

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

**MEETING – November 19, 2003**

**Present:**

Javier Romero	President
Lilly Calvache	Vice President
David H. Wiggs	General Manager
Leland Wong	Commissioner
Dan Mirisola	Board Member
Michael Moore	Retiree Member

**Absent:**

Ron Vazquez	Chief Financial Officer
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**Others Present:**

Duamel Vellon	Retirement Plan Manager
Vikki Burks	Recording Secretary
Neil Rue	PCA (Pension Consulting Alliance)
Mike Wilkinson	Deputy City Attorney

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

[Pledge of Allegiance]

Mr. Vellon indicated there was quorum of the Board.

President Romero expressed his condolences, on behalf of the Retirement Board, on the passing of Mr. Ron Vazquez's mother. He then proceeded to recognize individuals who requested to speak under Public Comments.

**PUBLIC COMMENTS**

Board President Romero recognized Mr. Donald E. Benton (Retiree).

Mr. Benton approached the podium and expressed his gratitude to Mr. David Wiggs and Chief Financial Office Mr. Ron Vazquez for their interest in his case, and for their understanding as to fundamental procedural fairness, in resolving implementation issues, by scheduling requested Board agenda item. He thanked Mr. Wilkinson and reported he was able to resolve (with Mr. Wilkinson) the differences on legal issues and interpretations, quickly, through regular e-mail communication, which the Board was advised of at the October 15, 2003 Board meeting. Mr. Benton stated the original implementation issue is still not resolved. He mentioned receiving an e-mail on October 9, 2003 from Mr. Vellon, which stated, "At this very moment, there is not a plausible answer to your concerns about the failure in implementation". Mr. Benton stated he

would acknowledge in writing, to Mr. Vellon, advising no Board action be required when the implementation is finally resolved. He noted President Romero expressed interest in looking further into this matter, and he would be available to communicate by e-mail. Mr. Benton thanked the Board and retired to the audience.

Mr. Vellon reported items 1 and 2 were submitted for consent approval as follows:

- 1. Approval of Minutes for the October 15, 2003 Regular Board.**
- 2. Termination from Monthly Rolls as of November 2003:  
Retirement Resolution for November 2003.  
Termination from the November 2003 Family Death Benefit Roll:  
Evadne Cokeh – attained 18 years of age.  
Termination from the November 2003 Survivorship Roll:  
Callie L. Monk – death.  
Termination from November 2003 Permanent Total Disability Roll:  
Leroy Barnes – death.**

Mr. Wong moved adoption of the above items 1 and 2 on consent. Seconded by Ms. Calvache and carried unanimously after the following vote:

Ayes: Romero, Moore, Wong, Mirisola, Wiggs, and Calvache  
Nays: None

- 3. Special Board Minutes of September 30, 2003.**
- 4. Report of Payment Authorizations as of October 2003.**
- 5. Short Term Investments as of October 31, 2003.**
- 6. Report on Long Term Investment as of September 30, 2003.**
- 7. Distribution of Securities by Type and Class as of August 31, 2003 and September 30, 2003.**
- 8. Statement of Investments Owned as of August 31, 2003 and September 30, 2003.**
- 9. Equity Investments as of August 31, 2003 and September 30, 2003.**
- 10. Notice of Deaths as of October 30, 2003.**
- 11. Schedule of proposed interview dates for the selection of: Small Growth Manager; Small Cap Value Manager; Emerging Market International Managers; Core Fixed Income Managers; High Yield Managers.**

Mr. Vellon recommended items 3 through 11 be received and filed. He pointed out item 11 encompasses the schedule of manager interviews suggested by PCA (Pension Consulting Alliance).

Mr. Moore moved the above Items 3 through 11 be received and filed. Seconded by Ms. Calvache and carried unanimously after the following vote:

Ayes: Romero, Moore, Wong, Wiggs, Mirisola and Calvache  
Nays: None

**12. Consideration of the Plan Consultant's (Pension Consulting Alliance) request for an increase in annual consulting fee for the 3<sup>rd</sup> year of their three year contract (Expires November 2004).**

Mr. Vellon stated Mr. Allan Emkin of PCA submitted this request to be placed on the agenda.

Mr. Neil Rue stated PCA was seeking an increase in their final third year of their contract, from \$100,00 to \$200,000, to match the fee on their first year of contract. He noted the original contract is a deescalating contract in a sense the fees decline over time each year. Mr. Rue stated this was reasonable in terms of its original intent; plenty of activity in the first year contract and by the third year contract, PCA was expecting to be in maintenance mode, primarily providing performance reports on existing assets. He expressed concerns this has not been the case, and there is still a lot of Board activity in the pipeline. He further expressed PCA is eager to continue working with the Board and wants to see through the transition to full external management taken care of in a diligent, careful and timely manner. He noted the proposal before the Board is intended to match the activity with the financial alignment that would make this a beneficial partnership for all concerned.

Mr. Moore inquired how PCA tracks costs originally budgeted for the amount set forth, versus new activity involved. Mr. Rue stated, in terms of manager searches, which is the bulk of the incremental activity, new work is involved. He stated the original scheduled contract contemplated, at this point in the process, the Board would be at a fully funded mode and PCA would be maintaining and issuing performance reports with possibly one or two incremental projects per year, but with these searches still pending, manager portfolio data definitely has changes and needs to be updated, meaning new information has to be gathered and reviewed causing significant incremental work involved with the remaining manager searches.

Mr. Wong stated he did not have a problem with the request for the increase and it may probably be well deserved, but he feels he does not have enough information to be able to make any type of decision today. He indicated he would like to see the original contract and what the scope of work called for as it relates to activities in year one, two and three and if indeed more new work was called for which was unforeseen for the third year contract. He suggested a deferral on this item until he could review the information.

