

CITY OF LOS ANGELES
DEPARTMENT OF WATER AND POWER
INTERDEPARTMENTAL CORRESPONDENCE

Date: December 3, 2014

To: Retirement Board Members

From:  Mary C. Higgins, Interim Retirement Plan Manager

Subject: Board Agenda Item No. 18: Discussion of Fixed Income Investment Guidelines; and Possible Action (December 10, 2014, Regular Retirement Board Meeting)

Recommendation

That the Board of Administration (Retirement Board) of the Water and Power Employees' Retirement Plan (Plan) adopt the attached Fixed Income Investment Guidelines and incorporate them into the Plan's Statement of Investment Objectives, Goals and Guidelines (Investment Policy).

Background

At the special Retirement Board meeting held on June 26, 2013, the Retirement Board approved a fundamental change to the investment policy for the fixed income portfolio (Resolution No. 13-91). The new structure was presented by the Plan's general consultant, Pension Consulting Alliance, Inc., (PCA) as a mechanism to mitigate risk and enhance returns in a financial market that has become dramatically different since the financial crisis in 2008.

The current fixed income holdings of the Plan's asset allocation structure consist of 90% core and 10% high yield securities, with two investment managers responsible for each component. Under the proposed changes, the guidelines would reduce the target allocation of core to 50% and will rename this component as Principal Protection. Principal Protection will continue to provide the safety component, however, with shorter duration and no exposure to corporate credit.

The other 50% of the fixed income allocation would be split into Extended Global Credit (Global Credit) and U.S. Bank Loans (Bank Loans), with two investment managers responsible for Global Credit and one for Bank Loans. Between the two components, Global Credit would receive 90% of the allocation, leaving Bank Loans with 10% of the allocation.

The revised guidelines address the description and risk/return expectation of each new component. The guidelines also define the benchmark, allocation and watch criteria for the segments. The Investment Policy also includes manager specific guidelines which staff and PCA negotiated with the investment managers.

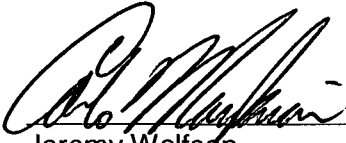

The following table highlights the proposed allocation within the fixed income asset class:

Segment/Style	Active/ Passive	Benchmark	% of Asset Class	Number of Managers
Total Fixed Income	Active	50% BC U.S. Intermediate Aggregate ex. Credit 30% BC Global Credit (hedged) 15% BC Global High Yield (hedged) 5% BC U.S. Bank Loans	100	5
Principal Protection	Active	BC U.S. Intermediate Aggregate ex. Credit	50	2
Extended Global Credit	Active	66.67% BC Global Credit (hedged) 33.33% BC Global High Yield (hedged)	45	2
U.S. Bank Loans	Active	BC U.S. Bank Loans	5	1

PCA recommends, and staff concurs, to adopt the attached revised Fixed Income Investment Guidelines and incorporate them into the Plan's Investment Policy. The changes were discussed with investment managers and they accepted the guidelines as stated.

The following documents are attached:

- Resolution No. 15-41
- Resolution No. 13-91

 Jeremy Wolfson
 Chief Investment Officer

MCH/JW/CM/FH:mea

RESOLUTION TO UPDATE THE PLAN'S FIXED INCOME INVESTMENT POLICY GUIDELINES

WHEREAS, the Board of Administration (Retirement Board) of the Water and Power Employees' Retirement Plan (Plan) approved a fundamental change to the investment policy for the fixed income portfolio at the special Retirement Board meeting held on June 26, 2013; and

WHEREAS, the new structure was presented by the Plan's general consultant, Pension Consulting Alliance, Inc., (PCA) as a mechanism to mitigate risk and enhance returns; and

WHEREAS, under the current fixed income guidelines, the Plan's asset allocation structure consist of 90% core and 10% high yield securities; and

WHEREAS, with the proposed changes, the guidelines would reduce target allocation of core to 50%, and the other 50% of the fixed income allocation would be spilt into Extended Global Credit (Global Credit) and U.S. Bank Loans (Bank Loans); and

WHEREAS, between the two high yield components, Global Credit will receive 90% of the allocation and Bank Loans will receive 10% of the allocation; and

WHEREAS, the updated guidelines include the description and risk/return expectation for each allocation; and

WHEREAS, staff and PCA negotiated manager specific guidelines within the Investment Policy with the investment managers; and

WHEREAS, PCA recommends, and staff concurs, to adopt the revised Fixed Income Investment Guidelines and incorporate them into the Plan's Investment Policy.

