

CITY OF LOS ANGELES  
BOARD OF DEFERRED COMPENSATION ADMINISTRATION

MINUTES  
MEETING OF JUNE 21, 2005 – 9:00 A.M.  
700 E. TEMPLE, ROOM 350

Board Members:

**Present:**

Shelley Smith, Chairperson  
Sgt. Thomas A. Dawson, Ph.D.  
Richard Kraus  
Javier Romero  
Maggie Whelan

Staff:

Personnel: Maryanne Keehn, Personnel  
Steven Montagna, Personnel  
Francois Verin, Personnel  
JoAnn Dominguez, Personnel  
Noreen Vincent, City Attorney

1. CALL TO ORDER

The Chairperson called the meeting to order at 9:12 a.m.

2. PUBLIC COMMENTS

None.

3. MINUTES

Sgt. Thomas Dawson clarified that the Board was being asked to adopt the minutes as amended by staff and distributed at the meeting. Mr. Kraus asked staff whether it was possible to, under the discussion of the Staff Administrative Report on page 4, add in the report number and an explanation of what was discussed. Staff indicated it could do so, stating that the item was a statistical report but this could be made not of. **A motion was made by Thomas Dawson, seconded by Richard Kraus, approving the minutes of the December 14, 2004 meeting as amended; the motion was unanimously adopted.**

#### 4. EXECUTIVE SESSION (pursuant to Government Code Section 54956.9(a))

**A motion was made by Tom Dawson, seconded by Richard Kraus, to enter Executive Session (pursuant to Government Code Section 54956.9(a)) to confer with the City Attorney regarding Galvin v. City of Los Angeles, Case No. BS 093076 and Nationwide Retirement Solutions, Inc. v. City of Los Angeles, et al., Case No. BS 093525; the motion was unanimously adopted. Following this discussion, a motion was made by Richard Kraus, seconded by Javier Romero, to end the executive session; the motion was unanimously adopted.**

#### 5. INVESTMENT PROVIDER PRESENTATION: FIDELITY FUNDS

Bill Samuels of Fidelity Investments was present to review the performance of the Fidelity Magellan and Fidelity Diversified International Fund offerings within the City's Deferred Compensation Plan. Mr. Samuels began by referring the Board to page 11 of his presentation booklet, in which he stated that the fundamental explanation for the under-performance of the Fidelity Magellan Fund was contained within the chart on this page. He noted that small-company stocks were coming off an unprecedented six-year period of out-performance relative to large-company stocks, and that during this period large-caps have averaged a 3.16% loss vs. a 4.01% average gain for small-caps. He stated further that looking at price-to-earnings ratios, the gap between the averages of small-caps vs. large-caps has narrowed during this period.

Mr. Samuels then referred the Board to a style-box analysis further demonstrating this phenomenon, indicating that over the last five years not only small-cap stocks but value stocks have outperformed their large, growth-oriented brethren. He indicated that the Magellan Fund is a mega-cap stock fund focused on the largest companies in the stock market universe. Ms. Smith commented that participants are encouraged to diversify their portfolios so as not to rely on only one market sector.

Mr. Samuels next discussed the impact of the dollar on international returns. He noted that international stocks had outperformed domestic equities over the last several years, although they have under-performed year-to-date in 2005. He stated that some of the prior out-performance of international stocks was due to the decline of the dollar, which in 2005 had rebounded, up 4.6% vs. the euro. Sgt. Dawson asked for further clarification of what the presentation booklet was indicating with respect to dollar appreciation. Mr. Samuels responded with specifics regarding where the dollar was valued relative to the euro at the beginning of the year and where it is valued currently.

Mr. Samuels asked if there were any questions from Board members prior to moving to the next section. Sgt. Dawson asked where the presentation, which purported to be about Fidelity and the City in partnership, addressed the City's funds specifically. Ms. Smith responded by indicating that the performance report represented the interests of those participants invested in the Magellan and Diversified International Funds specifically.

Turning to the Diversified International Fund, Mr. Samuels noted that the Fund had, notwithstanding one-year and year-to-date performance, outperformed its benchmark and peer group over three, five and ten year periods. He stated further that the Fund was in the top 18% of its peer group. Sgt. Dawson asked whether the Diversified International Fund included holdings in emerging markets, and Mr. Samuels indicated that the Fund only invested in fully developed international markets.