Ms. Calvache concurred with Mr. Wong noting she would like to know just how far behind the Board is in the searches and how much more needs to be done.

Mr. Moore moved deferral of item 12. Seconded by Mr. Wong and carried unanimously after the following vote:

Ayes: Romero, Moore, Wong, Wiggs, Mirisola and Calvache  
Nays: None

### **13. Reconsideration of Fred Alger as Growth Manager in light of recently published news.**

Mr. Vellon reported he and Mr. Wilkinson were at City Council yesterday (November 18, 2003) regarding another matter and Councilman Bernard Parks indicated he would be requesting a Council agenda item regarding the relationship between the City and any managers involved in the Mutual Fund or any other scandal. He commented on letters received from Merrill Lynch reporting full cooperation with all inquiries and investigations. Mr. Vellon indicated the subsidiary company the Board selected does not appear to be subject of these investigations and it apparently has more to do with their parent company. He indicated the Plan has not received any information from MFS, one of the managers selected by the Board. He noted the news today indicates an investigation has opened up to include Fidelity and MFS, though details are not yet clear. Mr. Vellon stated there is a request for comments filed by from Mr. Dan Chung, President of Fred Alger, who is present today.

Mr. Dan Chung, CFA, President, Ms. Teresa Phraner, Vice President of Fred Alger Management, Inc. and Mr. Ramon P. Marks, Sr. Partner of Dorsey & Whitney LLP approached the table.

Mr. Chung thanked the Board for allowing Fred Alger to both speak regarding these very important issues, and discuss fully and openly any concerns the Board has, affecting Fred Alger as well as the Mutual Fund Industry. He then introduced Mr. Ramon Marks and explained Dorsey & Whitney is an outside law firm Fred Alger has contracted since August 2003 to conduct an internal review of these issues and, Ms. Teresa Phraner is the Plan's client service representative.

Mr. Chung provided a one-page letter to the Board outlining the chronology of events beginning in August of 2003 when the SEC and the New York Attorney General sent out approximately 80 subpoenas to mutual fund companies requesting information regarding late trading, market timing and other practices. He stated Fred Alger immediately engaged Dorsey & Whitney to begin an internal review. Mr. Chung noted, during the review, it was discovered one client might have been involved in late trading in the area of retail mutual funds. He reported, upon discovering this, Fred Alger immediately suspended Mr. Jim Connelly and reported these findings to both the SEC and Attorney General. Mr. Chung further added, during investigations, it was also discovered Mr. Connelly had in fact attempted to obstruct justice by instructing subordinates to destroy documents/e-mails, and by not cooperating with Dorsey & Whitney. He stated, upon learning of this next event, he immediately fired Mr. Connelly and notified the proper authorities, to which Mr. Connelly was prosecuted and entered a guilty plea as well as a settlement with the SEC. Mr. Chung added a letter was sent to their clients on October 16, 2003 describing, in detail, the circumstances surrounding this one client's activity, which began in March of 2003 until August 2003.

Mr. Chung indicated an executive did interfere with the review and, therefore, caused legal events to unfold, generating a lot of media attention on Fred Alger Management. He emphasized Fred Alger Management has gone through most every transaction occurring this past year and found no other instances of late trading. Mr. Chung stated

the late trading occurrence was an isolated incident with one client, which is against policy and represented a subversion of company principles by Mr. Connelly. He stated they have done a thorough investigation of their investment team and none of their activities or conduct is in question. He added trading activities have been reviewed and are reviewed regularly (company policy) and there have been no improper trading by any investment professionals. Mr. Chung stated no investment professionals had any knowledge or participation in the arrangement of this late trading incident occurring at Fred Alger Management. He noted non-investment individuals at the company have shown great integrity, in particular those who refused to cooperate with Mr. Connelly when asked to destroy evidence or otherwise fail to cooperate with the internal review. Mr. Chung indicated the status of the investigation at this time is they are assessing whether shareholders have been impacted, in particular with the late trading activity. He mentioned Dorsey & Whitney have retained Deloitte & Touche to assess whether any financial harm was caused by late trading activity and, if there was, Fred Alger will make those shareholders whole and promised to return management fees in relation to the clients.

Mr. Chung stated Fred Alger has taken action with the issue of market timing. He noted, while they have not found any illegal market timing in any of their funds, they understand the concerns of their clients regarding this issue. Mr. Chung stated the industry is in the period of change and reform, and Fred Alger strives to be leaders and are helping regulators in setting higher standards, therefore, they have banned market timing in all of their mutual funds as of several weeks ago and are determined to put into place everything necessary to ensure this is effective going forward. He noted it has been a very difficult time for the company and employees feel just as betrayed as their clients by a senior executive whom they trusted. Mr. Chung stated LADWP is very important to Fred Alger and now, more than ever, the firm understands the need for every single employee to live up to the highest ethical and professional standards.

President Romero stated he requested this item be put on the agenda as he is struggling with this decision. He reported one of the many concerns he has is no one person from Alger top management called him, or the Retirement Plan Manager, before news of these events broke out. President Romero noted he did speak to Mr. Chung and client services staff did call the Plan, but after he had already read about it in the newspaper and there was no follow-up after. He stated fund managers have a fiduciary duty to their members and there is a certain standard level of care required of all managers and at this point he is not really comfortable starting out a new relationship. He added, going forward at this time, especially as the plan has not funded Fred Alger, it makes his decision a little easier.

Mr. Wong inquired when it was identified there were inappropriate occurrences, when did Fred Alger find out and at what point in time did management inform LADWP of the incidences. President Romero stated he heard about it from reading the Wall Street Journal.

