three years but anything beyond an initial three-year term would still require Council approval. Alex Basquez indicated her understanding was that an RFP must be issued every three years unless there was City Council approval, but staff could pose this question to the City Attorney. Ms. Whelan asked Ms. Choi for more information regarding the LACERS process. Ms. Choi responded that LACERS' contracts are approved for three years with an option to renew for an additional three years, and at the end of the first term the Board and staff evaluate performance and if it is deemed satisfactory, the second three-year term goes into effect. She indicated after the second three-year term an RFP would be issued. Ms. Whelan asked whether LACERS then goes to Council. Ms. Choi indicated no.

Mr. Perez indicated Pensions is similar except they do not have limitations on the number of options. He added that as long as staff and the Board establish that this is the best course and are exhibiting proper due diligence (when comparing the fees, relationships with other funds, etc.) they can move forward. He indicated that as fiduciaries, it is their duty to monitor the system; however if the Board relinquishes authority and submits consideration to Council, there is some potential that Council can override decisions that the Board has already established. Ms. Choi added that the approach described by Mr. Perez might be feasible unless the Council is deemed the ultimate fiduciary.

Mr. Mumma agreed with both Mr. Perez and Ms. Choi and since City money is involved in the pension systems, and they do not have to return to Council every three years, he believed the same should apply for the Deferred Compensation Plan, especially since the Plan incurs no cost to the City. Ms. Whelan noted the problem is with the City Charter, which creates specific authority for the retirement plans but does not mention the Deferred Compensation Plan, nothing that she wasn't even sure if the Ordinance had a clear definition of the Board's authority. Ms. Choi stated the Board should have fiduciary counsel review this information and if the Plan is in fact a trust, the Plan should follow the laws associated accordingly. Mr. Montagna responded that Plan assets have been placed into a trust based on an ordinance prepared by the City Attorney.

Mr. Canzano indicated that from his experience as a DWP Retirement Board member, he could not recall a time when DWP Employee Retirement System could extend past a three-year term. Mr. Cannon indicated that it seemed like this conversation has been addressed before and that the City Attorney needed to review this matter once again. Ms. Choi indicated that the Board needed an official legal opinion on the issue. Ms. Whelan agreed.

Mr. Kraus indicated he was unclear on the steps Council took to overrule the Board during the Nationwide situation and whether it required the RFP be reissued. Mr.

Montagna responded that the only power Council had was to veto the decision of the Board and return the decision for reconsideration. He stated Nationwide based its lawsuit on the proposition that Council did not have the authority to veto the decision because the City's Plan was the same as a retirement/pension plan, but the court did not make a determination on this because the case was dismissed on a technicality.

Mr. Perez indicated that this issue might need to be sent to outside counsel. Ms. Whelan asked if it was possible to have LACERS/Pensions assist with the cost for outside counsel. Ms. Choi indicated such an expenditure should be paid from the Plan's reserve account. Mr. Perez indicated a similar scenario took place with Pensions when their Board approved contracts using an outside counsel. Ms. Choi indicated their outside counsel are fiduciaries to the system and not the City, and perhaps the Plan could piggy back on current outside counsel contracts. She indicated LACERS currently has three firms under contract. Mr. Perez and Mr. Mumma indicated they did not believe it was the responsibility of Pensions to fund the Plan's outside counsel. Ms. Whelan stated the Board should draft a letter to the City Attorney requesting an opinion and also raise the possibility of using outside counsel due to potential conflict of interest.

Mr. Kraus asked whether this issue could be addressed with the other large California plans. Mr. Montagna indicated he could do so. Ms. Choi suggested an ordinance change may be involved depending on the response of the City Attorney. Mr. Montagna indicated the Board may wish to return to Council to once again seek increased discretion to execute Plan contracts. Ms. Choi indicated her concern that the Trustee issue related to the question of personal liability. Mr. Perez agreed that the Board needs to return to Council with this question as well as agreeing with Ms. Whelan and her letter inquiring into additional consultation from the Office of the City Attorney.

Mr. Montagna asked the Board to approve the initiation of the RFP process so that time was not lost pending investigation of the other issue. Ms. Basquez asked to clarify that the Board would like to determine the feasibility of issuing RFI instead of a RFP and options available with respect to the length of the current contract. Mr. Canzano concurred with Ms. Basquez.

Following this discussion, a motion was made by Margaret Whelan, seconded by Michael Perez, approving staff's proposed calendar for developing, issuing and evaluating a Request for Proposal (RFP) for Third-Party-Administrator services for the Deferred Compensation Plan, and directing staff to begin developing the RFP and Board reports in accordance with the proposed calendar; the motion was unanimously adopted.

Ms. Whelan left the meeting after consideration of this item.

8. BOARD REPORT 10-20: DEFERRED COMPENSATION PLAN BUDGET STATUS REPORT FOR QUARTER ENDING 03/31/09

Natasha Gameroz presented a budget reconciliation report for the quarter ending 03/31/10. She indicated staff was recommending reimbursements for the staffing support services provided to the Plan. She further noted that the reserve fund's projected surplus over the next five years was above the Board's targeted surplus level of $1.5 million. Mr. Mumma asked what services DWP performed in support of the Plan. Ms. Gameroz indicated the Plan reimbursed 5% of a Senior Clerk Typist salary for entering deductions for contributions and loans and handling corrections on the DWP payroll system, but that recently the Plan had received access to the DWP payroll system and these services would be phased out. Mr. Canzano asked where hardship processing fees were included in the report. Mr. Montagna indicated the figures provided by Great-West were net of these expenses, but staff could create a line item.

Following this discussion, **a motion was made by Richard Kraus, seconded by Michael Perez, to (a) receive and file the status report on Deferred Compensation Plan budget accounts for the quarter ending 3/31/10; and (b) approve reimbursements from the Deferred Compensation Plan Reserve Fund accounts to the Personnel Department for $91,389.79; City Attorney for $26,605.87; and DWP for $1,397.51; the motion was unanimously adopted.**

9. BOARD REPORT 10-21: STAFF REPORT

Mr. Montagna indicated he had attended the first meeting of the California Large Defined Contributions Plan in Sacramento, and that the meeting had been productive and inspired ideas for cooperative action between the plans. He further indicated that the notice regarding opening up advisory services to participants in the Self-Directed Brokerage Option (SDBO) would shortly be released.

10. REQUESTS FOR FUTURE AGENDA ITEMS

Mr. Canzano requested that staff review and report back regarding options for fiduciary training for Board members.

11. NEXT MEETING DATE – JULY 20, 2010

12. ADJOURNMENT

A motion was made by Richard Kraus seconded by John Mumma, to adjourn the meeting; the motion was unanimously adopted. The meeting adjourned at 11:39 a.m.

Minutes prepared by staff member Steven Montagna and Natasha Gameroz.