CITY OF LOS ANGELES
BOARD OF DEFERRED COMPENSATION ADMINISTRATION

PROPOSED MINUTES
MEETING OF AUGUST 20, 2019
700 E. TEMPLE STREET, ROOM 350

BOARD MEMBERS

| **Present:** | **Not Present:** |
| --- | --- |
| John Mumma, Chairperson | Linda P. Le |
| Raymond Ciranna, First Provisional Chair | Thomas Moutes, Vice-Chairperson |
| Wendy G. Macy, Third Provisional Chair | Robert Schoonover, Second Provisional Chair |
| Joshua Geller | |
| Hovhannes Gendjian | |
| Neil Guglielmo | |

PERSONNEL DEPARTMENT STAFF
Steven Montagna, Chief Personnel Analyst
Daniel Powell, Senior Personnel Analyst I
Anna Ancheta, Personnel Analyst
Mindy Lam, Personnel Analyst
Sandy Kaur, Administrative Intern II

OFFICE OF THE CITY ATTORNEY
Curtis Kidder, Assistant City Attorney

BANK OF THE WEST
Matthew Kirschenman, Vice President, Senior Government Relationship Manager
Lily Ng, Director, Director, Government Banking Manager
Craig Conley, Vice President, Fixed Income Sales

MERCER INVESTMENTS
Devon Muir, Principal
Ana Tom-Chow, Associate

## 1. CALL TO ORDER

John Mumma called the meeting to order at 9:03 a.m.

## 2. PUBLIC COMMENTS

There were no public comments.

## 3. INVESTMENT MANAGER PRESENTATION – BANK OF THE WEST (BOTW)

Matthew Kirschenman, Senior Relationship Manager, introduced his colleagues: Lily Ng, Director of Government Banking and Craig Conley, Vice President of Fixed Income Sales. Mr. Conley reported that the product used by the Deferred Compensation Plan (DCP) is their public fund interest checking and provided an interest rate of three-month LIBOR minus 15 basis points. Mr. Kirschenman reviewed interest rates for the fund going back ten years. He noted that rates are trending lower worldwide across LIBOR and US benchmarks.

Mr. Conley reported on the Federal Deposit Insurance Corporation (FDIC) insurance and the collateralization of non-insured amounts. He stated that the FDIC insures all assets administered by BOTW under its rules and regulations. He added that Bank of the West collateralizes all balances held by participants exceeding the amount insured by the FDIC. He explained that the first $250,000 of any deposit is FDIC-insured, and for a public entity, anything above that is collateralized in accordance with the State's collateralization rules.

Mr. Conley reviewed the economic/market section of the presentation and stated that the Fed is expected to cut interest rates by a quarter-point. He stated that there was a cut in July and a couple more are expected in September and December. He said that the Fed is trying to counteract the yield curve where short-term yields are significantly higher than long-term yields, a possible sign of a recession. He then provided a brief overview of BOTW's corporate background.

John Mumma asked if there have been any significant changes in the last ten years, affecting how participant assets are held. Mr. Conley stated that the State of California changed the collateralization rules from 110% straight collateralization to the now accepted 105% Federal Home Loan Bank, LLC collateralization. Lily Ng indicated that the rest of the program is unchanged since inception with the DCP.

Mr. Muir asked if BOTW had a perspective on LIBOR and the longevity of that reference rate. Mr. Conley explained that LIBOR is going to be transitioned out in 2021, and the banks are looking at potential alternatives. He said that the most likely alternative to LIBOR is the Secured Overnight Financing Rate (SOFR). Mr. Kirschenman clarified that the interest rates are built into the contract, and when the time comes, both the DCP and BOTW will discuss a mutually agreed-upon rate based on how the market is performing. Steven Montagna asked what the bank's appetite for new deposits would be in the event of a 0% interest rate environment. Mr. Conley replied that on the assumption that 0% would be the interest rate the bank would pay out but would earn a slightly higher rate for money being lent out. He explained that it would be dependent on whether the market goes into recession and how deep of a recession it would be. He noted that in 2009, US banks were taking money from the government and there was a decrease in lending. Mr. Kirschenman indicated that in such an instance, BOTW would strive to be one of the banks with continued capacity to seek deposits. Mr. Conley stated that BOTW was still aggressively pricing out deposits with 35 basis points compared to others with 25 bps during the last recession.

