CITY OF LOS ANGELES
BOARD OF DEFERRED COMPENSATION ADMINISTRATION

ADOPTED MINUTES
DECEMBER 20, 2016
700 E. TEMPLE STREET, ROOM 350

BOARD MEMBERS:

| **Present:** | **Not Present:** |
|---|---|
| John R. Mumma, Chairperson | Michael Amerian, Vice-Chairperson |
| Raymond Ciranna, Second Provisional Chair | Cliff Cannon, First Provisional Chair |
| Wendy G. Macy, Third Provisional Chair | Linda P. Le |
| Thomas Moutes | |
| Robert Schoonover | |
| Don Thomas | |

Staff:

| | | |
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| Personnel: | Jody Yoxsimer | Steven Montagna |
| | Matthew Vong | Daniel Powell |
| City Attorney: | Curtis Kidder | |

## 1. CALL TO ORDER

John Mumma called the meeting to order at 9:01 a.m.

## 2. PUBLIC COMMENTS

None.

## 3. MINUTES

**A motion was made by Tom Moutes, seconded by Robert Schoonover, to approve the November 30, 2016 meeting minutes as amended; the motion was adopted unanimously.**

4. PLAN ADMINISTRATOR QUARTERLY REVIEW: 09/30/16

Joan Watkins, Client Relationship Director with Empower Retirement, reviewed the Plan Overview section of the quarterly report and highlighted assets, contributions, and participant account balances in the Plan. She indicated that assets had grown by four percent for the quarter and that overall Plan assets totaled over $5.1 billion. She reported that there was an approximate 30% increase in deposits as well as a slight increase in distributions. She indicated that Roth assets in the plan continued to rise, with a 13.5% increase over the prior quarter.

Ms. Watkins continued her presentation and reviewed participation information, account balances, and asset allocations. She stated the overall trend remained the same with the DCP Large-Cap and DCP Stable Value Fund having the majority of assets. She reported a 227% increase in overall Plan assets over the past 14 years. She stated the number of participants had increased slightly from the previous quarter and the number of non-contributing participants increased slightly as well, presumably due to participant preferences to “front-load” contributions during the calendar year. She stated 588 participants were added during the quarter, bringing the year to date total to 1,559. She also indicated the median account balance increased to $50,328 and that the number of participants with a Roth account was 5,951, a seven percent increase from the prior quarter. Mr. Mumma asked if most new participants open a Roth account in addition to pre-tax. La Tanya Harris of Empower Retirement indicated that most participants that open a pre-tax account also open a Roth account.

Ms. Watkins reported that the Plan achieved a 33% increase in the number of overall participants over last 14 years, reaching 42,734 by the end of Q3 2016. She also provided a review of how assets/investments are distributed amongst different asset classes within the plan. She stated that all categories were up slightly except of a number of participants in the International, Small-Cap, and Fixed Bank funds. She noted, however, that there were no significant changes. She stated the highest percentage of Plan assets are invested in the DCP Large-Cap Fund at 32%, followed by the DCP Stable Value Fund and the profile portfolios at 21% and 18% respectively. She then reported on how participants’ contributions are being directed to different asset classes, with the profile portfolios comprising of 32% of overall Plan assets, followed by the Large-Cap at 26%, and Stable Value Fund at 13%. She reviewed Plan participant average account balances, reporting that participants maintaining an average account balance between $200,000 and $500,000 make up about 42% of plan assets and that there were 1,708 participants with account balances over $500,000, which is a number that continues to increase. Further, she reported that the number of participants with account balances over one million dollars continued to increase, with 163 by Q3 end, an increase from 135 in the prior quarter. She reported that the number of total distributions had decreased slightly, with the only significant change being partial distributions due to death claims, which saw an increase from 15 to 30 quarter over quarter. She reported that overall assets rolled into the plan was greater than assets rolled out. She noted in comparison to prior year data, overall assets rolled out had decreased, whereas assets rolled in had increased.

Ms. Watkins reviewed information on loan activity and noted there was no significant change from the prior quarter. She stated there was a slight increase in the number of retiree loans and converted loans. Additionally, she stated the number of defaults had increased significantly from 89 to 103 quarter over quarter. She stated there have been 505 new loan initiations year-to-date, a decrease from the previous year. She stated the average outstanding loan balance was $19,931, and there were 82 hardships approved. She noted six hardship request denials were due to non-qualifying events.

