

CITY OF LOS ANGELES  
BOARD OF DEFERRED COMPENSATION ADMINISTRATION

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

BOARD MEMBERS:

**Present:**

Eugene K. Canzano, Chairperson  
Richard Kraus, Vice-Chairperson  
Cliff Cannon, Second Provisional Chair  
Sangeeta Bhatia  
John R. Mumma  
Michael Perez

**Not Present:**

Sally Choi, First Provisional Chair  
Maggie Whelan, Third Provisional Chair

Staff:

Personnel: Steven Montagna  
Claudia Guevara

City Attorney: Anita Parys

1. CALL TO ORDER

Eugene Canzano called the meeting to order at 9:03 a.m.

2. PUBLIC COMMENTS

None.

3. MINUTES

Mr. Kraus, Mr. Canzano, Ms. Bhatia, and Mr. Cannon noted several typographical and name errors in the minutes; Mr. Kraus also asked if a statement he made regarding adding footnotes to an investment report could be added. **A motion was then made by Richard Kraus, seconded by Cliff Cannon, to adopt the minutes of the 06/15/10 Board meeting, as amended; the motion was unanimously adopted.**

4. BOARD REPORT 10-22: ELECTION OF OFFICERS

Mr. Montagna indicated that the Board was required to elect a new Chairperson and Vice-Chairperson in every even-numbered year, and that in preparing this report staff discovered that the most recent ordinance which modified the structure of the Board

apparently changed the timing of the election to January, when it used to be July. He indicated that although this appeared to be an error in drafting the ordinance staff did not see any reason it needed to be changed. He indicated the Board was further able, but not required, to change its Provisional Chair positions, and that Board members may wish to advise the Chairperson of any changes in Committee preferences.

**A motion was made by Richard Kraus and seconded by Mike Perez to elect Eugene Canzano as Board Chairperson; this motion was adopted with five affirmative votes (Bhatia, Cannon, Kraus, Mumma and Perez) and one abstention (Canzano). A motion was made by Cliff Cannon and seconded by Sangeeta Bhatia to elect Richard Kraus as Vice-Chairperson; this motion was adopted with five affirmative votes (Bhatia, Cannon, Canzano, Mumma and Perez) and one abstention (Kraus).**

Mr. Canzano next asked if Board members were interested in changes to Provisional Chair positions. Mr. Mumma indicated that he recalled a prior discussion about concerns with Maggie Whelan being in a position close to chairperson given her role overseeing staff. Mr. Perez acknowledged that he had raised this issue before. Mr. Canzano suggested that the matter of the Provisional Chairs be brought back to the Board at a time when Ms. Whelan and other Board members were present.

Mr. Canzano asked if there was interest on the part of Board members in changing Committee assignments. None requested a change in assignment.

## 5. INVESTMENT PROVIDER PRESENTATION: AMERICAN FUNDS

Lily Matias and Steve Caruthers of Capital Group Companies were present to review performance for Growth Fund of America and Investment Company of America. Mr. Caruthers indicated that the firm took a long-term, value oriented approach in making investment selections and used its multiple portfolio counselor system to manage its growth. He stated that using this approach allowed the firm to add new counselors in times of growth rather than require that one or a few individuals manage more money. He stated that the firm's objective was to develop seasoned professionals, and remarked that the average tenure of its counselors was 22 years. He said a commitment to low fees was another important component of the firm's philosophy.

Mr. Kraus asked if the fund was really a fund of funds. Mr. Caruthers replied that to some degree it was except that the counselors were not operating in silos and could share ideas and information. Mr. Kraus asked about the risks of duplication. Mr. Caruthers replied that this was addressed through the strategic assignment of new funds and controls over multiple positions in identical issues.

Mr. Caruthers next discussed the general economic backdrop, stating that the dominant theme currently was uncertainty, specifically regarding European debt, the impact of the oil spill in the Gulf of Mexico, and the political environment within the United States, Japan, Australia and the United Kingdom. He indicated that the objective for Growth

Fund of America was very simple, namely to look for company stock poised to go up in value. He stated that in the past the Fund was limited to 15% with respect to international stock exposure, but this had recently been increased to 25%.

Mr. Kraus asked about the degree to which the Fund invested in debt securities as part of meeting its growth objective. Mr. Caruthers replied that short and medium term debt were part of the approximately 10% cash holdings in the Fund. He said maintaining this cash position helped the Fund to handle its cash-flow needs without having to liquidate stock positions. Mr. Kraus asked whether some of these holdings were below investment grade, and Mr. Caruthers replied that typically the exposure to this kind of debt was minimal and held for total return opportunities.

