

**REGULAR MEETING OF THE BOARD OF ADMINISTRATION  
RETIREMENT BOARD  
WATER AND POWER EMPLOYEES' RETIREMENT PLAN**

**MEETING – September 17, 2003**

**Present:**

Javier Romero	President
Lilly Calvache	Vice President
Ron Vazquez	Chief Financial Officer
Michael Moore	Retiree Member

**Absent:**

Leland Wong	Commissioner
David H. Wiggs	General Manager
Dan Mirisola	Board Member

**Others Present:**

Duamel Vellon	Retirement Plan Manager
Silvia Tesseneer	Recording Secretary
Neil Rue	PCA (Pension Consultant Alliance)
Lou Mastro	Bank of New York (BNY)
Mary Jo Curwen	Deputy City Attorney
Mike Wilkinson	Deputy City Attorney

The meeting was called to order at 10:06 a.m. after the Pledge of Allegiance.

[Pledge of Allegiance]

Mr. Vellon indicated there was quorum of the Board.

President Romero inquired if there were any public comments and there were none.

President Romero stated he wanted to welcome Commissioner Leland Wong to the Retirement Board, even though he was not in attendance.

Mr. Vellon reported items 1 through 3 were submitted for consent approval as follows:

- 1. Approval of Minutes for the August 20, 2003 Regular Board Meeting and for August 28, 2003 Benefits Committee Meeting.**
- 2. Termination from Monthly Rolls as of September 2003:  
Retirement Resolution for September 2003.  
Terminations from the September 2003 Survivorship Roll: Bernice M. Emerich and Maureen Monger – death.  
Terminations from the September 2003 Family Death Benefit Roll: Troy Chase**

**and Karlene Chase attained 18 years of age.**

**3. Authority to Purchase Commercial Paper from the List of Approved Issuers.**

Mr. Moore moved adoption of the above items 1 through 3 on consent. Seconded by

Ms. Calvache and carried unanimously after the following vote:

Ayes: Romero, Vazquez, Moore, and Calvache

Nays: None

**4. Report of Payment Authorizations as of August 2003.**

**5. Short Term Investments as of August 31, 2003.**

**6. Stock Portfolio Listing as of July 31, 2003.**

**7. Report on Long Term Investment as of July 31, 2003.**

**8. Distribution of Securities by Type and Class as of July 31, 2003.**

**9. Statement of Investments owned as of July 31, 2003.**

**10. Equity Investments as of July 31, 2003.**

**11. Notice of Deaths as of August 2003.**

**12. Merrill Lynch Investment Managers (MLIM) summary regarding the funding of the ML Large Cap Index Fund and working with the appointed transition manager, Bank of New York (BNY).**

Mr. Vellon recommended items 4 through 12 be received and filed.

Ms. Calvache moved the above Items 4 through 12 be received and filed. Seconded by

Mr. Moore and carried unanimously after the following vote:

Ayes: Romero, Vazquez, Moore, and Calvache

Nays: None

**13. Consideration of Retirement Plan amendment to provide for charging the Plan expenses against the Trust (for payment of investment management fees due and payable under the newly adopted asset allocation structure).**

Mr. Vellon explained item 13 represented the Plan amendment submitted to the Board of Commissioners, by the Retirement Board, amending the Plan to provide for charging the Plan expenses against the Plan. He stated the amendment was adopted by the

Retirement Board, then by the Board of Commissioners, and is now back before the Retirement Board for formal approval.

Mr. Vazquez inquired if there was a resolution. Mr. Vellon responded the resolution was submitted, the first time around, and this was just a formality of a motion to accept the Plan amendment. Mr. Vazquez inquired if the resolution on page 13.5 of the agenda packet was the resolution previously adopted by the Retirement Board and submitted to the Board of Commissioners. Mr. Vellon responded in the affirmative.

Mr. Vazquez inquired about the number of votes needed for a valid Retirement Board action. President Romero responded it was the majority of the quorum present. Attorney Wilkinson clarified the City Attorney's office concluded a Board action requires the majority of the entire Board, which is four votes. President Romero expressed, his position, which is based on the specific Plan language, is the Board actions require the majority of the quorum present. He added he had already ruled on this once before at the suggestion of the City Attorney.

Mr. Vazquez suggested to table item 13, to be discussed at the next Board meeting. Mr. Moore inquired if Mr. Vazquez wanted to discuss what his reasoning was for tabling the item or wait until the next meeting. Mr. Vazquez expressed he felt the Board could not operate effectively when the City Attorney's office is advising they cannot conduct business with less than a majority vote of the full Board, and the Board members have a different interpretation. He stated this leaves him questioning which actions are actually valid. Mr. Vazquez then proposed the City Attorney's office submit explicit legal opinions, in writing, in the context as to how the Retirement Board has operated in the past, and indicating if there has been any change in the Charter so the Retirement Board is clear on what actions taken are legally valid. He indicated another reason for requesting the item be tabled was because he would like this item presented when more Board members are present, since President Romero voted against this particular resolution when it was initially passed by the Board. Mr. Vazquez also stated, in the event four votes are required, he does not want to compromise the item and have to go back again to the Board of Commissioners for a new Resolution. President Romero acknowledged Mr. Vazquez's concerns and reiterated the Plan specifically states the Board actions require the majority of quorum of the Board, and the Board is required to follow the Plan to the letter. He stated the Plan is what prevails; therefore he is not interested in Mr. Wilkinson's interpretation of the Charter, but the interpretation of the Plan. He requested the City Attorney's office submit what the Board's duties are with respect to following the Plan language regarding these issues. Discussion continued and it was the consensus to table item 13 until the next Board meeting, wherein the City Attorney's office would submit their legal opinion in writing.

