CITY OF LOS ANGELES
BOARD OF DEFERRED COMPENSATION ADMINISTRATION

PROPOSED MINUTES
REGULAR MEETING OF APRIL 20, 2010 – 9:00 A.M.
700 E. TEMPLE STREET, ROOM 350

BOARD MEMBERS:

Present:
Eugene Canzano, Chairperson
Richard Kraus, Vice-Chairperson
Maggie Whelan, Third Provisional Chair
Sangeeta Bhatia
Cliff Cannon
John R. Mumma
Michael Perez

Not Present:
Sally Choi, Second Provisional Chair

Staff:

Personnel:	Alejandrina Basquez Steven Montagna Natasha Gameroz Claudia Guevara
City Attorney:	Anita Parys Vicky Williams

1. CALL TO ORDER

Eugene Canzano called the meeting to order at 9:13 a.m.

2. PUBLIC COMMENTS

None.

3. MINUTES

Mr. Kraus noted a correction to a date provided on page two, and to a reference to a Board member on page three**. A motion was then made by Richard Kraus, seconded by Maggie Whelan, to adopt the minutes of the 03/16/10 Board meeting, as amended; the motion was unanimously adopted.**

4. INVESTMENT PROVIDER PRESENTATION: GALLIARD CAPITAL MANAGEMENT

Michael Norman, Principal with Galliard Capital Management, was present to review performance for the Deferred Compensation Plan Stable Value Fund. Mr. Norman began by indicating that Galliard was a wholly owned subsidiary of Wells Fargo with $53.6 billion of assets under management. He indicated assets had grown by $11.7 billion in the past year, with $4 billion coming from the Wells Fargo purchase of Wachovia. He indicated Galliard had added 20 clients and 12 new positions to the firm.

Mr. Norman next conducted a review of the broader economy. He indicated that at present the country was experiencing a jobless recovery. He stated that although inventories were being rebuilt, the consumer was not fully participating given headwinds of flat personal income and high unemployment. He stated that housing appeared to have hit a bottom but the recovery was likely to be muted as the Federal Reserve began withdrawing its mortgage purchase program. He indicated that although that program ended in March, demand for mortgage securities was still surprisingly strong and long-term rates had ticked up only slightly.

Mr. Norman next indicated that the past year had been a very good one for fixed income investments. He indicated that the flight to quality had become a flight to yield and that all fixed income sectors had outperformed Treasuries. With reference to stable value specifically, Mr. Norman stated there are two components: bond holdings and wrap contracts. He indicated that over the past 18 months there had been capacity constraints in the wrap market as wrap providers reassessed risk. He stated one of the consequences of this was higher wrap fees, and another consequence wwas wrap providers wishing to address risk in the investment guidelines. He noted that the latter is not a concern for Galliard given their conservative investment approach.

With respect to higher wrap fees, Mr. Norman stated that while on the one hand this would result in lower returns, on the other hand it would entice more providers into the market and thus expand wrap capacity. He cited as a recent example Mutual of Omaha entering the market in December and indicating it would only work with three providers, and that Galliard would be one of them with 50% of the total assets.

Mr. Norman next indicated that another effect of wrap providers exerting influence over investment guidelines was that the broad market segment of the underlying portfolio would be gradually shifted to the intermediate segment to help mitigate the impact of rising interest rates. Mr. Kraus asked how much was in the broad market segment and Mr. Norman replied approximately 11%. Mr. Norman indicated that wrap fees across the industry were rising from 8-10 basis points to 18-20 basis points, and that the City's fees were currently in the 12-20 range.

Mr. Norman next reviewed recent activity, noting that Galliard had taken over administration of the Hartford General Account the past July and at that time had also added another external manager, Prudential. He indicated the firm was interested in adding another external manager once the wrap market settled down. Mr. Mumma asked for the purpose of adding additional managers. Mr. Norman replied it added style diversification. Ms. Bhatia asked who selected the managers, and Mr. Norman replied that Galliard did.

Turning to performance, Mr. Norman indicated that the Fund had returned 3.93% over the past year and the book value of the assets in the portfolio was 102%, meaning they were worth more than the direct bond value. He indicated the Fund had six different issuers and that the effective duration of the portfolio was 2.73%. He indicated that downward pressure on interest rates would continue to a limited extent but that the firm did not expect the overall rate would fall significantly from where it was currently. He stated that 79% of the holdings were AAA or higher.

Mr. Kraus asked what was expected to happen with durations going forward. Mr. Norman replied that durations should shorten somewhat. Mr. Normal went on to indicate that cash flows into the Fund were still strong although they had tapered off as the rebound in equity markets had grown. Mr. Kraus asked if the Fund declared a quarterly rate, and Mr. Norman replied that the rate was actually subject to change daily. Mr. Kraus asked what the typical lag was in terms of yield relative to changes in the broad direction of interest rates. Mr. Norman indicated that it was generally a factor of the duration, but that more roughly it was about two years.