Mr. Chung stated a letter dated October 16, 2003 was sent out to all clients and he did not know if it was sent to each of the Board members or one office as a whole.

Mr. Wong inquired when did it all surface. Mr. Chung stated the first communication from the firm to all the clients is the letter dated October 16, 2003. He stated he wanted to make sure the first communication was correct and he wanted to be able to disseminate it to large and small clients at the same time, therefore, on October 16, 2003, letters were sent out and phone calls were made simultaneously. Mr. Chung indicated the news regarding Jim Connelly broke out earlier, as he had terminated Mr. Connelly on October 8, 2003, which is the same day he had learned of Mr. Connelly's attempt to obstruct justice. He informed the Board the SEC and the Attorney General came in two days later, October 10, 2003, to investigate and verify and interview other employees regarding Mr. Connelly in regards to the obstruction of justice and on Monday October 13, 2003 they arrested and indicted Mr. Connelly. Mr. Chung stated Fred Alger was caught off guard with the speed in which Mr. Connelly settled with the SEC and Attorney General. He noted both the SEC and Attorney General, as State and Federal regulators, are not required to give Fred Alger notice of what they are doing. Mr. Chung again reiterated they were caught off guard at how quickly a guilty plea was obtained from Mr. Connelly, just as they were preparing the client communication.

M. Wong inquired when exactly was Fred Alger going through the interview process with LADWP. Mr. Chung responded in March. Mr. Wong inquired when the contract was signed. President Romero responded in July 2003 and clarified they have not been funded as of yet. Mr. Moore inquired when the SEC first approached Fred Alger Management for information. Mr. Chung stated on August 21, 2003 the 80 or so mutual fund firms received subpoenas.

Mr. Vellon stated the Plan did receive a letter from Fred Alger sometime in September 2003, which was submitted at the Board's October 17 meeting, wherein, the company notified of Mr. Chung's appointment as company President.

Mr. Moore commended President Romero for putting this issue in the agenda so quickly, as he shares the same concerns and misgivings, as it is a very important issue. He stated the Board is entrusting Fred Alger with pension funds and ultimately the Board has to be able to trust Fred Alger to treat those funds with the care of fiduciaries. Mr. Moore stated besides the late trading issue there is an issue, which really has not been addressed as much, which is the market timing issue. He noted according to the SEC, approximately \$200 million on \$2.5 billion has been involved, which was allowed to trade, and what is the impact of this. Mr. Moore stated he heard estimates of 1-2% on a number of these funds and this is an impact on the shareholders and apparently this has been going on since the mid 1990's.

Mr. Chung stated regarding these issues, first is the law. He noted there are no guidelines or definitions regarding market timing and there has been no established industry practice. He indicated some funds allowed it, some did not, and recently in the press, of the 80-100 mutual funds which had been subpoenaed, roughly half have market timers or short time traders using some part of the funds. Mr. Chung reiterated, in the Fred Alger fund, and the Alger American fund, they did not bar market timing prior to a month ago. He noted they did not have any policy, which prohibited market timing. Mr. Moore stated he was under the impression Fred Alger limited to no more than six trades during the course of the year. Mr. Chung stated the language is contained in the

statement of additional information, quoting the precise language is “six exchanges by telephone or in writing”. He noted this provision was implemented long ago because many individual shareholders require manual processing of their order and is quite administratively expensive. Mr. Chung explained they have approximately 310 thousand individual shareholders, so the point of this language was to moderate administrative burdens, in particular market timers who were in the Alger Fund and were coming in as most do, by either an automated process or perhaps through the internet, but were not coming in by telephone or in writing. He stated their prospectus did not prohibit market timing or discourage it, having market timers in place with people and policies ensuring activities did not disrupt portfolio management. He emphasized, at this point, with the help of Dorsey & Whitney, who has engaged Deloitte and another firm to look into whether market timing in fact has caused any damage to shareholders. Mr. Chung added, there is good academic research which indicates most of the harm from market timers occurs only in international funds and the reason for this has more to do with the stale pricing or the inefficient pricing of the securities in the international markets compared to those within domestic funds. He noted Fred Alger does not have any international funds therefore they do not have the similar issue there.

Mr. Moore inquired if Fred Alger has made assurances, to the owners of the mutual funds, about reimbursing them for any market timing impact which may be found to have occurred, similar to the assurances given for the late trading. Mr. Chung stated Fred Alger is still awaiting a determination of what is or is not improper market timing, but if there is found to be improper market timing, Fred Alger will make the proper reimbursements. He noted the reason for waiting is simply in terms of the law, as there has not yet been a definition for what is improper market timing or simply what is short term trading, nevertheless, these are very important issues and he is still looking for guidance.

Mr. Moore stated Fred Alger mentioned none of the investment professionals were involved in any aspect of this relationship, and at the time Mr. Chung was the head of investment function. Mr. Chung stated he became chief investment officer on September 11, 2001. Mr. Moore inquired if Mr. Chung was aware of any of the events transpiring. Mr. Chung stated the sales and marketing function versus the investment function is entirely separate at the firm. He noted Mr. Connelly carried the title of Vice Chairman and did not report to him in any way, nor did he report to any other investment professional, so the facilitation, engagement, arrangement with respect to both late trading and market timing was solely Mr. Connelly's responsibility.