With respect to Magellan, Mr. Samuels stated that the Fund had under-performed over five years due to its mega-cap bias. He indicated that the Fund Manager, Bob Stansky, had no plans to change his investment strategy, and that with small-cap stocks having led the market for the past six years this would be the wrong time to do so. What was more difficult, indicated Mr. Samuels, was predicting whether the long-term leadership of the market was about to change, and that it was too early to make this call. He noted that there were indications this quarter that large-cap stocks might be on the cusp of assuming market leadership, and that Magellan was outperforming its benchmark thus far this quarter.

Mr. Samuels continued with this discussion by asking the Board to review Magellan's recent performance as compared to the S&P 100 and the Russell Top 200 Index. He stated that although the S&P 500 is the Fund's official prospectus benchmark, that index contains 200 small-cap stocks. He indicated that the S&P 100 is more indicative of the mega-cap stocks within which Magellan is primarily invested. He stated that the market capitalization of the average stock in the Magellan Fund is over \$1 billion. He stated that there are only 20 stocks which have attained that level of capitalization. He gave as an example Microsoft, which he stated has been dead for many for several years running despite a terrific balance sheet and growing profits. He indicated that the Magellan Fund is highly correlated with the S&P 100.

Ms. Smith indicated that many of the City's Plan participants invested in Magellan as long as a decade ago as a result of a previously strong record of out-performance. She stated that in some sense Magellan might have been a victim of its earlier success, and that inertia might be the explanation for why some participants had not moved their funds during the subsequent period of under-performance. Mr. Samuels indicated that market performance is cyclical and that the mega-cap bias associated with Magellan will eventually come back into favor. Ms. Smith indicated that investors have a tendency to chase returns and gave as an example concerns over a housing bubble in the U.S., relating recent information from a European economist detailing the effects of a burst bubble in several European countries and predicting a bubble deflation in the U.S. as well.

Mr. Samuels concluded his presentation. Mr. Kraus asked how much of Magellan's under-performance was the result of its large size. Mr. Samuels indicated that this was a factor but not the driving force. He stated that the Fidelity Contrafund, which was also a large fund and had 85-90% of the assets of Magellan, has many small and mid-cap holdings. He stated that Mr. Stansky manages Magellan much more conservatively,

and in particular is cognizant of the fact that many Magellan investors are people who reach the Fund through retirement plans. He stated that the Fund was closed in 1997 to new investors (both individual and retirement plans) but that City participants could continue to participate.

Mr. Kraus then expressed his concern that the Fund was under-performing the very specialized benchmarks and peers that were being used in the report. Mr. Samuels responded by indicating again this was due to the Fund's mega-cap bias, but Mr. Kraus indicated that the specialized benchmarks were mega-cap benchmarks. Mr. Kraus next asked how Magellan's performance would compare to the performance of the Dow. Mr. Samuels responded that it would likely compare very favorably to the Dow as a result of some Dow holdings such as General Motors.

Mr. Samuels concluded by saying that if he was back before the Board one year from now with mega-cap stocks having taken over market leadership but with Magellan having under-performed its benchmark and peer group, Fidelity would appropriately be questioning its relationship with Mr. Stansky and the Board should appropriately be questioning its relationship with Fidelity Magellan.

Ms. Smith thanked Mr. Samuels for his presentation.

## 6. GREAT-WEST QUARTERLY REPORT

Usha Archer of Great-West Retirement Services was present to review Plan statistics for the quarter ending 3/31/05. She stated that Great-West would be making some improvements to the report in the future, and that she welcomed comments and feedback from Board members with respect to what information they found useful. She stated that Great-West is continually looking for ways to improve its reporting and enhance the website.

Sgt. Dawson asked whether the Great-West website had been tested for hacking. Kent Morris of Great-West, who was present in the audience, responded that Great-West does indeed conduct such testing. Ms. Smith commented that the website provides many useful features for tracking performance and monitoring one's account. Ms. Archer stated that further improvements to the website would be forthcoming, including improvements to the loan page.

Ms. Archer began by indicating that Plan assets changed little in the first quarter of 2005 compared to the prior quarter, a reflection of the fact that the stock market was down during that period. She noted that since then the market has recovered some of its losses.

Ms. Archer then turned to participation. She indicated that enrollment grew to 34,690, and was now close to 60%. She indicated that the number of employees enrolled in the Plan but not contributing represented perhaps another 5% of the eligible population.