Ms. Watkins reported the number of participant calls to Participant Services totaled 10,566, a slight increase from 10,205 from the prior quarter. She also indicated that web usage was largely unchanged. She reported a quarterly change in online statement delivery, increasing from 33% to 34%. Mr. Mumma inquired as to whether the local representatives informed new participants of the ability to access information about the Plan online. Ms. Harris responded affirmatively.

Ms. Harris continued the presentation by reviewing statistics regarding participant contacts, meetings/facility visits, and group meetings. She reported on total number of participant contacts in the field as well as in the local office and noted that Empower representatives had met with over 11,000 participants during the third quarter of 2016. She noted that many of the individual meetings focused on accrued leave, Catch-Ups, deferrals, and distribution requests. She stated representatives led 115 meetings, and placed a concerted effort on visiting libraries. She indicated representatives reached out to all 72 City libraries to offer Plan meetings. She indicated half of the libraries elected to facilitate group meetings while half were still pending. She stated that representatives attended retirement exit meetings at LACERS as well as enrollment meetings at the DWP, LAWA, and Department of Building & Safety. She also reported that representatives continue to provide table service at the DWP, Harbor, LAX, and LAPPL benefit fairs. She noted that Empower facilitated many DROP meetings as there were significant numbers of participants exiting the DROP program. She stated that after the national election, some participants wanted to make investment changes. She concluded by indicating that local Empower Retirement representatives had received approximately 2,100 calls per month.

## 7. INVESTMENT REVIEW FOR QUARTER ENDING 09/30/16

Devon Muir and Michael Molino of Mercer Investments Consulting (Mercer) discussed the Deferred Compensation Plan's fund performance for the third quarter of 2016 and provided a brief update on recent fourth quarter fund performance. Mr. Muir indicated the third quarter of 2016 showed good performance as the fears of Brexit subsided and the market shifted back to risky assets. He stated that the Large-Cap market performed well, increasing by four percent, but noted that smaller cap stocks tended to perform better. He reported that growth stocks tended to outperform value and that the international equity markets had a good quarter. He stated, however, that much of the positive performance had been erased since the end of the election cycle. He indicated that the MSCI-EM had increased nine percent, and was up 16% year-to-date. He stated that the bond yield started to increase slightly since the end of 9/30. He stated the Fed acted last week to raise the key rate and as such, there continued to be upward pressure on interest rates. He indicated strong performance for the first three quarters with the Barclays Aggregate up 5.8% with the Plan's investment option outperforming the benchmark. He reported that as interest rates rose, REITs tended to underperform as investors traded off dividend yielding investments in favor of higher yielding bonds.

Mr. Muir then reviewed the City's investment options lineup and commented on asset allocation by tier. He reported there was significant growth during the quarter with assets up almost $212 million, a 4.2% change quarter over quarter. He reported net contributions of $56 million and $155 million of overall growth due to investment gains.

Mr. Muir indicated the Plan currently has Voya's Mid-Cap Opportunities Strategy in the DCP Mid-Cap Fund and noted that pursuant to the Plan's bylaws are currently written, the new hiring Voya as the Plan's TPA requires a procurement for a new mid-cap growth fund. He stated the matter was under review by the Investments Committee.

Mr. Muir provided a review of Mercer's due diligence visits with managers that are in the Plan. He reported that they met with Brandis and reaffirmed Mercer's conviction in their strategy. He stated that Brandis revealed that they are considering putting a soft close on the international Small-Cap strategy that the Plan is currently invested in, and Mercer views that as positive as the Plan would continue to be able to invest in that fund even as it would be closed to new investors. He stated Mercer met with Ceredex Value Advisors for an update with the portfolio manager and they continue to have high regard for his thought process and team. He stated that in the last few days, Ridgeworth Investments, which owns Ceredex, announced that it was to be acquired by Virtus Investment Partners, another investment management firm. He stated they are still evaluating that change, but it should not have a material effect on the overall investment with Ridgeworth. He stated Mercer met with Loomis Sayles and that Mercer maintains its conviction with them. He then reported that they met with MFS and indicated that MFS was undergoing an orderly senior leadership change, which in Mercer's belief will not have an impact on their international investments strategy.

