CITY OF LOS ANGELES
BOARD OF DEFERRED COMPENSATION ADMINISTRATION

PROPOSED MINUTES
MEETING OF FEBRUARY 19, 2019
700 E. TEMPLE STREET, ROOM 350

BOARD MEMBERS

Present:
John Mumma, Chairperson
Raymond Ciranna, First Provisional Chair
Thomas Moutes, Vice-Chairperson
Robert Schoonover, Second Provisional Chair
Wendy G. Macy, Third Provisional Chair
Joshua Geller
Hovhannes Gendjian
Linda P. Le

Not Present:
Neil Guglielmo

PERSONNEL DEPARTMENT STAFF
Jody Yoxsimer – Assistant General Manager
Steven Montagna – Chief Personnel Analyst
Isaias Cantú – Senior Management Analyst II
Daniel Powell – Personnel Analyst
Kevin Hirose – Personnel Analyst

OFFICE OF THE CITY ATTORNEY
Curtis Kidder – Assistant City Attorney

MERCER INVESTMENT CONSULTING
Devon Muir – Principal
Ana Tom-Chow – Associate

VOYA FINANCIAL
Michelle Williams – Vice President, Strategic Relationship Management

1. CALL TO ORDER

John Mumma called the meeting to order at 9:04 a.m.

2. PUBLIC COMMENTS

There were no public comments.

3. MINUTES

A motion was made by Hovhannes Gendjian, seconded by Thomas Moutes, to approve the minutes of the January 15, 2019 meeting; the motion was unanimously adopted.

4. INVESTMENT MANAGER PRESENTATION

The presentation from Voya Investment Management (Voya) on the DCP Mid-Cap Opportunities Fund Portfolio (Portfolio) was provided by Jeffrey Bianchi, Head of Growth and Portfolio Manager, and Ryan Jusko, Vice President Institutional Client Advisor. Mr. Bianchi began by providing a historical overview of Voya and indicated that he has managed the Portfolio since 2005 and as of quarter ending December 31, 2018, the Portfolio had approximately five billion dollars of assets under management. He stated assets are strong although Voya has stopped selling annuities and so as annuity holders retire there is a natural runoff of assets.

Mr. Bianchi explained Voya's view on portfolio management and the importance of having a method to determine how a stock is different from other similar stocks and what its advantages are, in order to outperform the benchmark. He indicated that growth expectations are the biggest drivers of stock valuation throughout the year. He explained in order to determine the future value of a stock, Voya makes a determination on the expectations embedded in the value of a stock, conducts research to understand future expectations in the value of a stock, and determines the advantages of picking stocks that can produce strong returns for the Portfolio. He reviewed Voya's quantitative disciplined investment process, the characteristics and selection of stocks, and the determination of risk level in the overall holdings. He indicated the process allows the Portfolio to have a well-balanced risk profile. He further stated the Portfolio contains 70 to 90 stocks and a tracking error relative to the benchmark of 4% to 6%. He stated 70% to 80% of Portfolio risk comes from stock-specific risk rather than sector risk.

Mr. Bianchi reviewed Portfolio performance and provided an overview of the top ten active weights in the Portfolio. He stated the active weights are comprised of durable growth, high quality companies with good free cash flow characteristics, and stocks less cyclical than the benchmark. He stated that even if the economy deteriorates, the stocks should still have the ability to grow. He reviewed the Portfolio's valuation metrics and indicated that those fluctuate throughout time. He stated current data indicates the Portfolio's price/earnings ratio and earnings per share growth is slightly less than the benchmark and that stock valuation and growth rates can fluctuate away from the benchmark depending on market opportunities for growth. Mr. Bianchi indicated the Portfolio's holdings were sector neutral relative to the benchmark.

Raymond Ciranna asked if the Portfolio had a tendency to go outside the benchmark or if current sector allocation percentages are typical. Mr. Bianchi responded that current allocations are typical and that Voya targets specific sector stocks that have the best opportunity to outperform the benchmark.