Mr. Moore inquired to what extent would Mr. Chung, as the person chiefly responsible for investments, have any say when he recognized there were large trades coming in which were caused by market timing. Mr. Chung stated he first has to note the way cash flows get reported to a portfolio manager. He stated they don't get to see the gross flow sales and purchases of the funds, but what they do see is a net number. Mr. Chung noted every day there are many transaction activities in a mutual fund or 401K, and Deloitte has just given Alger information noting approximately 1%, or less, on identified market timing transactions. He stated what a portfolio manager sees as result is not the gross sales or purchases, but the net cash number reported to them, so only when the net cash number is unusually large is when the portfolio manager would

notice it. Mr. Chung again reiterated Fred Alger had market timing policies and personnel in place specifically to monitor the cash flow and the activities of the market timers to ensure disruption was not caused to the portfolio sectors. He noted on occasion portfolio managers, including him, have noticed large cash flows and they have either objected or questioned. Mr. Chung stated it is quite possible to get a large cash flow, but it's from a large account, such as LADWP. He added the process was if the portfolio manager objected to it, they then would register it with sales and marketing, in particular, Jim Connelly, and question the activity, and then the matter would be resolved, depending on the circumstances such as the client, their frequency of the activity, the size of the cash flow, etc.

Mr. Marks, of Dorsey & Whitney, stated the investigation they are still conducting, mostly concerns market timing and this has come from the international funds. He added people are trying to make a play between the closing price of the stock abroad versus the closing price of the stock in the United States of the same company and Fred Alger does not have this, because they do not have any international investments. He noted it's stale pricing which attracts the people who want to grab the trades and Alger is not a very fertile mutual fund for stale pricing. Mr. Moore stated there was enough interest in doing so, presumably for profit.

Mr. Marks stated some people like to trade more short term or trade more rapidly and the idea of rapid trading wasn't something considered evil or unnecessarily bad, and this is where the correction of fair pricing is coming in, so one has to move up the price of their stock to reflect closing price in a foreign market. He stated Alger would like to do fair pricing, but the problem is there are no stale prices to adjust to a fair price, so the only standard is what's in the prospectuses and Alger Institutional fund had explicit language, stating they do not want timers in this fund, and in Alger American there was no language at all. Mr. Marks noted, in the Alger Fund, there is language about processing directly, in writing or through telephone, and this was tricky. He stated there has been one incident, where there was late trading with one client in 2003, for a few months, and the tragedy here is, particularly (after everything this company has already endured) one person got in the way of Dorsey & Whitney's investigation. Mr. Marks stated Alger had one limited episode by comparison, and it was the issue President Romero has fairly addressed, which has befallen the organization of Fred Alger.

Mr. Marks stated the response of the organization was extraordinary, in terms of the cooperation his company has received, and the collective outrage in response to the behavior of this person and there was this counter reaction against it and things just moved extraordinarily quick, and they immediately brought it to the Attorney General's attention. He noted the Attorney General's office thought it reflected well on the integrity of the organization, and legally, in terms of the investigation there was one late trading episode and then the impairment of the internal investigation. Mr. Marks stated they have not found any other late trading as it stands at this moment.

Mr. Vellon stated, for the record, a resolution would have to be adopted at a future meeting. He explained, for Mr. Wong's benefit, four managers have been hired by the Board, under contract: Merrill Lynch, MFS, Fred Alger and INTECH. He noted the contract with MFS is pending, but this should be completed as soon as they are done

with insurance issues. He added the Board is working with the Bank of New York (BNY) in doing the transition and the funding of those companies. Mr. Vellon indicated the Plan staff was waiting for this Board meeting today, to see what the situation is, because most of the companies selected have been mentioned (one way or another) in all these investigations Mr. Chung has so eloquently addressed. He added, Delaware and Fidelity have also been hired under contract and Fidelity has also been mentioned in the media, and all these contracts were also in the process of being finalized and their funding would follow.

Mr. Wong addressed the City Attorney, Mr. Mike Wilkinson, and inquired if a contract has been signed and no funds allocated, what is the termination clause for LADWP. Mr. Wilkinson responded LADWP has 30 days to terminate and the contracting firm has 60 days to terminate. He stated it is a valid contract and neither side has to find a particular reason to terminate, there is no need to claim a breach or anything like that. Mr. Moore added, since the company has not been funded, it becomes irrelevant. Mr. Vellon stated this is something staff needs to know, because they are in the process of doing the bulk of this work with BNY for the transition and funding.

President Romero inquired if there were any other questions or comments. Mr. Wiggs stated he doesn't know enough about this, other than what he has read and seen in the media, but it does appear to him to be an individual instance with this long standing firm. He stated this firm appears to be honorable and the people present here are trying to do the right thing and made the correction and reported to the proper authorities. Mr. Wiggs noted this is a difficult call and agrees there has to be a gut feeling for this situation and mentioned he does not know as much about the timing, when the Board was contacted and so forth, but, to some degree, he is comforted, somewhat, in which they reacted to the problem first and foremost and worried about the marketing even if it came a little bit later. He mentioned he would be a little more worried if everyone at Fred Alger was scrambling to hold onto accounts before they took care of the problem, and it seems as though they jumped on the problem as quickly as possible and the feedback is they did a good job on this. President Romero stated his position isn't necessarily just on this market timing, it was the whole experience and they have not been funded as of yet and he is wondering about the service LADWP would be getting in addition to all this they are dealing with.

Mr. Wong inquired if this can be a closed session item were a little more discussion could be involved. Mr. Wilkinson responded negatively, adding there is nothing right off the top to justify a closed session. Mr. Moore inquired if it could possibly be a potential litigation. Mr. Wilkinson stated everything in life these days could be a potential litigation and, therefore, it's got to be something more, and just looking to terminate the contract is not enough. Mr. Vellon clarified another point of information is with respect to Fidelity, the Board's decision was to consider getting into their commingled fund, which would be closer to this kind of situation, while all other managers selected will hold separate accounts.