Mr. Mumma inquired as to what would transpire with the Ridgeworth sale. Mr. Muir responded that Ridgeworth is a mutual fund company which owns some investment management firms including Ceredex. He stated that normally the acquisition process is simply an orderly transition to a new organizational platform. He indicated that the history of Ridgeworth is that it was previously owned by SunTrust Bank, but having lifted itself out bankruptcy in 2013, it was always expected another firm would acquire it.

Mr. Muir reviewed the Plan's asset allocation by tier. He noted that the DCP Stable Value Fund is second largest with approximately 21% of assets, and he reiterated that the risk-based profiles continue to see growth with over 17% of assets in the Plan. He reported that the DCP Large-Cap Stock Fund represents the single largest holding in plan. He then provided an investment expense analysis. He reported that the Plan's expenses are well below median cost in each category. He indicated that on a weighted average, Plan expenses cost 25 basis points, a number which is inclusive of administrative fees and other expenses.

Mr. Muir reviewed the three and five-year performance of the Plan's funds. He reported that the only fund with modest underperformance is the DCP Bond Fund, which had trailing underperformance as a legacy of PIMCO exposure, which had significant challenges leading up to their termination in 2014. He stated that Loomis Sayles had a rough start since replacing PIMCO as the active manager of the Plan's DCP Bond Fund, but has done well in 2016.

Mr. Muir continued his review of fund performance and stated that at the end of the third quarter, the FDIC-Insured Savings Account blended rate was approximately 56 basis points, up from 25 basis last year before the Fed took action. He stated the Fed took action again last week and that this option would be directly affected. He stated Mercer expects an approximate 25 basis point improvement in the next measurement period. He reported that the DCP Stable Value Fund, which represents close to 21% of assets and over $1 billion dollars, had continued good performance and performed well relative to other stable value funds. He stated the DCP Bond Fund has had excellent performance year-to-date as it had increased by 8.1% for the first three quarters of 2016. He noted the most recent quarter's performance was positive as well. He stated that active management had been the driving force behind that performance. He then reviewed the Plan's risk profile funds. He reported good performance for the quarter with a range of 1.7% to 5.2% returns from least conservative to most aggressive. He reported that on a year-to-date basis, all investments returned over 5.8%.

Mr. Muir stated that the DCP Large-Cap Stock Fund, representing approximately 30% of overall investment allocation at over $1.6 billion, performed well and tracked the benchmark. He stated that the DCP Mid-Cap Stock Fund had a good quarter with a return of 5.1% and performed in the 40$^{th}$ percentile among the peer group. He indicated that year-to-date performance lagged relative to the benchmark by approximately 90 basis points. He stated active management was particularly difficult in the current environment, but it still performed well relative to other actively managed funds.

He then reviewed the DCP Small-Cap Stock Fund. He reported that although there was underperformance relative to the benchmark, it was still above the median relative to other Small-Cap strategies. He stated it increased by approximately 10% year-to-date, which is good absolute performance and near the median. He reported that the underperformance relative to the benchmark was attributed to Hartford and, to a lesser extent, DFA, having challenges. He stated Hartford had exposure to biotech companies, one of which had a clinical trial that failed for a respiratory treatment, thus negatively affecting its stock value by 87%.

He reported the DCP International Equity Fund saw slight underperformance relative to the benchmark for a three-month period. He stated on a year-to-date basis, however, it saw narrower underperformance and strong performance relative to the group. He stated that exposure to emerging markets has been very helpful as DFA was up 18.4%, which is the top quartile of strategies on a YTD basis.

Mr. Molino stated Mercer would provide a post-quarter brief update. He indicated that equity markets had rallied significantly and fixed income markets fallen given the rise in yields. He stated the S&P 500 index and Small-Caps increased by 1.8% and 5.6% respectively. He indicated there had been a large dispersion between growth and value stocks, with growth stocks in the Small-Cap space up 2.2% and value stocks up almost 10%. He indicated Treasury yields have increased since the national election and quarter-to-date yields were up almost 80 basis points while the fixed income market was down over three percent. He further stated that international equity markets were down quarter-to-date, but were still in positive territory on a year-to-date basis.

Mr. Molino highlighted year-to-date data, stating that all the options in the Plan had positive performance ranging from 0.5% for the FDIC-Insured Savings Account to 17% for the DCP Small-Cap Fund. He stated that the FDIC account performed as expected as did the Stable Value Fund, which was up 1.9%. He reported that the DCP Bond Fund increased by 4.8% and ranked in the top quintile of its peer universe. He stated the Loomis Sayles Core Plus Bond Fund was up 7.2%, outperforming its benchmark.