She noted that the statistical report showed some volatility in the number of non-contributing participants. Ms. Smith asked if there was any sense as to why these participants were not contributing. Ms. Archer responded by indicating this could be the result of being stretched financially, especially with respect to housing payments, or making payments on loans, including Deferred Compensation Plan loans. Ms. Archer further indicated that, overall, enrollment also tended to track the performance of the markets, which had flattened out in recent quarters.

Ms. Whelan asked where the new participants were coming from. Ms. Archer indicated a large number were coming from DWP, which she said had an excellent orientation system in place for its new employees. She stated a large number had come from General Services Department and the Personnel Department's orientation classes, which included employees from a broad range of City departments. Ms. Whelan then asked whether Great-West participated in such orientations for the Department of Airports, given their relatively unrestricted capacity to hire. Staff member Maryanne Keehn responded by indicating that the Department had just recently been in contact with Airports on exactly this topic.

Turning to a discussion of net cash flow, Ms. Archer indicated that the two funds experiencing the largest net inflows were the Diversified International and Lotsoff Small-Cap Equity Funds, both of which inflows were hopefully reflective of an increased effort by local Great-West staff to encourage diversification as well as the phenomenon of "return-chasing." Ms. Smith commented that she agreed that the latter was a factor, but was encouraged that participants were becoming more broadly diversified. Ms. Archer also noted that the Hartford General Account was another popular option, and that its steady positive net cash flow was perhaps an indication of the Plan's competitive fixed-income products.

Reviewing a breakdown of Plan assets by asset class, Ms. Archer pointed out that the 2% figure on the Plan's Pre-Mixed funds for both 2005 and the year ago period was not reflective of the growth in those funds due to rounding. She indicated that in fact the percentage had grown from 1.7% to 2.3%.

Ms. Archer next reviewed deferral statistics, noting that contribution amounts tend to drop off at year-end as participants reach maximum contribution levels, then expand at the beginning of the year as participants get themselves on track to take advantage of higher limits. Ms. Smith asked whether there were flags within the payroll system to prevent participants from exceeding annual limits. Ms. Archer indicated that there were, and that the payroll system would reject any excess contributions and would automatically provide for a higher contribution limit for those over age 50. However, for those eligible for what she referred to as "big Catch-up," participants needed to enroll in order to have a special flag turned on within the payroll system to help them take advantage of the higher limit. Ms. Smith thanked Ms. Archer for this explanation, as she often received inquiries from participants on that topic.

Sgt. Dawson asked whether Police Officers participating in DROP were eligible to make contributions to the Plan since they were technically retired. Ms. Archer responded by indicating that they were in fact eligible.

Ms. Archer moved on to a discussion of average account balances, noting that 80% of participants have account balances of \$50,000 or less, and that the top 20% of participant account balances have 57% of assets. Ms. Whelan asked if that was reflective of the growth in enrollment, and Ms. Archer indicated that was certainly the case. She stated that Great-West, since assuming administration of the City's Plan, had added approximately 7,000 participants over the last five years, and unless those individuals were contributing at very high levels, given the bear market it would have been difficult for them to breach the \$50,000 mark.

Ms. Archer next discussed local office activity, starting with a review of group meeting activity. She indicated that 110 meetings were held, a large number of them at DWP and Fire facilities. Some of these meetings were educational seminars focused on individuals already enrolled in the Plan, or what Great-West referred to as "Plan Updates."

Ms. Archer then discussed the Plan's Forfeiture Account, which she noted had risen to over \$1 million at the end of the first quarter. Sgt. Dawson asked if these funds were of the type that they would be lost if they were not used. Ms. Smith responded that they were not and represented excess fee revenue that could be used to protect against a fee increase in the event that Plan assets declined. Ms. Whelan indicated that they could be used to fund other services. Staff member Steven Montagna indicated that this account was part of the presentation held at last month's meeting regarding Plan fees, and that staff would be returning shortly with a discussion of various options for utilizing surpluses.

Reviewing distributions, Ms. Archer stated that most of the Plan's distributions were periodic payments, with very few lump sums. She stated that some of the larger distributions were for purchase of service credit with the retirement systems. Regarding rollovers, she noted that approximately 3% of Plan assets had rolled out of the City's Plan since federal legislative changes allowed this several years ago, stating that this was a relatively small amount compared to industry averages, and in fact when rolled-in amounts were accounted for, the net amount of funds rolled out was extremely small.

Mr. Kraus asked whether a link could be added to the Great-West website back to the City's Plan-level website. Ms. Archer indicated this was being worked on, further noting that the website already had links to the City's three retirement systems. This concluded discussion of this agenda item.