Mr. Vazquez moved item 13 be tabled until the next Board meeting. Seconded by Mr. Moore and carried unanimously after the following vote:

Ayes: Romero, Vazquez, Moore, and Calvache

Nays: None

#### **14. Consideration of Pre-Tax Program for Service Credit Purchases under the DWP**

**Plan. (Attorney Terry Rosales and Mr. Peter Lakatos will be in attendance to answer questions).**

Mr. Vellon explained item 14 involves the Pre-Tax Program as an ongoing update item subject to monthly updates by Mr. Rosales and Mr. Lakatos.

President Romero recognized Mr. Lakatos.

Mr. Lakatos approached the podium. He noted, at the July meeting, he provided the Board with supplemental information from IBEW, which is the only union that responded to the request of considering the proposed Plan change. Mr. Lakatos stated IBEW reported this morning they are in agreement with the proposed change, provided there is an understanding that employees with existing contracts would have the opportunity to convert to the pre-tax contract. He stated, with this understanding, he expects written confirmation from IBEW, possibly tomorrow.

President Romero suggested having an agenda item for the Special Board meeting scheduled September 30<sup>th</sup>, including the letter signed, by the Union, in order to move forward.

**15. Consideration of Transfer from “Reserve for Investment Gains and Losses” to “General Reserve” in accordance with III C (8).**

Ms. Bhatia explained Item 15 represents a routine annual accounting adjustment in connection with preparing the annual financial statements, and also in compliance with the Retirement Plan Provision (Section III C). She explained said provision requires, that at the end of each fiscal year, the Net Gains must be transferred from the reserve for Investment Gains and Losses to the General Reserve. She stated, in compliance with this, it is recommended the Board approve the transfer of \$91,643,000 from the Reserve for Investment Gains and Losses to the General Reserve in the Retirement Fund, through Resolution 04-31. Mr. Vellon added this would leave 1% balance in the account pursuant to the Board’s policy.

Mr. Vazquez inquired what the \$5 million was supposed to be 1% of. Ms. Bhatia explained the Plan provides the General Reserve be kept at least 1% of the fund’s assets, and by transferring the \$91,643,000 from the Reserve for Investment Gains and Losses to the General Reserve, the balance would be \$134 million, which would be well over the 1% requirement. She added this would leave \$5.5 million in the Reserve for Investment Gains and Losses. Mr. Moore then moved adoption of Resolution 04-31. Seconded by Ms. Calvache and carried unanimously after the following vote:

Ayes: Romero, Vazquez, Moore, and Calvache

Nays: None

**16. Consideration of Amendment to the Plan’s Investment Guidelines to provide for Domestic Equity Growth and Value Segments and to modify the Passive Investment Guidelines.**

Mr. Vellon informed the Board Mr. Rue (PCA) was running late for the meeting due to a flight delay, but was expected to arrive at around 10:30 a.m. He then introduced Item 16 as the recommended investment guidelines for the Growth and Value managers and also a small amendment to the Passive Domestic manager guidelines to recognize managers could use either a “full replication technique” or a “stratified sampling technique” to replicate the index. Mr. Vellon indicated the Growth and Value guidelines were new and would be incorporated into the contracts. He added the guidelines the consultant (PCA) is proposing for the growth and value segments, include certain recommendations the new managers suggested. Mr. Vellon stated, eventually, staff would provide Board members with a clean copy of the guidelines, showing the names of the various managers and the reference resolution numbers. He also pointed out the performance objectives on page 16.10 of the agenda packet would be brought to Mr. Rue’s attention when he arrives. Mr. Vellon noted it is necessary to determine if PCA want a slightly different performance expectation for Merrill Lynch, compared to MFS. He stated after this has been resolved, the final expectations would be included and a clean copy will be submitted to the Board, and he then recommended Board adoption of Resolution 04-32.

Mr. Moore indicated he had a number of questions and he recognized the fact the other Board members had an opportunity to review the items a number of times. President Romero inquired if Mr. Moore would feel more comfortable tabling the item since the consultant was not present. Mr. Moore expressed it would be better for him to address a number of the items now, since the consultant was not present, to avoid taking up extra time when he arrives.

Mr. Moore referred to page 16.5 of the agenda packet under Portfolio Component Definition where it states, “[Manager A] will manage an active growth portfolio for the Plan that will provide equity participation in industry and market capitalization sectors. . . .” He stated, to his understanding, this statement refers to both industry and market capitalization sectors, and while one may talk about large, medium and small as being capitalization sectors, he does not feel this is the normal way this is used, particularly since this is for large cap. Mr. Moore suggested, for language and clarity’s sake, it would read better if it stated, “for the Plan that will provide equity participation in industry sectors with market capitalization representative . . . .” He indicated this statement also occurs again in the Passive Equity manager’s section and Large Cap Value guidelines. Mr. Vazquez commented he was comfortable with this change.

Mr. Vellon clarified the guidelines for Active Large Cap, Growth and Value were being presented to the Board for the first time, so the Board can make amendments and then adopt the amended document.

Mr. Moore referred to page 16.10 of the agenda packet and expressed his concern for the manner of evaluating the performance of Merrill Lynch relative to the Domestic Equity Active Large Cap Value. He pointed out, for the managers selected thus far, the Board decided they would be measured net of fees and expenses, but in this case, it states “gross of fees and expenses”. Mr. Vellon clarified this was a typo and it should state, “Net of fees”. He did, however, note Merrill Lynch did have fees and expenses

and dividends reinvested that the others do not, which still needed clarification from the consultant. Mr. Moore inquired if they were going to try and move this out. Mr. Vellon responded in the affirmative and explained the expenses and dividend reinvested was a request made by Merrill Lynch, and not MFS, and staff would be meeting with PCA to clarify if this is possible and inform the Board of the outcome.