Mr. Caruthers indicated that the Fund had \$161 billion in its portfolio. He reviewed the top ten holdings and compared sector diversification of the Fund vs. the S&P 500. He stated the Fund was overweight in technology. With respect to performance returns, he indicated that the Fund had lagged its benchmark over the past year due to some of its holdings in the technology and financials sectors, but that the impact of non-U.S. holdings was muted.

Ms. Bhatia asked if the Lipper Large-Growth Index was the most appropriate benchmark. Mr. Caruthers replied that this index, a peer group made up of the 30 largest mutual funds, was the most appropriate. Mr. Mumma asked if Growth Fund of America was part of this index, and Mr. Caruthers replied that it was.

Mr. Caruthers next discussed Investment Company of America, indicating that this was a flagship fund focused on dividend paying firms and holding a value tilt. He indicated that the Fund's international exposure was limited to 15% and not anticipated to change. He further stated that the Fund's present non-U.S. exposure was at 7.3%, which was below the long-term average of 10%, and was focused on investments in Spain, Germany and France. He indicated the Fund had \$62 billion in total assets, and did better in down markets.

The presentation then concluded.

## 6. BOARD REPORT 10-23: INVESTMENT MENU

Mr. Montagna indicated that staff and Mercer had developed a recommendation for structuring the Plan's core International fund. He indicated that the challenge in addressing this particular option was that, unlike with the other core options, a fairly broad universe was being collapsed into a single option.

Susan Dalton of Mercer Investment Consulting presented Mercer's report on this matter. She indicated that there were three potential models that were being proposed to the Board. The first model involved a passive manager and two active managers with probable growth/value orientations. The second model involved a passive manager along with an active developed markets and active emerging markets manager. The

third model involved developed markets, active emerging markets, and active small-cap managers. She stated that Mercer was recommending the third option as part of meeting the following objectives: to represent the full universe of international markets, establish meaningful lists of managers to choose from, achieve reasonable expenses, reduce the risk of overlapping exposure and reduce the complexity of ongoing management.

Ms. Dalton indicated that adding in a discrete small-cap manager would ensure that this segment of the international universe would be included since most passive and active managers did not dip down into the small-cap space, even though small-cap stocks represent 15% of the international fund universe. Mr. Kraus questioned the value of having the fund including all active managers, and asked if it was possible to find passive managers for each of the three segments of the fund. Ms. Dalton replied that she was unsure if there were such managers or indices tracking international small-cap stocks, and so the problem would be in fulfilling the objective of establishing a meaningful group of potential providers to choose from. Mr. Kraus indicated he would like this information in order to make a comparison. He further asked if the distinction between strategies and mutual funds was institutional vs. mutual fund products, and Ms. Dalton replied that it was.

Mr. Cannon asked for clarification of the distinction in fees between passive and active management. Ms. Dalton replied that the average international developed, emerging markets and small-cap fund fees were 120, 131 and 125 basis points, respectively, compared to 55 basis points for a passive manager. Mr. Perez noted that the fees being provided were the median, and that it might be possible to find lower-cost providers within a procurement process.

Ms. Dalton stated that eliminating the passive component would reduce the overlap of investments. Mr. Montagna added that investment overlap was a concern in terms of managing this investment option over time, as international markets were likely to evolve in significant ways in the coming years. As an example, Ms. Dalton indicated that the EAFE equity index had approximately 20% in emerging markets exposure. Mr. Kraus asked for the breakdown of the investment universe in the world index excluding the U.S. Ms. Dalton replied that emerging markets represented 22%, small-cap 15%, and large/mid cap stocks 63%.

Ms. Dalton next compared the risk/return of the various scenarios for structuring the fund in terms of active vs. passive management. Mr. Canzano indicated it was hard to believe that the 100% active model had virtually the same standard deviation of the 100% passive model. Ms. Dalton replied that there are opportunities available in international markets, particularly in the small-cap space, because of their relative inefficiency. Mr. Canzano questioned how likely it was for the Plan to be able to select the outperforming managers. Mr. Mumma asked about the structure of other plans. Ms. Dalton replied that L.A. County's international option was 100% active, while New York City's was 90% active with 10% passive, the latter for liquidity purposes. She stated the

State of California had the same basic structure as New York City, and that both plans used value and growth orientations for their active managers.

Mr. Mumma asked for the size of the Plan's current international asset pool, and Ms. Dalton replied that it was approximately \$175 million. Mr. Perez indicated that at Fire/Police Pensions holding down investment management costs was always a priority, but that they used mostly active management in the international space. Mr. Montagna referred the Board to the portion of the Mercer report which detailed the back-testing of the proposed model. Ms. Dalton indicated that the back-testing demonstrated that the model outperformed the MSCI EAFE and MSCI ACWII ex-US indices.