## 7. REPORT 05-19: TASK FORCE UPDATE

Mr. Montagna indicated that although the first meeting of the Administrative Issues Task Force had to be rescheduled, a new date had been set for June 23<sup>rd</sup> and it appeared that virtually all Task Force members would be able to make this date. Mr. Montagna stated that it had prepared for the first meeting by putting together a presentation to help bring Task Force members up to speed with respect to the events that led to Task Force formation and what input the Board was requesting from them.

Sgt. Dawson asked for further clarification on the question of why the CAO would no longer be acting as co-chair for the Task Forces. Mr. Montagna indicated that it was his understanding that the CAO determined that it would not be in a position to evaluate the process if asked to by Council if it was also a participant in the process. Ms. Whelan indicated this was her understanding as well.

Mr. Romero asked whether the meetings of these Task Forces were subject to the Brown Act and whether minutes would be taken. Noreen Vincent of the City Attorney's Office indicated that if they were bodies formed by the Board they would be subject to the Brown Act. Mr. Romero indicated that he understood certain Board members were involved in the Task Forces, but Ms. Smith clarified that these Task Forces did not include Board members, and that Mr. Romero was referring to the selection Committee for the Retired Participant Representative. Mr. Romero stated that, in either event, it should be made clear whether these were public meetings covered under the Brown Act. Mr. Montagna stated that the Task Force members were not appointed by the Board and were formed on a volunteer basis. Ms. Vincent stated that in general if it was not a standing Committee and did not contain a majority of the Board it would not be covered under the Brown Act.

Mr. Kraus asked whether he could obtain a copy of the presentation materials to be distributed to Task Force members. Mr. Montagna indicated he would do so.

## 8. BOARD REPORT 05-20: RETIRED PARTICIPANT REPRESENTATIVE

Ms. Smith indicated there was a report from staff indicating that the Retired Subcommittee recommended that Bill Stein be appointed as the next Retired Representative for the Board of Deferred Compensation Administration. Ms. Smith stated that Mr. Stein would make an excellent choice and fully supported his appointment. As a result, **a motion was made by Maggie Whelan, seconded by Tom Dawson, to appoint Mr. Stein as the next Retired Representative on the Board of Deferred Compensation Administration; the motion was unanimously adopted.**

## 9. REPORT 05-21: STAFF ADMINISTRATIVE REPORT

Mr. Montagna indicated there was only one item on the statistical report to which it wished to draw Board members' attention, and that was that the Plan had finally passed the \$2 billion mark. Ms. Keehn then indicated that she had a few items. She stated that on behalf of staff and the Board she wished to present a plaque to Mr. Dawson for his service on the Board, stating that although his time on the Board had been short he had made a great impact with his participation and questions. Ms. Whelan added that she also appreciated Sgt. Dawson's service and had learned a great deal from the questions he'd posed. Ms. Smith and Mr. Romero also thanked Sgt. Dawson for his service.

Mr. Romero asked whether a similar plaque could be prepared for Betty Porter. Ms. Keehn indicated that one had been created and staff would have distributed it today but Ms. Porter had indicated she was unable to attend the meeting. Ms. Smith indicated her preference that Ms. Porter be invited to the next Board meeting so she could be presented with her plaque.

Ms. Keehn then noted that staff member Francois Verin would also be leaving the Plan, in that he was being transferred to a different assignment within the Employee Benefits Division. Ms. Smith thanked him for his work and noted in particular her appreciation for the very effective way he had dealt with the program's hardship applicants. Mr. Romero also thanked Mr. Verin.

## 10. HARDSHIPS

Sgt. Dawson indicated he had a question on Case No. 05-12, asking whether it was appropriate to approve a \$3,000 distribution given the participant's \$2,000 in a savings account. Mr. Verin clarified that the \$2,000 figure actually represented a credit union loan, not an asset. As a result, **a motion was made by Javier Romero, seconded by Richard Kraus, to approve the hardship application in Case No. 05-12 for a withdrawal of \$3,000 (net); the motion was unanimously adopted.** Following some clarification of a debt reported in Case No. 05-13, **a motion was made by Maggie Whelan, seconded by Richard Kraus, approving the applicant in Case No. 05-13 for a full hardship withdrawal; the motion was unanimously adopted.**

## 11. NEXT MEETING DATE: JULY 19, 2005

## 12. ADJOURNMENT

The Chairperson adjourned the meeting at 11:27 a.m.

\* Minutes prepared by Staff member Steven Montagna