John Mumma asked about the institutional stability of BOTW compared to ten years ago. Mr. Conley explained that it is now significantly larger and that the financial crisis was used to acquire other branches, but most growth has been due to expansion.

Mr. Montagna inquired about negative interest rates and if the bank has assessed the potential impact of a negative interest rate economy. Mr. Conley replied that most of Europe has been in a negative interest rate environment for some time, but it has not been modeled out. He said it was unclear how banks would respond.

## 4. MERCER 2019 Q2 INVESTMENTS PERFORMANCE REPORT

Devon Muir, Principal, and Ana Tom-Chow, Associate, from Mercer Investments (Mercer), introduced themselves to the Board. Mr. Muir presented the Performance Evaluation Report for the Second Quarter of 2019. He indicated that it had been a positive July until concerns surfaced regarding trade tariffs and the Fed rate. For the year to date, he stated that the DCP is in a positive start to 2019 because of particularly strong U.S. equities in the second quarter. He indicated that the DCP benefited from the performance, with the S&P 500 up by 4.3% for the quarter and Russell 1000 growth up by 4.6%. Mr. Muir said that growth tended to outperform value by a modest margin, but value stocks are still positive. He explained that large-cap stocks tended to outperform the small-sized caps. He noted that the international equity landscape has had positive returns but is outpaced by U.S. equities.

Mr. Muir reported that there had been a significant decline in interest rates over the past several quarters. He stated that there are concerns about the slowing economy and the global economy had a significant effect on interest rates. He stated that the positive for that environment is that it's beneficial to be invested in bonds. He reported that tariffs and interest rate policy dominated the major themes during the period. He said that the Fed signaled it would cut rates and cut the first quarter-point in July, which was a reversal from last year. He speculated that there would be at least two more quarter-point rate reductions over the next three Fed meetings. He indicated that Fed action and the trade conflict with China are the primary sources of volatility in the market.

Mr. Muir said that with respect to the trade conflict, the U.S. was hoping to achieve a long-term benefit. He indicated that if there is an all-out trade war, the worst-case scenario is it could significantly negatively affect the growth of the U.S. and Chinese economies. He stated that the long-term ramifications are to be debated, and the immediate term does not stimulate growth in the overall economy.

Mr. Muir then reviewed U.S. equities and noted that generally, there had been positive performance in all sectors except healthcare. He stated that there are significant concerns with the larger healthcare providers on the possibility of moving to a single-payer system, and ongoing issues with the pharmaceutical companies. He then reviewed the fixed income environment and noted that due to falling interest rates, near-term bonds had performed very well, which benefited the DCP's bond portfolio.

Mr. Mumma asked whether Mercer agrees with BOTW's assessment that the market will transition away from LIBOR. Mr. Muir answered that they've heard that the benchmark is likely to sunset in 2021 or 2022. He said that LIBOR is a self-reporting benchmark and that the mandated reporting is likely to discontinue. He then discussed how SOFR might be a more favorable benchmark due to its insulation from erroneous self-reporting.

Mr. Gendjian asked what the impact would be of entering a negative interest rate environment. Mr. Muir answered that if that environment were to occur in the U.S., it would mean the market thinks the U.S. is in a substantial slowdown or a recessionary period. Mr. Montagna suggested that it might be a prudent exercise to review some worst-case scenarios in the next two to five years. He stated that it would be helpful to consider what the impact would be on a large plan like the DCP and its investment options and how participants might react. Mr. Mumma expressed agreement in further considering the implications of such a market environment for the DCP. Mr. Muir stated that it's a good exercise to ask the question, but he also assured the Board that the DCP had seen positive returns for the year despite volatility.

Mr. Muir then reviewed highlights for the DCP's assets in the second quarter and noted that the DCP reached $6.8 billion in assets. He then reviewed the investment manager updates and noted that on July 26, 2019, the research team met with Ceredex Value Advisors, one of the DCP's mid-cap managers. He stated that Mercer reaffirmed their rating, and they continue to be impressed with Don Wordell's portfolio management experience. Mr. Muir then reviewed the meeting with Dimensional Fund Advisors (DFA). He stated that they conducted a deep dive into the emerging markets strategy and continue to have conviction. As part of their ongoing due diligence, he noted that there is a substantial growth in assets at DFA over the past ten years, moving from $100 billion to $550 billion assets. He indicated that given their broad diversification across names in their portfolios and their quantitative approach, Mercer is not concerned with capacity. He said that they would continue to monitor over the longer term.