The presentation then concluded.

5. BOARD REPORT 10-08: INVESTMENT MANAGER PROCUREMENT

Mr. Montagna indicated that at the prior Board meeting the Board had instructed staff to draft correspondence to the City Attorney's Office regarding the issues and questions raised in its prior month's report concerning investment manager procurement. Mr. Montagna indicated that staff had drafted a letter which was attached to its report.

Mr. Mumma asked if the fourth question posed in the letter, asking whether mutual funds could be exempted from demonstrating compliance with the Standard Provisions, should be asked or if staff was confident of what the response would be. Mr. Montagna replied that from his view it would be difficult to respond negatively to this question given that the Plan had been permitted to select investment options from 1983 through 1999 without engaging in public solicitation processes. Ms. Whelan asked if it was necessary to ask the question, and Mr. Montagna replied that it was not necessary to ask it at the present time, and could be pursued later depending on what responses were provided to the other questions. Ms. Whelan indicated that she supported not asking the question now if it was not necessary.

Mr. Perez asked what degree of independence the Board maintained with respect to its selection of investment managers given its fiduciary obligations to participants. Ms. Whelan indicated that this was an important question but was unsure of whether now was the appropriate time to be raising it. Mr. Cannon indicated that he would be in favor of posing the question since it appeared to be so fundamental to the Board's authority.

Montagna indicated that in 2004 when an outside vendor had challenged the City Council's ability to exercise discretion over the Board's decisions, the City had defended itself by arguing that the Council had ultimate authority over the Plan because it had created the Board through ordinance and could dissolve it if it wished. He suggested that it might make more sense to raise this issue in another context rather than tying it to this issue. Ms. Whelan indicated her preference to proceed incrementally by first establishing a position on this issue.

Mr. Mumma asked whether the reference in the letter's attachment to vendors executing contracts with the City should be changed to refer to the Board. Mr. Montagna indicated that this would make sense and did not state anything that was already stated in the Administrative Code, which explicitly provided the Board with contracting authority. Mr. Perez further suggested that the phrase "applicable to the Board" be added at the end of the final bolded section on that same item number. Ms. Bhatia asked if the reference on this same page to Request for Proposal should really be to a Request for Information. Mr. Montagna replied that his understanding was that a Request for Information was a document issued for investigatory rather than contracting purposes, but that a dual reference could be included in the correspondence.

Following this discussion, **a motion was made by Richard Kraus, seconded by Mike Perez, approving the draft correspondence from the Board to the City Attorney concerning investment manager procurement, amended as follows: (a) eliminating question four on page four; (b) including a dual reference to Request for Proposal/Request for Information on page five; and (c) replacing references to "the City" with references to "the Board" as appropriate in question ten on page five, and including the phrase "applicable to the Board" at the end of the final bolded section on that same item number; the motion was unanimously adopted**.

6. BOARD REPORT 10-09: INVESTMENT MENU

Mr. Montagna presented the staff report regarding proposed changes to the Deferred Compensation Plan investment menu. He began by indicating that the Board had initiated this process in order to design an investment menu that could more effectively promote diversification by streamlining the number of core options and branding them by the Plan rather than investment manager. He indicated that the goal was to reduce the number of options to approximately 10-12 given research indicating that having more than this number tended to cause worse asset allocation decisions among participants.

He next reviewed steps already taken by the Board, which included elimination of a number of funds due to under-performance, eliminating the Certificates of Deposit, eliminating the Hartford General Account and creating a Plan-branded stable value fund, expanding the number of asset allocation funds, adding a mid-cap index fund, expanding the brokerage window, and surveying Plan participants regarding proposed changes. He indicated that the remaining steps included developing the final core menu, implementing it, and then creating an investment policy for maintaining it over time. Mr. Montagna next reviewed the key components of the menu and summarized the two recommendations made by the Board's Investments Committee and the three issues remaining to be resolved by the full Board concerning the composition of the Plan's Mid-Cap, Small-Cap and International stock fund options.

Mr. Montagna indicated that in the proposed new core menu there would be three tiers. He stated the first tier would include Ultra-Conservative, Conservative, Moderate, Aggressive, and Ultra-Aggressive Asset allocation funds; the second tier would have the Deferred Compensation Plan Savings Account, Stable Value, Bond Fund, Large-Cap, Mid-Cap, Small-Cap, and International funds; and the third tier would be the Brokerage Window. He stated that ideally the bulk of participant assets would be invested in the asset allocation funds, as they provided a simple, low-cost means of achieving diversification consistent with individual risk tolerance.