Mr. Bianchi reviewed Portfolio performance attribution from January 1, 2018, through December 31, 2018, and stated the Portfolio underperformed the market by 206 basis points. He stated the big detractor came from the Industrials sector. He indicated Voya underestimated the degree to which cyclical stocks would decline during 2018, particularly in the housing industry. He stated that the housing industry had been seeing strong price increases and strong demand, and that Voya thought earnings would rise but this did not end up being the case and those holdings underperformed. He indicated the housing stocks that underperformed are no longer contained in the Portfolio and Voya has moved to late cycle stocks, such as those found in the aerospace industry.

Mr. Mumma inquired if the Portfolio's strategy would be adjusted as a result of the potential impact of tariffs from China. Mr. Bianchi responded that there are concerns over tariffs; however, it is anticipated that the tariff situation with China will be resolved with a relatively low consequence to the overall economy. He indicated that Voya's view for 2019 is that earning expectations will fall and leading economic indicators turn negative. He stated the Federal Reserve indicated that they would not raise interest rates.

Mr. Ciranna called attention to the Portfolio's performance and requested explanation regarding performance against the benchmark. Mr. Bianchi responded that in 2013 and 2014 the strategy had underperformed based in part on its exposure to commodity stocks and stated that Voya changed its strategy and reduced exposure to commodities. He stated the emphasis had shifted to growth areas, such as technology and consumer discretionary stocks.

Mr. Moutes asked for additional explanation regarding the five-year and ten-year returns, as they indicated significant underperformance relative to the benchmark. Mr. Bianchi responded that the last ten years have been unprecedented for investors due to the monetary stimulus and its effect on stock valuations, which hindered the Portfolio from outperforming the benchmark. He stated that the Federal Reserve indicated the monetary stimulus will end which will provide greater opportunities to outperform the benchmark.

Devon Muir commented that over the five- and ten-year period approximately 75% and 85% of managers have underperformed the index, respectively, and asked if Voya sees structural issues with the benchmark that make it difficult for this strategy to achieve returns equal to or better than the benchmark. Mr. Bianchi responded by indicating that Voya was hired to outperform the benchmark, regardless of the situation. He indicated the biggest challenge in keeping up with the benchmark was a result of overall monetary stimulus which resulted in many stocks rising indiscriminately without regard to their underlying value.

Mr. Ciranna commented that performance over the last ten-year period suggests the DCP would have been in a better position if the City's Mid-Cap fund had been 100% passive. Mr. Bianchi explained that risk assets had positive performance over the last ten years because of the monetary stimulus. He indicated that the Portfolio's value orientation and stock-picking discipline provides greater protection in a declining market, which investors do not take into account in a bull market.

Mr. Gendjian inquired if Voya believes its selection process needs to be altered. Mr. Bianchi responded the stock selection process will remain the same but that performance attribution is reviewed on a five-year basis and Voya also continuously reviews analyst performance and team composition.

5. QUARTERLY INVESTMENT & ECONOMIC REVIEW: DECEMBER 31, 2019

Mr. Muir, Principal from Mercer Investment Consulting (Mercer) presented the Performance Evaluation Report for the Fourth Quarter of 2018. At the Board's request, he began with his analysis of Voya's performance. He stated that over a ten-year period the Portfolio's performance was at 14.1% and in the 26th percentile of active mid-cap growth managers, which underperformed the benchmark return of 15.1%. He explained the DCP Mid-Cap Stock Fund is a blended construction, with 25% allocation to Active Mid-Cap Growth, 25% Active Mid-Cap Value, and 50% to passive funds. He stated that Voya on an absolute basis delivered strong returns compared to its peer group of active managers and over five- and ten-year periods. He stated that having an active manager to provide some level of downside protection is of value.