Mr. Ciranna asked if Mr. Muir could expand more on the China-A shares. Mr. Muir answered that the DFA's approach to emerging market investments is to be invested in highly regulated markets that are also highly liquid. He indicated that China-A shares had not met those hurdles until recently which has resulted in DFA being receptive to exploring that space.

Mr. Muir reviewed the comments about Galliard from the last meeting regarding the significant amount of management changes and their affiliation with Wells Fargo. He said that Wells Fargo selling their recordkeeping business has some effects on investors in co-mingled products that Galliard manages but does not directly affect the DCP's separate account. He assured that they are monitoring the five senior management departures and their generational transition. He indicated that Mike Norman, who has presented to the Board, is now the lead of the firm, and Mercer will continue to have conviction in staff and depth of the team at Galliard. He then provided a brief staffing update regarding the Voya mid-cap growth strategy.

Mr. Muir reported on the DCP's investment expenses. He stated that the total investment expense is 18 basis points after expense rebates, and the administrative expense is four basis points. He indicated that the "all-in" expense is a total of 22 basis-points, which he indicated is a competitive fee.

Mr. Muir then reviewed the compliance table and performance of the DCP's funds. He provided a review of the DCP's risk-based funds, and Ms. Tom-Chow provided a review of the equity options.

Mr. Ciranna commented that the Brandes option had extremely low percentile rankings during the last five years. Mr. Muir noted that Brandes' position was significantly value-oriented and held positions in consumer staples that have fallen out of favor. He indicated that Brandes' underperformance would be addressed during the normal procurement process. He noted that the DCP International Stock Fund is a blended fund, and Brandes only manages 17.5% of it. He said that the MFS Product is currently delivering excess performance. He reported that the growth fund managed by MFS constitutes 65% of the fund and it has provided strong performance.

Mr. Muir commented that despite recent market volatility, he thinks that this is a positive report featuring continued positive returns. Chairperson John Mumma thanked Mr. Muir for the report.

## 5. BOARD REPORT 19-30: STAFFING COSTS REIMBURSEMENTS FOURTH QUARTER 2018

Mr. Powell stated that staff recommended approval of reimbursements from the DCP Reserve Fund to the Personnel Department for $151,180.71 and to the City Attorney for $36,342.60 for the quarter ending June 30, 2019. He noted that the report includes a 10-year projection, which estimates that the projected surplus of the reserve fund will cross the $5 million threshold within the next ten years. He indicated that this would be addressed with the Plan Governance & Administrative Issues Committee in the near future.

Following this discussion, **a motion was made by Mr. Gendjian, seconded by Mr. Ciranna, to approve reimbursements from the Reserve Fund to the Personnel Department for $151,180.71 and City Attorney for $36,342.60 for the quarter ending June 30, 2019; the motion was unanimously adopted.**

## 6. BOARD REPORT 19-31: PLAN PROJECTS AND ACTIVITIES REPORT: JULY 2019

Mr. Powell reported that on August 3, 2019, the DCP partnered with LACERS to offer an all-day Financial Wellness Event for active and retired employees. He stated that the event went well, and staff received positive feedback from attendees regarding the covered topics. Mr. Powell reported that the DCP has been providing content for the Personnel Department's monthly newsletter which launched earlier this year. He noted that the newsletter provides a significant increase in traffic to the DCP website.

Following this discussion, **a motion was made by Mr. Geller, seconded by Mr. Gendjian, to receive and file the monthly projects and activities report for July 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.**

## 7. REQUESTS FOR FUTURE AGENDA ITEMS

Mr. Mumma suggested that, given recent market volatility, staff prepare communications to help ensure employees don't make investment decisions that they may regret later regret. Mr. Powell indicated that staff would do so.

## 8. ADJOURNMENT

The meeting adjourned at 10:08 a.m.

*Minutes prepared by staff members Anna Ancheta and Mindy Lam.*