NOW, THEREFORE, BE IT RESOLVED, the Retirement Board hereby authorizes the Interim Retirement Plan Manager to modify the Plan's Investment Policy by adopting the policy guidelines language presented above and to inform the Plan's Fixed Income managers accordingly.

I HEREBY CERTIFY, the foregoing is a full, true, and correct copy of a Resolution adopted by the Retirement Board of Administration [created by Section 1102(b) of the Los Angeles City Charter] at its regular meeting held on December 10, 2014.



Mary C. Higgins
Interim Retirement Plan Manager

RESOLUTION TO RESTRUCTURE THE FIXED INCOME ASSET CLASS

WHEREAS, the current fixed income component of the Plan's asset allocation structure consists of 90% core and 10% high yield securities; and

WHEREAS, the current core plus structure is measured against the Barclays Capital Aggregate Index (BC Aggregate) and to the Barclays High Yield Index (BC High Yield); and

WHEREAS, the core fixed income portfolio in the Retirement Fund (RF) includes two active fixed income managers, Wells Capital and JP Morgan; and

WHEREAS, the high yield portfolio in the RF includes two active fixed income managers, Wells Capital and Loomis Sayles; and

WHEREAS, the core fixed income portfolio in the Retiree Health Benefits Fund (RHBF) includes two active fixed income managers, Wells Capital Core and JP Morgan Core; and

WHEREAS, the high yield portfolio in the RHBF includes one active fixed income manager, Wells Capital; and

WHEREAS, at the Special Retirement Board meeting held on May 15, 2013, representatives from PCA proposed restructuring the Plan's Fixed Income asset class from core plus to a new two-tier structure for the purpose of reducing interest rate risk, increasing income, maintaining high credit quality and improving the risk-adjusted return profile; and

WHEREAS, the new structure will include a "Safety" component, which will be similar in holdings to the Plan's current core portfolios, however shortening the duration and eliminating the credit component; and

WHEREAS, the "Safety" component will be benchmarked against the Barclays Capital US Intermediate Aggregate ex Credit Index (BC Intermediate Aggregate), a subset of the current BC Aggregate benchmark; and

WHEREAS, the new fixed income structure will also include a Global Credit component expected to provide higher levels of income along with potential capital appreciation; and

WHEREAS, the following table highlights the Proposed Mandates of the Fixed Income Restructuring Plan:

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-Safety component (2 managers)

- Treasuries
- U.S. Government related securities
- Securitized Mortgage Backed, Commercial Mortgage Backed and Asset Backed securities

-Global Credit (3-5 managers)

- Multiverse Credit
 - International and Emerging Markets Government related debt
- Corporate debt
 - U.S., International and Emerging Markets debt
 - Investment Grade
- Global High Yield (Possibly combined with Multiverse Credit)
- Bank Loans (1 manager)

;and

WHEREAS, the benchmark for the high yield component will change from the BC High Yield to the Barclays Global High Yield Index-hedged (BC Global HY) since the mandate is changing from a domestic to a global mandate; and

WHEREAS, PCA recommends two new benchmarks within the Global Credit component, Barclays Multiverse Credit-hedged and the Barclays US Bank Loans, to reflect the new mandates; and

WHEREAS, the following table highlights the proposed allocation within the fixed income asset class:

Proposed Fixed Income Asset Class & Manager Structure

Segment/Style	Active/ Passiv	Benchmark	% of Asset Class	# of Managers
Total Fixed Income	Active	Blended:	100	5-7*
		50% BC Intermediate Aggregate ex. Credit 30% BC Multiverse Credit (hedged) 15% BC Global High Yield (hedged) 5% BC US Bank Loans		
Safety	Active	BC Intermediate Aggregate ex. Credit	50	2
Global Credit	Active	Blended:	50	3-5*
		60% BC Multiverse Credit (hedged) 30% BC Global High Yield (hedged) 10% BC US Bank Loans		

*Will be determined during multi-mandate RFP process

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WHEREAS, PCA and Staff recommend the Retirement Board approve the fixed-income restructuring and changes to the fixed income policy.

NOW, THEREFORE, BE IT RESOLVED, the Retirement Plan Manager is hereby authorized to restructure the Plan's Fixed Income asset class and amend the fixed income policy as outlined above.

I HEREBY CERTIFY, the foregoing is a full, true, and correct copy of a Resolution adopted by the Retirement Board of Administration [created by Section 1102 (b) of the Los Angeles City Charter] at its Special meeting held on June 26, 2013.



Sangeeta Bhatia
Retirement Plan Manager