Mr. Moore referred to the last paragraph on page 16.5 of the agenda packet stating, "Security position sizes for the INTECH portfolio will be limited to a maximum overweight of 2.5% differential from the position weight in the benchmark", and inquired if it meant they can only establish positions that are no greater than or less than 2.5% in any particular position. Ms. Bhatia responded, this means the managers are allowed 5% plus the additional range of 2.5%, which only applies to INTECH. Mr. Moore inquired if this applies to a particular position, i.e. a particular stock. Mr. Vellon responded it applies to stocks. Mr. Moore, as an example, inquired if INTECH owns General Electric could they only increase or decrease their position by 2.5% over or above what the index itself has. Mr. Vellon responded this was correct. Mr. Moore commented this was a fairly tight restriction on the INTECH managers. Mr. Vellon responded this was at the request of INTECH. Ms. Bhatia explained the sentence, with regards to the 2.5%, should be read in conjunction with the 5% in the previous paragraph. She added, the other managers have 5%, but INTECH requested an additional 2.5%, consequently they are subject to a maximum of 7.5%

Mr. Moore referred to page 16.7 where it states, "Manager A (Passive Core Equity)", and suggested "(Passive Large Core Equity)" be inserted for consistency's sake. He then referred back to page 16.10, wherein the two provisos inserted for MFS Institutional Advisors gives them a little more latitude with respect to the data and R-squared (at the request of MFS), and inquired if the rest of the Board was comfortable with this. Mr. Vellon responded both the consultant and the Board were comfortable with this in the past.

Mr. Moore referred to page 16.13, item 2, wherein it states, "A secondary objective is to achieve an investment . . . . . which will provide for an increased funding of the Plan's liabilities", and suggested it be changed to "provide for a full funding of the Plan's liabilities." Mr. Vellon responded he felt this was a perfectly reasonable amendment. President Romero inquired, since the Board had already taken action on these guidelines, was it necessary they come back again for approval. Mr. Vellon responded this is the appropriate time to make changes since the document is being submitted for amendment at the request of PCA and the Plan investment managers.

Mr. Moore referred to page 16.14 of the agenda packet (noting it appears in one other section also) wherein it states, "The Board will monitor and assess the actual asset allocation versus policy and will rebalance as appropriate." He then inquired if the Board should be more definitive in terms of what is appropriate, such as semi-annually, once a year, etc. President Romero suggested deferring this issue for PCA to address. Mr. Vellon commented there should be an interval, because the market moves everyday and the Board should not be rebalancing everyday or every week and there should also be some kind of pattern, at least to revisit the asset allocation, and then determine if rebalancing is needed. He also suggested the consultant should address this matter.

Mr. Moore referred to page 16.16 of the agenda packet, regarding the reference to the core bonds in the portfolio, where it states, "The portfolio will be composed primarily of issues with a duration between 4-6 years. He then expressed this was a relatively short timeframe and inquired if this was the maturities this Plan has purchased historically. President Romero again stated this was an issue PCA should address. Mr. Vellon commented, as a matter of background, it was possible the index being used as a reference (Lehman), has a maturity within that range, but PCA should address the issue.

Mr. Moore referred to page 16.21 of the agenda packet where it states, "Investment in non-dollar denominated bonds is permitted, however, shall not exceed 15% of the market value of a single manager portfolio or 10% of the market value of the aggregate market value of the core fixed income portfolio". He then inquired how would a manager of one portfolio know whether or not he is exceeding the limit imposed on the combined portfolio. Mr. Vellon responded the manager would not know, but it is the consultant's job to monitor performance, compliance with the guidelines and compliance with the parameters the Board has established, as well as exposure to any single industry or percentage of a company. He added, the downside to this is, the consultant does not do this every single day, so in any short period of time there could be some variance from those numbers as the market value moves and as the managers buy and sell.

Mr. Moore referred to page 16.17 of the agenda packet stating, "The Board may require that active equity managers direct brokerage transactions for Plan assets for soft dollar usage and commission recapture, only when best execution can be assured". He requested clarification of this. Mr. Vellon responded, in terms of how the industry works, there is value in the brokerage commissions and the Department of Labor requires Pension Plans need to monitor brokerage, because there is a value intrinsic to these so it falls within the purview of the fiduciary responsibility of the Board. He stated managers, as a matter of policy, tend to have full discretion in their use of brokerage, but some Plans can decide, for example, to give full discretion on 75% of the commission generated, but 25% can be dealt through a certain broker because they do it, for instance, at a penny a share are otherwise providing a particular service, etc. to the Board. Mr. Vellon explained the Investment Management Policy on page 16.17 recognizes Board members have the ability to do this, but, to his knowledge, have never utilized it. He added the language was only permissive and the Board members would have to take specific action. He suggested PCA could address this issue in more detail.

Mr. Neil Rue (PCA) arrived.

Mr. Moore reviewed some of the issues he was concerned about needing input from the consultant. He started on page 16.14 of the agenda packet where it states, "the Board will monitor and assess the actual asset allocation versus policy and will rebalance as appropriate". He then inquired whether or not it was appropriate to be a little more specific with respect to the responsibility of the Retirement Board in terms of timing as far as semi-annually, annually, etc. Mr. Rue inquired if anyone had responded to Mr. Moore's concerns. Mr. Vellon stated he did concur with Mr. Moore there should be

a time frame because the market values change everyday and this should not be visited everyday.

Mr. Rue stated there were two basic approaches and one was to have some bands around the targets, which are not currently in the policy so it would be best to review the policy and how far the actual portfolio is away from the policy and to develop an automatic rebalancing procedure on some periodic basis, at a minimum quarterly. Mr. Moore suggested changing the sentence to state, "on a quarterly basis the Board will monitor or assess the actual asset allocation". Mr. Rue also indicated typically Board's review the asset allocation and reaffirm it on an annual basis, but staff is responsible for rebalancing the portfolio back to the extent it deviated significantly from policy targets and this function occurs on a quarterly basis. President Romero inquired if the advisors and consultants inform the Board when the portfolio is out of balance. Mr. Rue responded this would flow through the quarterly performance reporting process, but this could be lagged and staff may be monitoring the portfolio a little more closely and on a more frequent basis than the consultant. Mr. Vellon commented if they were going to do it quarterly and they submit quarterly reports, then that is the perfect timing to revisit the rebalancing, but to have expectations that staff can do something before that point might not be the best way to go and this was not his recommendation. Mr. Moore commented, in terms of the Board's oversight, this was an appropriate interval and he agreed the allocations should not be changed. Mr. Rue suggested rewording the sentence to state, "monitor allocations quarterly" because it would be consistent with looking at the Board reviewing with the consultant and the quarterly performance reports.