Mr. Mumma asked if there had been discussion about the use of just a single option in the international space when there were multiple options in the other categories. Mr. Canzano clarified that under the menu redesign there would be only a single option in each asset class. Mr. Mumma indicated he was not aware of this when engaging in the prior discussions about the investment menu. Ms. Bhatia indicated her concern about taking current options away from participants. Mr. Montagna indicated that the whole premise of the menu redesign effort was to consolidate Plan options in order to promote more effective asset allocation decisions by Plan participants.

Usha Archer of Great-West Retirement Services was present and indicated that when the County transitioned its plan, approximately 3,500 employees attended meetings concerning the changes and there were very few complaints. She stated that the primary concern expressed by some attendees related to broadening what was available in the self-directed brokerage option. Lisa Tilley of Great-West Retirement Services was also present and indicated that the problem in retaining old funds, even if they were frozen to new contributions, was that federal regulations required that, for disclosure purposes, information about all of the options had to be communicated equally, so from the participant perspective they would see the full list of funds.

Mr. Canzano asked that Mercer return with a comparison of the proposed model with a 100% passive structure as opposed to 100% active structure. Discussion under this item then concluded.

## 7. BOARD REPORT 10-24: CORRESPONDENCE TO CITY ATTORNEY REGARDING TRUST STATUS

Mr. Montagna indicated that per the Board's request staff had drafted correspondence to the City Attorney's Office raising questions regarding the Plan trustee and the relationship and responsibilities of the Board relative to the program. He stated that before reviewing the specifics of the letter he would walk through the various attachments to the report since they provided perspective on the questions being raised and the context in which they had arisen at various times in the past.

He began with Attachment B, which he stated was a report staff and the consultant prepared in January 1998 proposing that the Board approve certain language to be

recommended to the City Council regarding how to implement the Federal government's new trust requirement for the Plan. He stated that prior to that point Section 457 assets were not required to be held in trust, but in 1996 Federal legislation was passed requiring that these assets be held in trust. He indicated that in an effort to comply staff drafted certain language to have the Council designate the Board as trustee and also to create a trust document which would detail the duties and responsibilities of the Board.

Next he discussed Attachment C, the minutes of the meeting at which the report in Attachment B was considered. He indicated that the minutes reflected that City Attorney Pete Echeverria was present and informed the Board that it did not have the legal status necessary to be established as trustee for the Plan.

Mr. Montagna next noted Attachment D, which was the ordinance that was ultimately adopted by Council and which included a statement on Page 1, Sec. 4.1404, that assets of the Plan "shall be held by the City in trust..." Mr. Montagna indicated that Mr. Echeverria had indicated this language was sufficient to satisfy the trust requirement.

Mr. Montagna next discussed Attachment E, the ordinance that gave the Board contracting authority for the Plan. He indicated that the Council specifically discussed the question of whether actions of the Board should be reviewable by Council, and a decision was made by Council to retain its ability to veto decisions of the Board, even if the provisions of then Proposition 5 were repealed, which they ultimately were under Charter reform.

Mr. Montagna next discussed Attachment F, which was the City's brief in the Nationwide lawsuit. He stated that the heart of this legal issue was the question of whether the Council had the right to veto decisions of the Board under the State Constitution Article 16, Section 17. He stated that the City Attorney had argued that the Constitution was never intended to provide the Board with plenary authority in the same way that authority was afforded to retirement and pension plans. He stated that although this issue was never resolved by the court, the brief represented the City's position on this matter and Attachment G, the brief from Nationwide, represented the opposing view.

Mr. Kraus asked what kind of response the Board hoped to get in posing these questions. Mr. Montagna replied that the intent would be to obtain clarity on who the Plan trustee is and what were its specific duties and responsibilities. Mr. Cannon asked whose decision it would be on the question of using outside counsel. Ms. Parys responded that this decision would be made by the City Attorney. Mr. Perez added that there was a Charter provision providing that it was the City Attorney's decision on the use of outside counsel. Mr. Perez further indicated he was interested in knowing where the fiduciary liability resided, and if the City Council is the ultimate fiduciary what would be their specific liability.

Mr. Cannon asked if the letter should be clearer that the Plan would assume the costs of using outside counsel. Mr. Montagna replied that the Board might not wish to obligate itself to pay without having a clearer idea of what those costs might be. Ms. Parys indicated that the cost issue could be deferred pending an initial review of the correspondence and determination as to whether outside counsel might be needed.

Mr. Perez asked if the Board was asking for a formal opinion. Mr. Montagna indicated that it would be valuable to have a formal response since it would resolve the issue not only for this Board but for future Boards. Mr. Perez asked that the wording of the letter be changed to reflect this. Ms. Bhatia suggested changing the wording of the third question since it implied that the Board did not think it was the trustee.