Ms. Bhatia expressed her concerns regarding the proposal to change the Plan's investment menu. She first stated she was concerned about the survey dating back two years, and that in the past two years much had changed in the economic environment. She indicated transition costs have also not been addressed and was curious as to the impact. Mr. Montagna replied that it was important to consider the original goal of the redesign effort, which was to encourage asset allocation. He further indicated that the Board had already taken many steps towards this goal and thus far there had been little negative feedback from participants. He stated that throughout the process the Board had made efforts to communicate with participants regarding the changes and reasons behind them. He indicated the County of Los Angeles and City of New York had already instituted similar redesign strategies, and that the expansion of the Self-Directed Brokerage Option (SDBO) would help to mitigate the impact.

Mr. Canzano indicated his agreement with the direction taken by staff and the Investments Committee. He stated he believed that the Plan was moving in the right direction and his concerns related to how best to balance active versus passive management. Mr. Kraus asked if the Plan should consider grandfathering funds in order to avoid negative reaction. Mr. Montagna replied that the Board could do this but adding time would not so much avoid as delay that reaction, because eventually the funds would need to be terminated. Mr. Canzano indicated that in communicating to participants the Plan should address participant questions regarding why they are no longer able to invest into certain funds. Ms. Bhatia replied that she agreed with the idea of grandfathering funds. She indicated that closing funds arbitrarily is not the right approach and reiterated her concern about transition costs. Mr. Montagna replied that there were no transition costs associated with liquidating these funds.

Ms. Bhatia indicated that she had encountered costs associated with transitioning her own funds. Mr. Canzano indicated that all costs have already been reviewed and that based on survey data there appeared to be participant support for branding the funds by the Plan. Susie Ardeshir of Mercer Investment Consulting indicated that the transition cost would be potential opportunity costs if an eliminated fund outperformed following its elimination, but there was no way to predict this.

Mr. Mumma indicated he had recently returned from a conference in which these topics were the focus of discussion. He stated his agreement with the proposed redesign objective and that the Board had a fiduciary responsibility to design a menu that helped participants with diversification. He indicated this kind of approach was what was being adopted at the national level. He indicated he was interested in learning more about the potential cost impact. Susan Dalton of Mercer Investment Consulting indicated that there would be no transition fees associated with cashing out mutual funds, and that such transition costs only applied in moving certain institutional account structures.

Mr. Canzano indicated his understanding that the Plan intended to notify participants that they could transfer funds before changes were implemented or move assets to the SDBO. Mr. Montagna replied that effective communications would be an essential component of making these changes, and that participants would have the opportunity to voice concerns. Mr. Canzano suggested that Great-West help disseminate information through the website. Gary Robison of Great-West indicated that Citywide group meetings were an approach that had been used in the past and might be applied in this situation. Mr. Perez indicated that that many participants would be unable to attend such meetings and might not open statements. Mr. Montagna indicated the Plan could use all available communication opportunities at its disposal, whether it be the website, meetings, or other communication tools.

Mr. Mumma stated that after reviewing the survey results he believed the Plan should do everything possible to streamline the investment menu. Mr. Canzano indicated he agreed with Mr. Kraus. Ms. Bhatia replied that the survey did not include everyone in the Plan. Mr. Montagna replied that approximately 23% of the participant population had responded and this was a very high response rate. Mr. Cannon asked what outreach efforts could be made for retirees. Mr. Robison indicated that print communication materials could be used, and Ms. Archer indicated that meetings are publicized to all participants and spread out across the greater Los Angeles area to be widely accessible. Mr. Perez asked about the possibility of using email and whether Great-West maintained participant email addresses. Mr. Robison replied that Great-West has been developing an email database but was just at the earliest stages. Mr. Kraus indicated the retirement/pensions systems might have some email information available. Mr. Perez offered a section in the Pensions newsletter for the Plan to communicate, and Mr. Mumma also suggested using the Thin Blue Line publication.

Following this discussion, the Board then turned to discussion of the first Committee recommendation which was to replace the Plan's current large-cap investment funds with a new "DCP Large-Cap Stock Fund" which would be 100% comprised of a passively managed S&P 500 Index Fund. Mr. Canzano indicated he was in support of the recommendation. Ms. Bhatia asked what would comprise the underlying investment options. Mr. Montagna replied that the concept was to have all large cap funds transitioned over to the index fund, which presently was the Vanguard Institutional Index Fund, which in turn would be branded as the City of Los Angeles DCP Large Cap Fund. Ms. Bhatia asked about the availability of the terminated options in the SDBO. Mr.