Mr. Wiggs inquired if this needed to be decided today. President Romero stated the Board is ready to fund the new managers and a decision had to be made. Mr. Wong mentioned President Romero had very strong feelings regarding this and inquired as to

what his thoughts on this were. President Romero indicated he would prefer to go back to the initial candidates interviewed during the process and look for another firm. He stated he personally does not feel comfortable with this whole situation.

Mr. Moore inquired, with respect to the other organizations mentioned, such as Fidelity and Merrill Lynch and the fact some of their activities are being looked at as well, and his recollection is the investigation of those firms did not involve high level corporate officers, is this correct. Mr. Rue stated in general this is correct. He noted the framework PCA looks for is if there is a distribution arm and/or one has an investment arm, and the question is are the ethical fiduciary violations impacting the investment arm. He noted the example of Putnam is a completely different story, compared to Fred Alger, because there were investment fiduciaries who, had the Board hired Putnam, those were the people who were running the money and this is not the case at Fred Alger as far as he knew. Mr. Rue explained one would not know what may unfold in the future, but up to this point, the investment arm of Alger remains clean, therefore PCA would take a little bit of a different tack in approaching an Alger type of situation, versus a Putnam situation. He noted, at Putnam, \$21 billion were leaving Putnam, primarily on the international fund, which is their franchise product (running at approximately \$45 billion across all the different vehicle lines) primarily because the CIO and some of his lieutenants, at some time or another were doing market timing trades within their product.

Mr. Moore inquired when the original assessment of large capital active managers was made, were there other firms which could quickly fall in line behind Fred Alger were the Board to make a decision not to proceed with Alger. Mr. Rue responded affirmatively. He added 25 RFP's were received and the Board chose to select Fred Alger for particular reasons. He reiterated the main point is whether or not they still meet those subjective criteria the Board believes are worthwhile. Mr. Moore inquired what sort of a time delay would there be if the Board were to make such a decision, delaying approximately \$212 million, by putting into place another contract, after making a new selection (although those funds are invested presently). Mr. Rue stated the funds are invested, although not in growth stocks, but are invested in equities at this point. He informed the Board if they wanted to trade managers, in part it would entail reviewing the interview process, and, of the candidates interviewed, is there one in there which would be a viable substitute. Mr. Wong inquired if there were a top one, two and three candidate. Mr. Rue responded affirmatively, adding it shouldn't take long to make the manager selection, along with contract negotiations and so forth, it would take approximately 4-6 weeks.

Mr. Mirisola agreed with President Romero, Mr. Moore and Mr. Wiggs, adding, in the past the Board has hired other managers under investigation no one brought the subject for Board consideration like now. He noted the response from Fred Alger was fast for their organization, and being a small organization it is more likely they can involve somebody at the top level, and he appreciated the fact they did a thorough investigation before they actually gave a response, as opposed to a response expected. He praised Fred Alger's response in the form of a document covering all areas. Mr. Mirisola stated he would be willing to give them the benefit of the doubt until it is proven something is inaccurate in the letter they sent out. He expressed Fred Alger representatives did what

he thinks is a quick and prudent response and did not make any misrepresentation therefore, he has not lost any faith in them as an organization. Mr. Mirisola reiterated the Board hired Fred Alger for other reasons besides how they would respond to being accused or investigated, and he didn't think those had changed. He expressed agreement with the recommendation in PCA's memo, suggesting the Board monitor Alger and continue on with hiring them, as he does not see any reason to cancel the relationship and start over. Mr. Mirisola mentioned he does not know exactly how fresh his memory is on the firms interviewed, 6-7 months ago, and, he doesn't believe the Board will be able to find a better candidate in that pool.

Mr. Wiggs stated, as he understands it, the concern is getting started and not having the relationship desired under this scenario. He indicated the firm is fine and he is comfortable moving forward, to see where this goes, because the contract has a 30-day cancellation policy.

President Romero stated given a choice, he would prefer to hire someone to manage \$212 million, having no questions with respect to potential litigation, rather than a firm under question. He noted the City Council has expressed concern about what the City's Pension Boards are doing with respect to these money managers getting caught in market timing and late trading. President Romero commented the Board has an obligation as a public pension fund and a responsibility to the pension fund industry nationwide. He stated the Board has the ability to make a decision, which is going to send a message for money managers not to do these kinds of things, especially with the low returns equities are producing today. President Romero stated PCA has been on record confirming every firm interviewed could do just as well, therefore, he prefers the Board go with a new firm.

Mr. Rue commented, if the Board were to go back and review the list of managers previously interviewed, and eliminated firms not subject to subpoena by the SEC because of any uncertainties, the list would become materially smaller. He added there was no way to foresee the risk of legal settlements with any of the managers considered. Mr. Rue advised, when selecting another manager, the Board should be cognizant of putting themselves in the same boat they are already in.

President Romero reiterated his concern was not just the illegal trading, but also the whole experience with Fred Alger.

Commissioner Wong inquired when was the next Board meeting. Mr. Vellon responded a Special Board meeting was scheduled for December 3, 2003, for the selection of finalist firms to be interviewed by the Board at the December 10<sup>th</sup> Special Board meeting. He added a Regular Board meeting is scheduled for December 17, 2003. Commissioner Wong then inquired if the Board could direct to not allocate the funds to Fred Alger and take another two weeks to make a decision on the matter, since it represents a big and sensitive decision for the Plan. President Romero responded a decision could be made to fund the existing managers, then revisit the whole process and decide if Fred Alger is the best candidate. Commissioner Wong suggested the Board obtain more information on who the other finalist candidates were, and if the Board decided to terminate the contract with Fred Alger, what the costs would be, the

timing issues and who would be affected. He then moved to defer this item 13 and continue the funding of the other managers in coordination with the transition manager. Seconded by Mr. Wiggs and carried by majority after the following vote:

Ayes: Romero, Mirisola, Calvache, Wiggs and Wong  
Nays: Moore

Mr. Vellon indicated staff would continue working with BNY/GTM on the funding of the new managers (minus Fred Alger), and as more information comes to the table, it would be presented to the Board. He added, the present status of the transition efforts suggests it will not be completed by the time Board members meet next month.