Mr. Geller asked if the Board's investment manager selection process should be modified to allow for greater control by the Board of the investment managers during market changes. Mr. Muir responded that the City's process is deliberate and thorough. He stated that the Board revisited the Investment Policy Statement recently and reviewed the constructions and allocations of the investment models. He indicated that there was downside protection during the last quarter and despite the negative equity markets, the DCP Mid-Cap Stock Fund showed positive results. He indicated saving money on the downside, even 1% or 2%, can produce significant compounding effects over the long term. Mr. Ciranna asked for explanation of Mercer's analysis regarding Voya's information sheet. Mr. Muir replied by explaining five-year statistics relating to returns, the Alpha underperforming the benchmark, and the Beta market level exposure.

Mr. Muir next reviewed overall market performance and stated that performance was negative in the fourth quarter. He indicated the key theme for the quarter was that value stocks tended to protect a little more in a declining market than growth-oriented stocks. He stated Large-Cap stocks (as represented by the Russell 1000 benchmark) tended to perform better than Small-Cap stocks (as represented by the Russell 2000 benchmark), and that international stocks (as represented by the MSCI EAFE benchmark) performed better than U.S. stocks. He stated in the fixed-income category, Treasuries performed well due to the risk-off market. He commented that the price of oil was down 40% for the quarter and commodity indices were down 10% to 23%.

In discussing Plan statistics, Mr. Muir indicated the DCP ended the year at $6.037 billion and fourth quarter assets decreased by approximately $586 million, quarter over quarter, due to investment losses. He stated the DCP had 46,899 participants with account balances and the average account balance was $124,467. He reported that as of trading at the end of February 14, 2019, assets were back up to $6.454 billion. He indicated the DCP Mid-Cap Stock Fund was up 13.4% and the Small-Cap Stock Fund was up 15.9% year to date. He reported on assets within the Profile funds and stated the Conservative Profile Fund was up 4.3% and the Ultra-Aggressive Profile Fund was up 10.7% year to date.

Mr. Muir next reported on the allocation of assets in the DCP. He stated that Stable Value Fund holdings grew to 19.1%, to the result of equity market declines and participant transfers into the option. He reported the DCP Large-Cap Stock Fund continued to be the single largest option at 29.9% and as a group the Profile funds were at 19.1%.

Mr. Muir reported on investment expenses and stated Mercer monitors the fund net expense ratio, which is 18 basis points inclusive of three basis points of revenue sharing deducted from the overall expense ratio. He stated that 23 basis points is the weighted average cost after administration is included, which is a very competitive cost level. There were no further questions from the Board.

6. BOARD REPORT 19-05: FDIC-INSURED SAVINGS ACCOUNT CREDITING METHODOLOGIES AND PROVIDER SELECTIONS

Daniel Powell reported that at its December 18, 2018, meeting the Board reviewed staff's report on responses to the Request for Proposal (RFP) for FDIC-Insured Savings Account providers. He stated the Board directed staff and Mercer to review the potential for establishing a common crediting methodology and crediting contingencies for the service providers. He stated that two of the providers were based on the London Interbank Offered Rate (LIBOR) index rate, with the third based on the Federal Funds rate. He explained that LIBOR may be discontinued or altered during the five-year term of the FDIC contracts.

Mr. Powell stated that Mercer and staff contacted the three providers to discuss crediting methodologies. He explained that East West Bank's crediting rate was consistent with the rate provided under its current contract with the City but that East West Bank had indicated it was a rate not being offered to new businesses. He stated MUFG Union Bank was not able to offer a crediting methodology different than what they included in their RFP response. He stated that Bank of the West agreed to modify its crediting methodology and offer three-month LIBOR less 15 basis points, the same methodology used by MUFG Union Bank.

Mr. Powell stated that staff recommended the Board move forward with approving selection of the three providers but provide that the contracts include provisions relating to the final rate crediting methodologies and provisions for negotiating and implementing a LIBOR replacement index.

Mr. Muir stated the three providers were skeptical about LIBOR ending due to the volume of transactions tied to it. He stated it was reasonable for the DCP to have a contingency plan built in to the contract to allow for uniformity among the providers should LIBOR cease to exist.