Mr. Molino reviewed the risk based profiles and reported that all funds saw positive year-to-date performance as equities rallied so strongly, but highlighted that the more aggressive funds performed better. Mr. Muir stated that it was hard to understate how big of a sell-off there has been in the bond market and that it has been characterized as one of the biggest bond market routs in history. He reported that the effect of that is seen in the most conservative risk profiles, which is a legacy of bond exposure.

Mr. Mumma inquired as to when Mercer thinks the Fed will act again in terms of raising interest rates. Mr. Muir responded that Fed Chair Yellen is indicating rate increases are going to be a more regular occurrence than once a year. He stated Mercer expects multiple rate increases next year due to low levels of unemployment. He stated the economy may also see inflation. Mr. Mumma asked whether Mercer expects a 0.25% increase each time. Mr. Muir responded affirmatively. Mr. Mumma inquired how the market built this expectation into pricing. Mr. Muir stated the markets are expecting the Fed will act repeatedly during the upcoming year.

Mr. Molino reported that the DCP Large-Cap Stock Fund increased by 9.8% on an absolute basis due to strong performance from equity options. He stated the DCP Mid-Cap Stock Fund increased by 11.4% and then reviewed the fund's underlying options.. He reported that the DCP Small-Cap Stock Fund was up 17% year-to-date, underperforming its benchmark by 1%. He stated the DFA Small-Cap Value Portfolio, though up by 24%, underperformed slightly. He indicated the Hartford Small Cap Growth Fund was up 11%, outperforming its benchmark. Mr. Molino then reviewed the DCP International Fund. He indicated that year-to-date performance showed an increase of 1.4%, while quarter-to-date performance was negative, thus taking away gains. He also reviewed its underlying options and stated that diversification helped the Fund. He indicated that the MFS International Fund was down 2.1% on an absolute basis, but the Small-Cap and emerging market funds were up four percent and 12% respectively, resulting in overall positive fund performance. Mr. Muir stated that the positive performance is the result of the work the Plan put into constructing the fund.

Mr. Muir returned to the topic of the anticipated likelihood that the Fed would increase the key interest rate. He stated that the market forecasts a backloaded rate raising policy. He stated that probabilities at the end of the prior week placed the likelihood of a February rate hike at 6%, with increased likelihood each month, up to 90% in September. Mr. Mumma inquired as to whether there is less volatility in the bond market since the market expects the rate hike. Mr. Muir responded that the bond market is responding in part to the Fed's policy, but is also responding to expectations of fiscal stimulus. He stated there is an expectation of potential higher levels of debt accumulation as well as a potential for inflation.

8. BOARD REPORT 16-39: PLAN PROJECTS AND ACTIVITIES REPORT

Matthew Vong updated the Board on the status of current and/or pending Plan projects and activities for November 2016. Mr. Vong reported that staff finalized its annual communication regarding annual contribution limits, which remain unchanged from 2016. He reported that, in conjunction with this communication, staff introduced a custom contribution calculator web tool which allows participants to see how their biweekly contributions translate to a percentage of pay.

He stated that the Plan Governance and Administrative Issues Committee met on December 7, 2016. He reported that no actions were taken pending further research and report backs from staff which will be provided at a follow-up meeting scheduled to take place in the next couple months. He also reported that the Plan Investments Committee met on December 14, 2016 and that staff expects a report from the Committee to the Board related to the Plan's Mid-cap Fund. He indicated that a follow-up meeting is scheduled over the next 30-60 days. He stated that any recommendations made by either committee will be brought to full Board for consideration and approval.

**A motion was made by Mr. Schoonover, seconded by Don Thomas, to receive and file staff's update on Plan projects and activities during October 2016; the motion was unanimously adopted.**

## 9. REQUESTS FOR FUTURE AGENDA ITEMS

None.

## 10. FUTURE MEETING DATES – January 17, 2017

## 11. ADJOURNMENT

**A motion was made by Mr. Schoonover, seconded by Ray Ciranna, to adjourn the meeting; the motion was unanimously adopted.** The meeting adjourned at 9:56 a.m.

*Minutes prepared by staff member Daniel Powell.*