Mr. Chung concluded his presentation by expressing Fred Alger was a mid-size firm and DWP was one of their most important clients. He stated, based on their ability to work with clients and satisfy DWP requirements, Board members will find the firm exceptional.

Mr. Moore pointed out he did not vote on the deferral of this item, because his mind was spinning in terms of whether he favored it or not. He stated he was not comfortable with what he had heard so far and agreed with President Romero's concerns. Mr. Moore indicated if a vote had been taken today he would have voted to cancel the contract with Fred Alger. He added, given the deferral had been made, he suggests the Board take the opportunity to educate themselves and ask questions of staff and PCA to satisfy themselves on the issue. Mr. Moore expressed his main question is, which firms would remain if Fred Alger was removed and what criteria would be used in selecting a new firm. He indicated some dialogue was necessary between now and the next meeting to make sure the Board is satisfied.

Mr. Vellon inquired if Mr. Moore wanted to be recorded as abstaining on the vote. Mr. Moore clarified he was voting "nay".

President Romero called for a brief recess at 11:20.

[Recess]

The Board meeting reconvened at 11:23 a.m.

President Romero announced, he was having a technical problem with his hearing devices and proceeded to turn the remainder of the meeting over to Vice-President Ms. Calvache. Ms. Calvache presided over the meeting and proceeded to Agenda item 14.

#### **14. Consideration of Resolution Approving the Schedule of Funding and Mailing of Monthly Pension Payments for calendar year 2004.**

Mr. Vellon stated item 14 represents the annual resolution concerning the funding of monthly pension payments for calendar year 2004. He explained it was a standard requirement for staff to be able to issue the checks every year and Board approval was recommended.

Mr. Mirisola inquired if the resolution included the new Board policy that assures the checks are made payable by the 1<sup>st</sup> of the month. Mr. Vellon responded in the affirmative, adding if the 1<sup>st</sup> fell on a Saturday or holiday the checks are payable the day before. Mr. Mirisola then moved approval of Resolution 04-47. Seconded by Mr. Moore and carried unanimously after the following vote:

Ayes: Romero, Mirisola, Calvache, Wiggs, Wong and Moore.

Nays: None

**15. Consideration of Plan Actuary's requests relative to the calculation of Actuarial employer contributions:**

**a) Reconsideration of smoothing technique for recognition of Plan gains/losses.**

**b) Evaluation of possible consideration of existing Plan's financial statement reserves.**

Mr. Vellon explained item 15 represents a Plan actuary's request, relative to the calculation of the actuarial employer contributions. He noted this item was placed on the agenda at the request of Mr. Paul Angelo (The Segal Company), the Plan's actuary.

Mr. Angelo approached the table and President Calvache recognized him.

Mr. Angelo explained, when the Segal Co. Actuaries reviewed the actuarial results for this year, they found there was an open issue between the Company and the Retirement Board, involving the asset smoothing method, which was initially raised in 1999. Mr. Angelo stated there had been a lot of review and reconsideration of the smoothing methods in the public sector, since the method is intended to assist in situations like the present volatility in the markets.

Mr. Angelo referred to a memo and a copy of a report included with the Board agenda packet, written by the Segal Company in 1999. He reported the Segal Company was retained in 1998 to do an actuary audit (Towers Perrin was then the Plan's actuary), and review the Board methods. Mr. Angelo stated the audit raised no particular issues, but the review of methods raised several concerns. He referred to a report, on page 15.2 of the Board agenda packet, which raised three issues: 1) the smoothing method, 2) the reserving basis and 3) the amortization methods. Mr. Angelo noted, when the Segal Co. was hired as the actuary the following year, the Board adopted a change in the amortization method and deferred action on the other two items. He added the whole issue of smoothing was a very controversial matter back in 1999. He explained the whole idea is, instead of just utilizing the market value to drive the cost of the Plan, because it is volatile, they use a method that damps the fluctuation. He noted this is standard practice for all Retirement Plans, including public sector Plans. He indicated the previous Board rejected the recommendation forcefully, and he was told they did not want to hear anymore about it. Mr. Angelo reported during the upmarket, in the late 90s, this method and the method the Segal Co. prefers behaved somewhat similarly, meaning they both lagged market when there is really high performance, but when the market goes down these methods behave very differently.

Mr. Angelo stated it is only now the Segal Co. is in a situation where they feel brave enough to come before the Retirement Board again and invite them to consider whether it is time to take another look at the smoothing method, similar to the recommendation made in 1999. He expressed, at this point, the Segal Co. was looking for direction on whether or not the Board was interested in reviewing this, and if not, then next month they will present an actuarial report based on exactly the same methods used since 1996. Mr. Angelo reported the Department's current contribution rate is currently 8.66% of pay and if the same procedures are followed in his actuarial analysis the contribution rate will increase north of 19.2% of pay. He explained this increase is due almost entirely to investment losses and almost all other retirement systems are facing these same increases. Mr. Angelo stated the Retirement Board members have discretion as to how quickly they want the employer contribution results to react to the downturn in the market and this is what smoothing methods do. He emphasized he was not there to encourage the Board to make a decision, but whether or not the Board wanted to open up the issue.