Following this discussion, **a motion was made by Mr. Ciranna, seconded by Mr. Moutes, to (a)**

receive and file report regarding crediting methodology proposals from Bank of the West, East West Bank, and Union Bank; (b) select Bank of the West, East West Bank, and MUFG Union Bank as providers for the DCP FDIC-Insured Savings Account for five year contract terms beginning October 1, 2019, and ending September 30, 2024; and (c) direct staff to draft proposed contracts for the selected providers and authorize the Board Chairperson to execute the contracts, to include provisions relating to the final rate crediting methodologies and provisions for negotiating and implementing a LIBOR replacement index as identified in staff's report, subject to agreement between the City and contracted providers as to all applicable terms and conditions; the motion was unanimously adopted.

7. BOARD REPORT 19-06: GENDER AND AGE REVIEW OF DCP PARTICIPATION, CONTRIBUTION, AND RISK TOLERANCE PATTERNS

Sandeep Kaur reported that the Board expressed interest in gender and age demographics of DCP participants. She stated that as of November 30, 2018, DCP's participants totaled 46,766, with 72% being male and 28% being female. She referenced a 2015 Vanguard study indicating that in voluntary Internal Revenue Code (IRC) Section 401(k) plans, women on average have greater participation rates than men, 66% to 58%, respectively. She stated that across the full-time City workforce contribution rates for both genders are the same and that both genders contribute approximately 7% of their income towards their DCP Account.

Ms. Kaur reported on gender investment risk tolerance levels and stated that overall both genders invest similarly. She indicated that male participants invest in the Ultra-Aggressive portfolio and female participants invest in the Moderate Portfolio at higher relative percentages. She stated that academic studies indicate male participants take more investment risks compared to female participants. She stated that staff recommends that the Board direct the Participant Engagement Committee (PEC) to consider gender-based marketing for future communication strategies.

Mr. Geller inquired what gender-based marketing involves. Mr. Powell responded that staff does not presently have specific materials to propose but that they would focus on issues or interests that might be uniquely appealing to members of a gender group. Wendy Macy asked if the Board could be provided with more detailed breakdowns of the gender participation data by various sub-population groups.

Ms. Kaur next reported on age demographics of DCP participants and indicated the average age of active participants is 46 and the average age of retired participants is 63. She stated the age grouping of 40 through 49 has the highest participation rate and contributions increase as employee tenure in the City increases. She stated that the Auto Enrollment Program could help increase participation at earlier ages. She stated the age grouping of 20 through 29 has a higher contribution rate than the subsequent two age groupings, which can be attributed to the DCP's historical focus on contributions as dollar amounts versus percent-of-pay. She stated that for age group risk tolerance levels, younger age groups invest more aggressively, and as participants reach the later stages of their careers, their risk tolerance decreases.

Following this discussion **a motion was made by Mr. Geller, seconded by Mr. Gendjian, to (a) receive and file the report regarding gender and age as they relate to participation rates, contribution rates, and risk tolerance; (b) direct the Participant Engagement Committee to consider gender-based messaging in developing future marketing and educational materials and strategies; and (c) direct the Participant Engagement Committee to consider promoting utilization of the percent-of-pay contribution option in developing future marketing and educational materials and strategies; the motion was unanimously adopted.**

Following Board Report 19-06, Mr. Moutes left the Board meeting. A quorum of the Board was still present for the remainder of the meeting.

8. BOARD REPORT 19-07: 2019 RESOURCES REVIEW AND ANNUAL BUDGET ADOPTION

Kevin Hirose reported that on February 5, 2019, the Plan Governance and Administrative Issues Committee (Committee) convened to conduct a DCP resource review and to review key variables used in forecasting long-term projections of DCP Reserve Fund (Reserve Fund) balances. He began by reviewing the Reserve Fund target and forecasting assumptions. He stated that in order to maintain stability within the Reserve Fund, the DCP tries to maintain a target reserve amount of 50% of annual operating expenses. He indicated the Reserve Fund target is approximately $1.4 million and, as of September 30, 2018, the Reserve Fund has approximately $3.4 million. He reported asset growth for the DCP rose 2% for year ending 2018. He stated that although growth was lower than historical averages, five-year and ten-year growth rates were 7.6% and 9.6%, respectively. He indicated these growth rates exceeded the 6.5% assumed growth rate.