Montagna indicated that all of the proposed eliminated funds were available in the SDBO, although the American Funds had sale loads. Ms. Dalton indicated that the assets could be transferred to the SDBO in-kind, but Mr. Montagna indicated Great-West had just informed him they could not do this and therefore staff was exploring with the American Funds waiving the sales load. Mr. Kraus asked for clarification of data provided on page seventeen of the Mercer booklet. Ms. Dalton replied that the figures listed on that page matched those presented at the Committee Meeting, and that it was difficult to outperform the benchmark in the large cap space.

Mr. Perez asked for clarification of what the Board would be voting on. Mr. Montagna indicated it would be to adopt the proposed structure but that details of implementation regarding timing, procurement, and other related matters would be provided at a later date. Following this discussion, **a motion was made by Michael Perez, seconded by Cliff Cannon, approving replacement of the Plan's current large-cap investment funds with a new "DCP Large-Cap Stock Fund" which would be 100% comprised of a passively managed S&P 500 Index Fund and which would include funds mapped over from the elimination of the incumbent actively-managed large-cap funds; the motion was unanimously adopted.**

The Board next discussed the proposal regarding the DCP Bond Fund. Mr. Montagna indicated the recommendation was to replace the Plan's current bond funds with a new "DCP Bond Fund" comprised 50% of an actively-managed bond fund and 50% of a passively managed fund. Ms. Bhatia asked where the DCP Bond Fund would fall within the three tiers; Mr. Montagna replied Tier Two. Ms. Bhatia asked why the Board could not adopt a similar strategy for the large cap fund. Mr. Kraus indicated that each category was evaluated on a case-by-case basis and Ms. Dalton indicated that there were more opportunities for out-performance in bond investing as compared to large-cap stocks. Following this discussion, **a motion was made by Michael Perez, seconded by Cliff Cannon, approving replacement of the Plan's current bond funds with a new "DCP Bond Fund" which would be comprised 50% of an actively-managed bond fund and 50% passively managed fund; the motion was unanimously adopted**.

Mr. Montagna indicated that the remaining action items would be brought back to the next Board meeting.

7. BOARD REPORT 10-10: DEFERRED COMPENSATION PLAN BUDGET STATUS REPORT FOR QUARTER ENDING 12/31/09

Natasha Gameroz presented a budget reconciliation report for the quarter ending 12/31/09. She indicated that staff was recommending reimbursements for the staffing support services provided to the Plan. She further noted that the reserve fund's projected surpluses over the next five years had grown as a result of the strong recovery in Plan assets over the past year, which had risen 27% during the final three quarters of the year, as well as reduced staffing expenditures. Following this discussion, **a motion was made by Richard Kraus, seconded by Sangeeta Bhatia, to (a)**

receive and file the status report on Deferred Compensation Plan budget accounts for the quarter ending 12/31/09; and (b) approve reimbursements from the Deferred Compensation Plan Reserve Fund accounts to the Personnel Department for $94,585.85; City Attorney for $30,935.38; and DWP for $1,3797.51; the motion was unanimously adopted.

8. PLAN SPONSOR SURVEY RESULTS

Usha Archer of Great-West Retirement Services was present to review results of the recent Plan sponsor survey. She indicated that the respondents suggested general satisfaction with in the subject areas, with some questions, such as those regarding enrollment materials and use of the automated phone line, generating higher "no opinion" responses presumably because respondents were not familiar with the materials/services. Mr. Kraus asked if there was additional detail available regarding the four written comments noted in the summary report. Ms. Archer replied that the comments were all favorable, with one respondent noting the difficulty a participant had experienced on an issue.

9. BOARD REPORT 10-11: STAFF REPORT

Mr. Montagna indicated he could respond to questions regarding the report. Mr. Kraus noted that the report referenced the next meeting date as May 19, but that the actual date would be May 18. Mr. Canzano noted that bi-weekly deferrals continued to be strong. Following this discussion, **a motion was made by Sangeeta Bhatia, seconded by Richard Kraus, to receive and file the report; the motion was unanimously adopted**.

10. REQUESTS FOR FUTURE AGENDA ITEMS

Mr. Canzano asked if staff could pursue encouraging the appropriate labor members to fill the vacant Labor Representative seat on the Board. Mr. Mumma asked if it was possible to obtain a report regarding the number of de minimis accounts in the Plan, and Mr. Canzano indicated this could be added as a project. Mr. Mumma further asked if there was any issue with attending a gathering he'd recently been notified of, and Board members suggested he contact the City Attorney's Office.

11. NEXT MEETING DATE – MAY 18, 2010

12. ADJOURNMENT

A motion was made by Richard Kraus, seconded by Sangeeta Bhatia, to adjourn the meeting; the motion was unanimously adopted. The meeting adjourned at 12:01 p.m.

Minutes prepared by staff member Steven Montagna and Natasha Gameroz.