Mr. Wiggs expressed it was critical the Board take a look at the more current smoothing method and do what is appropriate for the Plan, but given the circumstances and volatility, this is a major issue for the Department to try to deal with. He then encouraged Board members to follow the advice of the actuary and to update the Plan with the appropriate smoothing method.

Mr. Moore concurred with Mr. Wiggs and inquired what would transpire if the Board decided to take a look at the smoothing method and would Mr. Angelo come back to the Board with charts comparing the various approaches showing pros and cons. Mr. Angelo responded the Segal Company was thoroughly committed to trustee education. He stated the firm would ask for a slightly longer than usual slot on the Board agenda in order to provide the Board with a brief description of what the methods are and how the current method compares with the alternatives. Mr. Angelo added the Segal Co. has already researched which method DWP should select and the open questions were 4 or 5-year smoothing and how to transition from the current method to the new one, which will impact the immediate employer contribution rate. He stated the extreme method would actually shave 11 percentage points off of the 19, and this is the range of impact on the employer contribution rate determined by this transition decision.

Mr. Romero inquired if this was a system reflective of other public pension Plans, and not unique to DWP. Mr. Angelo responded it was not unique to DWP and the method would drag the Department into the late 20<sup>th</sup> century, because the current method is out of date. He then indicated there were standards of practice under which actuaries operate, published by the Actuarial Standards Board. He stated, at the website "actuarialstandardsboard.org", one can find an exposure draft of proposed standards on asset smoothing methods and under this proposed standard, which may or may not be adopted, DWP's current method would not meet generally accepted actuarial standards. Mr. Segal indicated if this method continues, on the signature page of DWP's financial report, the Segal Co. would certify "this report has been completed in accordance of generally accepted actuarial standards with the exception of the assets smoothing method". He clarified this does not mean he would not be able to use the method, but

he would have to flag the report.

Mr. Vellon inquired if this would fall within the contract agreement the Segal Co. currently has or would the company have to bill the Board separately. Mr. Angelo responded this was a special study outside of the usual agreement and would cost \$15,000 to \$20,000.

Mr. Mirisola reminded Board members when he first became a Board member in May of 2000, one of the first things he recalls bringing up was the fact the Department was on "payment holiday" and had been since 1996. He pointed out, what was being discussed at that time was how the delay payment of contributions, but as the Segal Co. did their actuarial smoothing, it would still, somehow, in some place, at a later date come back to bite the Board. Mr. Mirisola stated he had attended the classes taught by the Segal Company, wherein Mr. Angelo indicated the "payment holiday" everyone was on would come back and bite them on their rear end and they would have to pay it all back. He stated it has now come to fruition, but each time he brought up this issue at the classes, Mr. Angelo expressed it was not that big of a deal. Mr. Mirisola stated, if the Department had not been on "payment holiday", at a benefit to them, and detriment now to the Plan, they would not be in the current position of having to pay it back. He further added the whole point of using an actuary is to always have the employer contributions at a stable amount to avoid the situation they are currently in.

Mr. Angelo responded it was never intended in any of the lectures to state the "payment holiday" or the surpluses would necessarily have to be paid back. He clarified, at any point, in any evaluation, if from that day forward the fund earned 8%, then the contribution holiday would not have to be paid back and one would eventually get back to the normal cost, which is approximately 10%. Mr. Angelo explained the idea of having to go above the 10% normal cost was due to unforeseeable events, being the downturn of the market in the last three years.

Mr. Angelo compared the current and proposed methods, indicating, with either method, during the run-up in the market in the late 90s, DWP would still have had the "payment holiday" and a surplus of actuarial assets above liability. He explained the reason for this, is the fact there was so much money coming into the Plan under DWP's policy, which is to pay the normal cost and amortize either an overfunding for an additional cost or amortize a surplus for a reduction in cost. Mr. Mirisola argued DWP never had to do the employer contribution holiday, and had the Board done what Mr. Angelo stated, as the actuary, and continued to contribute, the issue would not have to be discussed today. He stated because there was a surplus and Mr. Freeman (former General Manager) wanted to find money at the time, to pay down the debt, the Board approved the "payment holiday".

Mr. Moore commented, ultimately the way it is currently structured, the Department is going to end up paying its share, it just spreads out the pluses and minuses over a period of time. He pointed out the Board is in the process of going through a major change in the portfolio, and according to the Segal Co.'s memo, some of the smoothing techniques employed at DWP have evolved from a much earlier point in time when the portfolio was quite different. Mr. Moore also noted, because of the ongoing transition,

the Department has a lot of gains and losses needing to be dealt with. He requested Mr. Angelo, as part of his upcoming presentation to the Board, go through the elementary process of smoothing.

Mr. Vellon indicated, if Board members desired, a resolution could be adopted today, to expedite the actuary's review process. He suggested the following language as a possibility:

WHEREAS, the Plan's Actuary, Mr. Paul Angelo (Segal Company) requested the Retirement Board reconsider its gains/losses recognition technique, in connection with the June 30, 2003 actuarial valuation, and

WHEREAS, the Plan Actuary appeared before the Retirement Board on November 19, 2003 and reported the gains/losses smoothing recognition technique, currently used by the Retirement Board, is outdated, and

WHEREAS, the Plan's Actuary recommended the Board authorize him to analyze and report on more modern gain/losses valuation smoothing techniques, therefore

BE IT RESOLVED, the Retirement Plan Manager be, and hereby is, authorized to engage the Plan's Actuary for the above described analysis and report at a cost not to exceed \$20,000.00, and

BE IT FURTHER RESOLVED, the Plan's Actuary should have such report available for discussion at the Board's December 2003 meeting.