Mr. Moore referred back to page 16.16 and reiterated his concerns regarding the language in the sentence "the portfolio will be composed primarily of issues with a duration between 4-6 years." He stated this seems fairly short-term because if the market were at the other end of the spectrum there might be wisdom in considering things that are much longer in duration than 4-6 years. He then inquired if the present language constrains the Board. Mr. Rue responded the long-term structure of the portfolio would be an investment grade, well diversified, core bond portfolio that would be benchmarked against the Lehman aggregate index, which has a duration between 4-5 years. He then suggested rewording the language to read, "the portfolio will typically revolve around the duration of the benchmark plus or minus 1 year." Mr. Moore requested an explanation as to why the Lehman aggregate changes in its duration. Mr. Rue responded this was a function of changes in interest rates. He explained when interest rates change, the value of a bond changes and it in turn changes the duration calculation.

Mr. Vazquez inquired, if bond rates go to 15% on a long-term bond, what impact would this have on the Lehman index and would they react to extending the maturity of their index to 30 years because rates have gone up. Mr. Rue stated they would not actively manage the portfolio at all, but it would just be this huge bond universe and whatever the duration of those bonds are in that type of interest rate environment, this would extend the duration modestly.

Mr. Vazquez indicated he would prefer to see flexibility in the language with the average duration of the core bond portfolio. He also stated, to the extent the rates should ever skyrocket, he thinks the Board needs to make a determination whether to maintain the asset allocation and the benchmark or to make a decision to lock in whatever works for the portfolio in the long term. More discussion ensued among the Board members. Mr. Vazquez suggested instead of “the portfolio will be comprised primarily of issues” it should read “the portfolio will maintain a duration within 1-2 years of the index”. Mr. Rue suggested adding “plus or minus 1 year of the benchmark”. Mr. Vazquez agreed.

Mr. Moore again referred to page 16.21 of the agenda packet where it states, “Investment in non-dollar denominated bonds permitted, however, shall not exceed 15% of the market value of a single manager portfolio or 10% of the aggregate market value of the core fixed income portfolio.” He then inquired how an individual manager has any view as to what the total core fixed income portfolio would consist of, since he only has a piece of it. Mr. Rue responded this would be in the manager guidelines for the Core Fixed Income portfolio that will flow through to a manager at no more than 15%. He reiterated PCA feels monitoring the guidelines was a staff function. Mr. Moore stated unless staff wants to take on this responsibility, it would be better to drop out the portion of the guidelines that talks about the combined portfolios and just deal with the individual manager’s guidelines. Mr. Rue responded, in aggregate, once given a set of guidelines, the managers have a highly automated system where they can plug in all these things and generate compliance reports and these guidelines are the risk tolerance for the portfolios. Mr. Vazquez clarified the question is regarding the sentence stating “15% for any single manager, but then also states “in aggregate all the portfolios should not be more than 10%”. He then inquired if each manager can do 15%, and if they do, then it does not fit in with the 10%.

Mr. Vellon reiterated, the Board has been making massive decisions, in terms of the investment restructuring, and monitoring has to be the function of the consultant, as the person who is receiving the numbers every quarter. He added having aggregate controls is appropriate and necessary.

Mr. Rue stated, in terms of the question, he has given that language and he agrees the Board should address the 15%. Mr. Vazquez then inquired if Mr. Rue was suggesting the Board leave the language as is and then, when they engage in core fixed income managers, the contracts will be specific as to not violate the 10%. Mr. Rue responded in the affirmative. Mr. Moore commented this manager would be held only to the contract the Board establishes with that manager and the other language relates only to the Board in terms of what guidelines they are trying to establish with the whole portfolio. Mr. Vellon informed Mr. Moore the portfolio had to be monitored, because there were a lot more guidelines, such as the quality of the securities, exposure to any one industry, or percentage of stock ownership relative to overall all issue of the company stocks. Mr. Moore expressed, he would think from Mr. Vellon’s standpoint, that he would want to see the freedom to invest up to the 10% level and anything between 10% and 15% they would have to touch basis with the Board as to not violate the overall 10% as a requirement in the contract. Mr. Vellon expressed he was not in favor of this, because this slows down the process and the Board is trying to make it flow smoothly, which is where the guidelines come in, and somebody besides the

manager needs to be monitoring compliance. He stated the question seems to be should this be the responsibility of the consultant, whose contract provides for this, or should it be the staff. Mr. Moore stated it was not a matter of it being a consultant or staff, but that there is not a very effective control and the control is going to be exercised after the fact. The discussion continued among the Board members.

Mr. Moore again referred to page 16.17, where it states "The Board may require that active equity managers direct brokerage transactions for Plan assets for soft dollar usage and commission recapture, only when best execution can be assured." He expressed he was troubled by this because there is no easy visibility into what is being obtained for the direction of transactions to a particular broker, and he would be much more comfortable if they used a public agency. Mr. Rue inquired if Mr. Moore was indicating he would rather have a recapture program where one recaptures commissions and no service is involved and one obtains a rebate back to the fund and there are no soft dollar services. Mr. Moore expressed he did not know who was keeping track of all the transactions and what the net benefit is to the Board versus various players within the Plan. A discussion ensued among the Board members. Mr. Moore recommended striking the sentence.