Mr. Hirose reviewed multiple reserve fund projection scenarios as of September 30, 2018. He first reviewed the baseline scenario, which is the status quo projection that results in a projected ten-year surplus of $3.5 million. He indicated the surplus was significantly above the target of $1.8 million. He then reviewed a projection involving a worst-case scenario involving a 30% decline in assets, using the current key assumptions. He indicated that with a 30% decline in assets the Reserve Fund would be eliminated by 2024, which would ultimately mean that participant fees would need to be increased in order for the DCP to fulfill its expense obligations.

Mr. Hirose next reviewed the impact of a potential one-half basis point (0.005%) reduction to participant fees versus a reduction of the fee cap to $110 versus a combination of both scenarios. He indicated the scenarios would result in the projected reserve falling below target. He stated the Committee realized that a significant decline in the investment markets should be considered a real risk over the next ten years and recommended that no reductions be made to participant fees or the fee cap at this time.

Mr. Hirose stated the Committee discussed revising the assumptions used in projections for the Reserve Fund and recommended that the Board approve increasing the net growth participation to 3%, increasing annual indirect salary reimbursement rates to 115%, and adopting staff's proposed DCP budget for Plan Year 2019. He stated that net participation rose by 6% in 2018, and with continued City hiring and expansion of the Auto Enrollment Program the Committee believed it was prudent to increase the assumed long-term rate of net growth in participation. Finally, he stated the increase to indirect salary reimbursements is due to costs trending higher than current assumptions.

Mr. Ciranna inquired about the drivers behind the increase to the Special Rates. Steven Montagna responded that health and retirement costs are contributing factors and tend to increase over time.

Following this discussion, **a motion was made by Mr. Gendjian, seconded by Robert Schoonover, to (a) approve recommendations from the Plan Governance and Administrative Issues Committee to revise assumptions used in projections for the DCP Reserve Fund to include increasing the assumption of annual net growth in participation from 2% to 3% and increasing the assumption of annual indirect salary reimbursement rates from 100% to 115%; and (b) adopt staff's proposed DCP budget for Plan Year 2019; the motion was unanimously adopted.**

9. BOARD REPORT 19-08: PROJECTS AND ACTIVITIES REPORT: JANUARY 2019

Mr. Montagna reported that DCP staff and the Board's legal Counsel attended a pilot cybersecurity workshop held by Segal Consulting on January 17, 2019. He stated the major takeaway was that in addition to plan sponsor vendors having a cybersecurity preparedness plan, it is important for individual plan sponsors to have a cybersecurity assessment and response strategy to address an actual event. He explained that staff is conducting research and preparing a detailed report which will include recommendations for Board action.

Mr. Geller inquired about the DCP's Third-Party Administrator's (TPA) contractual obligations during an actual event. Mr. Montagna responded that the TPA contract contains a data security agreement and a cybersecurity insurance policy.Mr. Mumma inquired about staff's exposure to a cybersecurity event. Mr. Montgana responded that staff's upcoming report will address that question.include a broad landscape of the City's cybersecurity policies and discuss the issues that impact the DCP.

Mr. Montagna concluded by stating that Matthew Vong accepted a job opportunity with the Department of Public Works, Bureau of Santiation. He stated that staff had initiated the process of backfilling this vacancy. Mr. Mumma stated the Board appreciated his time served and wish him well.

Following this discussion, **a motion was made by Mr. Ciranna, seconded by Ms. Macy, to receive and file the monthly projects and activities report for January 2019, including updates regarding Communications; Activities; 2019 DCP Strategic Initiatives Update; Board Information Requests; Completed Projects/Meeting Calendar; Staffing; and Committee Assignments; the motion was unanimously adopted.**

10. REQUESTS FOR FUTURE AGENDA ITEMS

The Board did not make any specific requests for future agenda items.

11. ADJOURNMENT

The meeting adjourned at 10:35 a.m.

Minutes prepared by staff member Kevin Hirose