Mr. Mumma indicated that his membership were watching this issue closely and, if a determination was made that the Board was not or could not be the trustee, might take action to pursue it further. Mr. Kraus asked if a lawsuit was filed who would be sued. Ms. Parys indicated it would presumably be the Council. Ms. Bhatia asked if there was insurance for Board members. Ms. Parys responded there was not. Mr. Mumma stated that without insurance one would generally not be considered a trustee. Mr. Montagna noted that he had presented this issue to other large California plans and none of them had addressed it, and that each utilized similar structures in which a legislative body created an administrative board or committee to oversee the Plan. He stated that none of these plans had insurance for their Board members except for the County of Los Angeles.

Concurrent with this discussion, the question arose as to whether the Board was presently acting as trustee. Mr. Montagna indicated that this was a difficult question to answer since there had been no formal definition of the trustee's duties and responsibilities. Ms. Parys indicated that the Board was performing actions consistent with that of a trustee.

Mr. Kraus asked what the implications to the Board would be of clarifying the trustee status. Mr. Montagna replied that he was unsure if any of the responsibilities or limitations of the Board would change, since it appeared that even the retirement/pension plans were subject to the City's procurement rules, and the Board already had all other administrative responsibilities for governing the Plan. Mr. Kraus indicated that he thought the contracting issue was going to be addressed, and Mr. Montagna replied that this would occur at the next Board meeting.

Board members then discussed a number of potential wording changes to the questions posed in the letter before Mr. Kraus suggested that it be revised to essentially ask whether the Board was the trustee and if not, who was. Board members agreed on giving this general direction for the redrafting. Mr. Cannon asked what the Board would do if it received answers it wasn't looking for. Mr. Mumma replied that elections might be the long-term solution. Mr. Perez indicated that the questions were worth asking but didn't see a need to rush the letter and suggested that staff return with the redraft which

would give Board members further time to consider the issue. Mr. Canzano agreed and directed staff to return at the next meeting with a redrafted letter.

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

Ms. Bhatia left the meeting at the beginning of considering this item. Mr. Montagna indicated that the next item on the calendar for the Board's TPA RFP was a proposed disclosure form for Board and staff members regarding contacts with vendors during the procurement process. He indicated that staff was proposing that each Board and staff member, and any consultant or outside rater, who would be involved in the process should sign the form. He stated that the language used was similar to language used in the 2006 RFP for the rating panel. He further noted that staff and the City Attorney had not completed their research on the procurement questions raised at the prior meeting, that the City Attorney's Office was conducting research with the City's retirement/pension plans, and that staff expected being able to report back on this comprehensively at the Board's August meeting.

Mr. Mumma asked who would sign this, and Mr. Montagna replied anyone who was involved in the review or decision-making process. Mr. Canzano asked if the wording on the form should be changed to modify the reference to "RFP" since the Board was contemplating issuing an RFI. Mr. Montagna indicated it could be revised to refer more generally to "procurement process."

Mr. Perez indicated that the form might be overkill and Fire/Police Pensions did not do this for its search processes. Following this discussion, **a motion was made by Richard Kraus, seconded by John Mumma, to approve the disclosure form as modified; the motion was adopted by a vote of 4-1, with Canzano, Kraus, Mumma, and Cannon voting aye, and Perez voting nay.**

Ms. Bhatia returned to the meeting. There was further discussion, with Mr. Perez asking if the form was necessary. Mr. Montagna replied that as an outcome of the highly politicized 2004 RFP process there was an interest in greater transparency, and this document represented an attempt to build on the transparency used in the 2006 RFP. Mr. Cannon asked if the conflict-of-interest forms he had previously completed fulfilled the same objective. Mr. Montagna replied that this form was stronger than State ethics requirements because it was asking for disclosure of contacts. Mr. Kraus recalled that in 2005 the Board might have collectively affirmed its adherence to these principles without signing a form. Mr. Perez indicated that, since he had voted no previously, he would like to have the motion reconsidered. As a result, **the motion made by Richard Kraus and seconded by John Mumma to approve the disclosure form as modified was reconsidered; the motion was unanimously adopted.**



## 9. BOARD REPORT 10-21: STAFF REPORT

Mr. Montagna reviewed the staff report, indicating that counter activity numbers had been declining as ERIP counselings had been largely completed. He also noted that in the charts on contributions staff was now indicating dollar amounts from the equivalent period in the prior year, and noted that in this month contributions were approximately 11% less than they had been in the prior year. Discussion of this item concluded.

## 10. REQUESTS FOR FUTURE AGENDA ITEMS

Mr. Mumma indicated that Pensions had identified several hundred Police Officers whose buybacks of Academy time were still pending from a period of time before the Pension Savings Plan was in effect. Mr. Montagna indicated he was not aware of this but offered the Plan's assistance if members wished to purchase that time using funds they might have in the Deferred Compensation Plan.

## 11. NEXT MEETING DATE – AUGUST 17, 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 11:55 a.m.