Mr. Moore referred to page 16.19 of the agenda packet where it states, "the domestic equities portfolios can acquire American Depository Receipts (ADR's)." He stated this should be put in the International Equities, and not the Domestic Equities, and if the search were for Domestic, why would there be a desire on the part of a Domestic manager to be able to invest in ADR's. Mr. Rue responded the benchmark, the Russell 3000 and all the constituent benchmarks DWP has, do not include ADR's. Mr. Moore emphasized, for clarity, he recommends omitting the ADR's for the Domestic Equities and replacing it in the Non-U.S. Equities. Mr. Rue suggested leaving it both ways because it will allow flexibility in both places for the active managers. Mr. Vellon commented when the contract was negotiated for the specific managers, this same issue arose, and the reference to ADR's under "unauthorized" investments was removed from the specific manager guidelines at the recommendation of PCA. Mr. Moore withdrew his motion for changes on this issue. Mr. Vellon suggested giving staff a chance to revisit the issue and they will bring it back to the table.

Mr. Moore referred to page 16.21 where it states, "the total portfolio's average rating will be A or better by Moody's or Standard & Poor's, however, the lowest debt rating permissible is Baa3 (Moody's or BBB- Standard and Poor's). He then inquired how the average rating of "A" compares to what DWP has had and other comparable pension Plans have. Mr. Rue responded, as far as other large core portfolios, they tend to be higher quality. He explained other large core portfolios tend to be higher, and on the corporate side, it has been more of a challenge, because of a lot of well-known companies crossed over in the corporate bond market over the last year and a half. Mr. Rue added it has been a challenge in terms of continuing to maintain the "AAA" within the corporate sector. He stated there were virtually no "AAAs" in corporate land, but Plan sponsored portfolios tend to be more rated in the "AA" and better. Mr. Vazquez inquired how the Lehman Aggregate was considered in the rating. Mr. Rue responded it was rated "AAA". Mr. Vellon inquired if it was fair to say the language is what PCA had recommended to the Board, based on the asset allocation

study. Mr. Rue responded in the affirmative. Mr. Vellon suggested, if there was discomfort by any Board member with the current language, it should be revisited, to figure out how this would affect the whole expectation of the Plan's portfolio. Mr. Rue commented that particular guideline was more a function of how much one wants the managers to go down the credit risk spectrum in order to add value. More discussion ensued among the Board members.

Mr. Vellon noted Mr. Rue conducted an Asset Liability and an Asset Allocation study and also made a projection the current long-term performance expectation was in the area of 8%. He added PCA also came up with a more efficient portfolio producing almost this rate over the long term, at a reduced risk. He then inquired, if the Board changes the language to "AAA", should they maintain the same kind of return expectation over the long term or would it not make a difference at all. Mr. Rue responded to the extent the Board is hiring active managers (which PCA recommends), they are most likely going to be taking active risks which will add value beyond the core "AAA" Passive portfolio. Mr. Rue indicated they might be taking a little bit of a credit risk in terms of the active managers having portfolios that are slightly different from the benchmark, but the expectation is to add 50 basis points to the fixed income portfolio through active management, so, over the entire portfolio, the expectation is to get somewhere between 10 and 20 basis points of excess return through this process. Mr. Vellon inquired if the Board hires six new investment managers and instructs them they cannot hold less than "AAA", would they still be expected to have this kind of additional return over the long term. Mr. Rue responded they could not do this. Mr. Vellon stated this was his point, because when PCA made the recommendation, it was predicated on the fact managers were going to be allowed to manage under certain parameters and risks. Mr. Rue commented, subsequent to this, the Board also adopted active managers to hopefully add incremental value in terms of the portfolios.

Mr. Moore inquired about Mr. Vazquez's comfort level with the present language. Mr. Vazquez responded he would leave the language as is, because the Board is not going to hire any managers having an overall portfolio that is graded "AA", because that manager would be out of business in a short period of time to the extent there is too much risk taken. He added the type of managers the Board is looking for are top of the line long-term prudent investors. Mr. Rue commented the active manager portfolios would be rated somewhere between "A+" and "AAA-" depending on the manager's style. Mr. Vellon informed Mr. Moore this was something the consultant would be monitoring so the Board would have an opportunity to make an assessment and the guidelines is not cast in concrete, but this is a live document subject to Board amendment.

Mr. Moore noted on page 16.20 (item 2), 16.22 (item 9) and in some of the other guidelines, it states the managers are supposed to stay fully invested 95% or even 99% and other guidelines state, although fully invested, it is encouraged for transitional or temporary investment purposes, they may not have to be. He then inquired about the variance in the way this is handled. Mr. Rue responded this was fairly generic language and active managers would be dealing with cash to some degree. Mr. Moore commented he was just concerned with the inconsistency. Mr. Rue stated the intent is that managers be fully invested. He added, to the extent there is no disagreement, this

clause could be put in the other asset classes, emphasizing this is not unique to the International and Fixed Income asset classes.

Mr. Vazquez inquired if any changes were going to be made. Mr. Rue suggested it would be better to be consistent one way or the other. Mr. Moore stated, since the other requires specific numbers which will vary depending on the type of fund, it would be better to put the clause.

Mr. Vellon referred to page 16.10. He explained Mr. Moore was concerned with the performance objectives and the guidelines for the Domestic Equity Manager Large Cap Value indicate. He noted on an annual basis it is expected to outperform the Russell 1000 value index return, net of fee, except with Merrill Lynch, it will add expenses and the measure would be gross of fees. He stated, the question was, does PCA see a need to have a different language for Merrill Lynch versus MFS, or should there be a single language for both. Mr. Rue responded all managers should be benchmarked net of fees and he had expressed this several weeks ago. He suggested putting the “fees and expenses” for both and the dividend reinvested pertaining to the Russell 1000 Value Index and having dividends reinvested in the index for both value managers. Mr. Vellon indicated a correction would be made for the same sentence to be included for both value portfolios.

Mr. Rue commented Boards usually make a choice to include manager guidelines and the typical approach is to have a single set of guidelines for each manager. He stated DWP has a different format because it is a general guideline for each class of managers. Mr. Rue suggested, instead of using words such as “Manager A”, it should state “the Manager”. Mr. Vellon indicated this phrase was a typo and it was already noted and it would be corrected to show the managers names as applicable. Mr. Rue suggested the specific reference to specific managers should be shown as exception footnotes. Mr. Moore summarized the other changes he suggested before Mr. Rue’s arrival.

President Romero inquired if an action was required. Mr. Vellon indicated the action would be to adopt the Investment guidelines as amended today, but staff will submit the final version to Mr. Rue for his review, so he knows exactly what changes were adopted by the Board.

Mr. Moore then moved adoption of Resolution 04-32 with the noted amendments.

Seconded by Ms. Calvache and carried unanimously after the following vote:

Ayes: Romero, Vazquez, Moore, and Calvache

Nays: None

#### **17. Discussion of potential Request for Proposal (RFP) for a Plan’s External Auditor.**

Mr. Vellon introduced item 17 as the discussion of potential Request for Proposal (RFP) for a Plan’s External Auditor. He indicated this was something he requested be placed

on the agenda on the basis of the major changes adopted by the Board such as active management of assets and selection of multiple investment managers. He suggested the Plan is close to \$6 billion and there is a need for someone to monitor compliance and making reports directly to the Board. Mr. Vellon stated, in addition to this, DWP pays \$25 million a month in benefits and it would be good to have someone audit these as an external auditor. He clarified this was being presented to the Board for discussion only and staff would try to develop an RFP in coordination with the DWP auditor's office and will bring such RFP back to the Board for consideration. Mr. Vazquez requested something in writing with regards to scope and frequency of the audits be submitted to the Board. Mr. Vellon explained the frequency would be once a year and the scope would be the whole Plan. Mr. Vazquez indicated he would need more data on the scope and something more defined that would go out in an RFP as to what the expectations are.

Mr. Moore inquired if Mr. Vellon was asking for a replacement of Simpson & Simpson. Mr. Vellon responded in the negative, adding Simpson & Simpson only audit the financial statements every year and they do not perform a comprehensive audit of the whole Plan operation. He indicated this was presented only to see if the Board was receptive to the idea.

President Romero stated he understands Mr. Vellon's concerns, and when the process moves to full discretion it is prudent, before it begins, to have checks and balances, and to maintain continuity. He indicated he was in full support of this. Mr. Vazquez expressed he was not against an audit, he was just inquiring about the RFP and the scope of the plan. Mr. Vellon explained an RFP would state this is a \$6 billion Plan and we issue payments to the retirees in the area of so many million dollars per month, we issue disability and death benefits of so many million dollars per month and there is a Plan document controlling how the benefits are calculated and we would like to make sure that every year the usual and customary practices for auditors are implemented, relative to operations like the DWP Plan. He added a portion of the RFP would state we are also in the process of moving into a full discretion investment management structure, within an asset allocation program, subject quarterly reviews, with a stable of 14 managers.

Mr. Vellon reported there were standard auditing techniques typically used for Plans like DWP's and these audits represent a standard procedure for most Public Plans. He explained the Board, can consider internal or external auditors, but an analysis was already done by the DWP Internal Auditors and they indicated they do not have the expertise to monitor/evaluate the investment side.

Mr. Moore inquired if the external auditor would be focusing on the transaction relative to the dollar movement, or the performance of the 14 managers and PCA, in terms of what the Board's expectations are versus what they view as performance against those expectations. Mr. Vellon explained performance is typically outside of an external audit. He noted an audit has to do with correctness of calculations, whether managers are properly selected and if the selected managers are staying within general guidelines. Mr. Vellon suggested, perhaps a professional auditor can attend a future Board meeting to give the Board an idea of what their job entails.

Ms. Calvache indicated a long time ago, the Board discussed this and came to the consensus an audit was needed, but there was no formal action. Mr. Vellon commented, many years ago DWP was paying \$5 to \$10 million a month, but now payments exceed \$25 million and this will be compounded by having 14 full discretion managers. He then reiterated, in an operation like this, it would be prudent to have someone looking over your shoulders and giving direct reports to the Board, perhaps annually or once every two years. Mr. Vellon added there is great value to the Plan in having an auditor and he strongly recommended it. Mr. Moore expressed he was not opposed to having the external auditor, but agreed with Mr. Vazquez that more information was needed on what it would actually encompass. He also suggested it would be a good idea to have one of the auditing firms give the Board an idea of what they do exactly.

- 18. Consideration of draft contract agreements for “search” services agencies in connection with the Plan’s old pending death benefit claims:**
- a) **International Claims Specialists.**
  - b) **Docu-Search.**

Mr. Vellon explained Item 18 was intended for the pending old death cases (totaling 40 – 45 cases) which have not been paid, some going back 20+ years. He added this was part of a due diligence effort before figuring out how to close those claims. Mr. Vellon reported two search specialist firms were initially identified, and both initially made a proposal of \$75 per “match” and \$50 for “no matches”. He stated, at the request of the Board, staff went back to the firms and one of them stated the effort was the same, whether or not a match was found. Mr. Vellon reported this firm (Docu Search) would only accept the \$75 (match) and \$50 (no match) fee. He added the other agency (International Claims Specialists) modified their fee to \$90 for “matches” and \$15 for “no matches”. Mr. Vellon suggested having one agency run all of the pending cases at \$90/\$15 and then take the ones left (as no matches) to the other company at \$75 and \$50. He indicated the resolution in the agenda packet also incorporates prior suggestions by Mr. Moore and approval was recommended.

Ms. Calvache moved adoption of Resolution 04-24. Seconded by Mr. Moore and carried unanimously after the following vote:

Ayes: Romero, Vazquez, Moore, and Calvache  
Nays: None

- 19. Consideration of use of Exchange Traded Funds (ETF’s) to gain exposure to Small Cap Equity and International Equity (Developed and Emerging) segments.**

Mr. Vellon explained item 19 refers to a report presented to the Board at a prior meeting and Mr. Moore had questions regarding this. He explained the report includes a recommendation that the Exchange Traded Funds (ETF’s) could be alternatives for the Board to have exposure to International investments and Small Capitalization

companies, and the Board could just leave it up to the transition manager for them to explore this option.

Mr. Rue expressed this was an interesting topic to explore and the main issue is the goal of getting exposure to asset classes instead of waiting with large cash reserves. He stated, with the exception of the Plan's International Equity exposure, which is pretty close to being funded, DWP's portfolio will have the overall asset class exposure. Mr. Rue stated, given some of the tradeoffs discussed in his memo, some of the more specialized ETFs are very possible and PCA went to a couple of investment banks and discussed what their expertise was in the market. He suggested ETFs might be useful during the transition period if given to the transition manager to oversee as an interim exposure.

President Romero commented this was not something he was in support of or against, but just wanted it addressed by the consultant, with regards to getting particular types of exposure. Mr. Moore expressed one of his concerns is the language of the resolution does not seem to tie well to what he believes is PCA's recommendation. He stated, to his understanding, PCA recommends the Plan forego the ETF options in the International mandates and delegate the transition managers to use ETFs to gain potential exposure to the Small Cap segment during the interim review contract approval periods, but only if the transition manager believes these are appropriate. Mr. Moore then compared the language of the resolution, indicating it states, "Board members, upon recommendation of PCA, are in favor of pursuing ETFs to gain exposure to the Domestic Equity market and the International Equity market". He noted, to his understanding PCA has not said this relative to the International Equity market. He stated the resolution seems too permissive "that the staff is asked to coordinate with the Plan's consultant to use the ETFs, if possible, through the Plan's newly hired Transition Managers." Mr. Moore expressed he was concerned that the resolution is very permissive and still encourages staff to discuss this with the transition managers and PCA's report strongly argues against preceding this way, both because of the liquidity, the cost associated with it and the time it would take to trade in and out. He expressed the Board should not pursue this at all and recommended not approving the resolution. President Romero agreed with Mr. Moore's recommendation.

Mr. Vellon quoted from PCA's report, indicating their memo provides some details on specific ETFs the Board might consider "for gaining exposure to Small Cap Domestic Equity segments and the developed and emerging segments of the International Equity markets". He clarified he does not see a reason why the Board would have to pursue this option.

## **20. Board Contracts Coming Due Within the Next 6 Months: BNY Western Trust Company (expires February 29, 2004).**

Mr. Vellon stated, typically any contract expiring within the next six months is brought to the Board's attention in case Board members want to pursue various options. He reported the next contract due was BNY Western Trust, for custodian services.

President Romero indicated he values the relationship DWP has had with BNY (Bank of New York) and they have provided quality work to the Board. He inquired of the Board if they find any value in going out and seeing what the competition has to offer now that the Board is going into a full discretion format and to also see if BNY is providing the best pricing. President Romero reported DWP has worked with BNY since the 1980s and there haven't been any problems with them with respect to their custodian services.

Mr. Vazquez recommended going out with an RFP for custodian services. Mr. Moore inquired how long it has been since an RFP was done. Ms. Bhatia responded two years ago. Mr. Vazquez clarified if an RFP was done just two years ago, he withdraws his recommendation and instead appoint BNY for a third year.

President Romero commented his only concern was that two years ago the Board was not fully invested under active management and there are other BNY services the Board is currently dealing with.

Mr. Vellon clarified when it is stated, "the relationship goes back to the mid 80's", it is referring to BNY starting out as Bank of America, before the acquisition of the Trust Services Division by BNY. Mr. Moore inquired if there was any advantage, given all the other major changes, putting this off until all the other things are taken care of. President Romero responded it needed to be addressed now, because the contract expires in six months and there is going to be a lot more activity.

Mr. Vazquez inquired, with the change to full discretion management, what impact is this going to have on custodial activities. Mr. Vellon responded he had talked with BNY representatives earlier in the morning and they expect a significant impact, in terms of the activity, and wanted to discuss the relationship. Mr. Vazquez stated, given that, he recommends going out with the RFP, rather than renegotiating fees with BNY under the current contract. Ms. Calvache also expressed she would be in favor of an RFP.

Mr. Vazquez moved issuing an RFP for custodian services. Seconded by Ms. Calvache and carried unanimously after the following vote:

Ayes: Romero, Vazquez, Moore, and Calvache

Nays: None

President Romero expressed he hoped to continue a relationship with BNY, but the Board wants to make sure they are getting the best bank for their money. He then requested a representative of BNY address the issue of the press reports (Wall Street Journal) with respect to Bank of America and their inappropriate overnight trading practices relative to the Nations Fund, currently used by the Plan through BNY. President Romero also reported the press also talks about a broker from Merrill Lynch arrested earlier with respect to this type issue with Bank of America, but relative to other hedge funds. He reiterated DWP has a STIF fund that is used (Nations Fund) and inquired if there would be an impact on DWP in any way, relative to the investigations in progress. He requested that BNY provide something in writing, just to say the hedge funds and overnight trading with Nations Fund does not affect DWP's relative to STIF fund.

Mr. Mastro approached the podium.

President Romero recognized Mr. Mastro.

Mr. Mastro commented, with regards to the RFP for custodian services, it encompasses the security lending guidelines the Board may develop with PCA, and it appears there might be some ability for the investment guidelines to be broadened somewhat, to allow for the Board to generate more income for the Retirement Plan which can be used to offset the BNY custody fees.

Mr. Mastro also commented on the other discussion regarding the “compliance monitoring” and this was a BNY function available to the Board at their request. Mr. Vellon inquired if there was any additional cost for this service. Mr. Mastro responded there was an additional cost, but in the spirit of trying to mitigate the cost to the Plan, the relaxation of the security lending guidelines will present an opportunity to possibly offset those costs under a comprehensive scope. He also pointed out, in the interim, as DWP hires their International Managers, the current custody agreement with BNY does not have language allowing for the managers to settle foreign transactions or the custody of those foreign assets, so BNY staff have begun the process of working with Plan staff on contract amendments coordinated with legal counsel, to actually facilitate the implementation of the Board’s international mandate. Mr. Mastro concluded his remarks and returned to the audience.

Mr. Vellon expressed, the services received from BNY, since the time he joined DWP, have been excellent and Msrs. Kuhn and Mastro, and the rest of their staff have always been very helpful and professional when called upon.

**21. Consideration of Retirement Plan Amendment to Rescind Eligibility for Department of Water and Power Employees’ Retirement Plan Death and Disability Benefits for Daily Rates Employees Represented by the Orange Counties Building Trades Council and Hired on or After February 18, 2003 (The Date of the Board of Commissioners Approval of the applicable Memorandum of Understanding).**

Mr. Vellon presented Item 21 as the consideration of Retirement Plan Amendment to Rescind Eligibility for DWP Employees’ Retirement Plan Death and Disability Benefits for Daily Rate Employees, Represented by the Orange Counties Building Trades Council and hired after February 18, 2003. He added this was the result of a recent MOU provided by Labor Relations and adopted by the Board of Commissioners. He informed the Board Mr. Lakatos was present to make a presentation.

Mr. Lakatos approached the podium.

President Romero recognized Mr. Lakatos.

Mr. Lakatos stated the Los Angeles and Orange County Building Trades Council represents daily-rated civil service employees and for some 40 years DWP did not have a contract with that organization. He stated in about the year 2000 it was determined DWP is required, under the Administrative Code, to provide prevailing wages available in the industry including pension benefits. He added coverage under the DWP plan would represent double coverage for new employees and this is the reason for the proposed Plan change. He reported there are about three members of the council covered by the Plan and they are expected to maintain their coverage under a "grandfather" provision. Mr. Vellon reiterated this amendment results from the MOU, approved by the Board of Commissioners and Plan staff would be working with the attorneys and labor relations to make sure the appropriate language is submitted to the Board of Commissioners and to the Retirement Board.

Mr. Vazquez moved adoption of Resolution 04-33. Seconded by Ms. Calvache and carried unanimously after the following vote:

Ayes: Romero, Vazquez, Moore, and Calvache  
Nays: None

Mr. Lakatos was excused.

President Romero ruled Item 23 be taken out of order (due to Item 22 being Closed Session).

**23. Retirement Plan Manager's comments.**

**a) DWP Plan Newsletter for retirees (September 10, 2003 Edition).**

Mr. Vellon reported the Board had already received a copy of the September 10, 2003 Newsletter for DWP retirees.

**b) Update on office remodeling.**

Mr. Vellon informed the Board Mr. Salas cleared the remodeling of the Retirement office. He added the DWP Architect will submit a written plan, as requested by Mr. Salas, in order to start building so many cubicles at a time. He indicated he had not received anything from the Architect yet. President Romero requested the Architect come before the Board to provide a regular updates.

**c) General Items.**

Special Board Meeting September 30, 2003

Mr. Vellon announced the next Special Board meeting would be held September 30, 2003, for the performance evaluation. He noted Mr. Moore expressed interest in certain performance data and this will be provided by PCA.

## Personnel Changes - The Boston Company

Mr. Vellon stated a letter was received from The Boston Company representatives reporting Mr. Quinn Stills' resignation. He added over many years Mr. Stills had been the main contact with the Board, along with Mr. Harkins.

Mr. Harkins (of The Boston Company) approached the podium.

President Romero recognized Mr. Harkins.

Mr. Harkins reported Mr. Stills submitted a resignation letter after 13 years with the firm, and since then he had been in talks with his Senior Management to finalize the terms of his separation. He stated it was a mutually agreed upon an amicable departure and the parent company is still in talks with Mr. Stills in order to provide him with seed capital for a new firm he is starting. Mr. Harkins indicated as soon as Mr. Stills submitted his resignation letter, the primary contact for DWP was transferred to being under the care of their Large Cap Investment team. He added Mr. Stills has been before DWP's Board many times and has been the face of the portfolio management process, but had also been drawing on the resources of the Boston Company team. He then handed out a listing of the team members, consisting of 16 employees, and indicated he and Pete Lopez will continue to work very closely with the DWP's account. Mr. Harkins recognized DWP presents an interesting situation and what they do for DWP is unique and he would make sure that Robert Eastman, the portfolio manager who is going to be the head person, does not do anything to trade the account into one of the other Boston Company strategies so he maintains the basic characteristics, such as low turnover, etc., and the historic concept will continue on through the end of the assignment, understanding the larger changes the Board is making. He stated, since it was Mr. Eastman's investment group who worked on the portfolio, he is already up to speed. Mr. Vellon commented the Board has received a copy of the letter sent by The Boston Company confirming what Mr. Harkin has just reported.

President Romero thanked Mr. Harkins for his timely notification and for coming in person before the Board.

Mr. Harkins left the meeting.

President Romero announced Board members would convene in closed session pursuant to Section 54956.9 to confer with legal counsel on the Los Angeles Superior Court Case No. 297925 as listed on the Board's agenda item 22.

### **22. CLOSED SESSION Pursuant to Section 54956.9 to Confer with Legal Counsel on Mandeson v. Department of Water and Power Employees' Retirement Plan, et al., Los Angeles Superior Court Case No. 297925.**

[A closed session took place.]

During open session, President Romero reported in order to comply with Section 54956.9 there was a unanimous vote authorizing the City Attorney to proceed as recommended.

The Board meeting was adjourned at 12:36 p.m.

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JAVIER ROMERO  
President

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DUAMEL VELLON  
Secretary

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SILVIA TESSENEER  
Recording Secretary