Mr. Wiggs so moved (The Resolution will be numbered 04-48). Seconded by Mr. Moore and carried unanimously after the following vote:

Ayes: Romero, Mirisola, Calvache, Wiggs, Wong and Moore.

Nays: None

Mr. Angelo addressed item "b" of the agenda. He indicated, given the press of time in getting results, the Segal company will describe DWP's reserving methods in the actuarial report to be submitted next month, but will not do an in-depth analysis at this time. He stated he would like to separate the issues of reserving and smoothing methods and he is not looking at taking a hard thorough review of the reserving issues in the limited time frame between now and next month.

Mr. Moore inquired why Mr. Angelo chooses not to review the reserving issues. He commented there seems to be a lot of relationship between the two and he did not want to look at one without looking at the other. Mr. Angelo responded the practical reason is, when looking at the pattern of reserves over the last four years, they are relatively stable. He explained the two were related, but it is sufficiently and separately complicated and it would be better to deal with them as separate issues. Mr. Angelo assured the Board there will be available some

general idea of what the impact of the current reserving method is, but the Segal Company is not even sure exactly how DWP's current accounting method works. He recommended the Board table this particular item for now, and deal with it between valuations rather than during one.

It was the consensus to so proceed. After more discussion, the Board thanked Mr. Angelo and he was excused. Mr. Angelo retired to the audience.

**16. 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. (For final approval after adoption by the Board of Water and Power Commissioners).**

Mr. Vellon stated item 16 represents an ongoing matter relating to a Plan amendment to provide charging the Plan expenses against the Fund (rather than being paid directly by DWP). He pointed out the Board had approved a Plan amendment authorizing the Board to so proceed and the amendment was presented to the Board of Commissioners and was adopted by them. Mr. Vellon stated such action by the Commissioners came before the Board for the usual final 3<sup>rd</sup> step approval. He reported, at this time an issue arose concerning the number of votes necessary for a legitimate Board action and the Board members directed to place it on today's agenda for a vote.

Mr. Moore suggested tabling items 16 and item 18 (the attorney opinion relative to what represents a majority of the Retirement Board) until Mr. Vazquez could be present. He anticipated clearly the same vote situation would occur, and moreover, Mr. Vazquez was the Board member pushing for item 16.

Mr. Mirisola indicated he agreed with Mr. Moore regarding item 16, but inquired if Attorney Wilkinson had consulted with the Board's fiduciary attorney with regards to item 18. Attorney Wilkinson responded he had not consulted with fiduciary counsel and the City Attorney's office does not believe it is a matter of fiduciary counsel. Mr. Mirisola expressed he would be in favor of asking their fiduciary counsel to review this, because his understanding of Article V (of the City Charter) specifically excludes DWP, and the specific language overrides the general language in such a document. He also pointed out, in Section 11 of the Charter, the Retirement Plan is adopted as part of the Charter and there exists a conflict between the Plan document and the City Attorney's interpretation of Article V, on whether or not it includes DWP. Mr. Mirisola added, this fact was not addressed in the legal opinion. A discussion ensued.

Mr. Mirisola suggested referring the issue to the Board's fiduciary counsel, in order for them to review the Plan document and Charter and give the Board an opinion. Mr. Romero commented there was no harm in Mr. Mirisola's request, and getting more information would be an opportunity for the Board to make a conscious decision, because he has also been on record questioning the use of Article V as opposed to the Plan language. Mr. Mirisola indicated if the fiduciary

counsel comes back with the same opinion as the City Attorney's office then that will be the end of it and there would be no need for further discussion.

Attorney Wilkinson pointed out the Board received a memo from himself, Attorney Weisz Jones and the Chief Deputy, which speaks directly, should there be any question. He stated the Board can opt to do whatever they choose with this advice, but it should be clear if there are any votes this Board believes passes with three votes and results in any action needing the sign off for "Form and Legality", the City Attorney's office would not provide such stamp.

Mr. Moore commented he had similar concerns to Mr. Mirisola's and recognizes the passage of the new Charter does change the way the language reads and it has many complicated things from a legal standpoint. He stated the difference has to do with the fact that in section 05-01 it talks about each Department created must do these things, but when looking at section 11-02 which is the other one dealing with the pension, it talks about Boards created and the Department's Plan was created within the Department of Water and Power, which goes back to the original Plan. Mr. Wiggs commented the language used in changing the Charter eliminated the clarity of the language that was there before.

Mr. Moore inquired if the Board takes a decision with only three votes, what liability would they face if sued and who faces the liability, the Board members as individuals, the Retirement system or the Department. Attorney Wilkinson responded the City Attorney's office has a great concern with regards to all of the above. He explained, if an action was taken, a contract signed, or a contract was terminated, and the Board accepts the legal advice as correct, it would not be a valid action of the Board. Mr. Moore inquired if the Board does act without accepting the legal advice and is sued, will the City of Attorney's office not represent the Board. Attorney Wilkinson responded he could not answer this question right now, but it would definitely be a concern, because the Board would be taking an action on which counsel has advised was not legal.

Mr. Wiggs commented the City Attorney's office would probably be called as a witness against the Board. He stated if the City Attorney's office is not going to change their standpoint, then the Board should not get themselves in the position of voting something out that could impose liability or be voided. Mr. Wiggs expressed the presence of five Board members should be required in order to get four votes and it does not matter if the Board obtains 10 law firms to side with the Board if they still have the City Attorney's office saying the votes are unlawful. Mr. Mirisola expressed the reason it is so important is that the City Attorney's office takes the position of being an eighth Board member. He pointed out the other Departments have Retirement Boards with nine members and it is easier for them to get a quorum.

Mr. Mirisola inquired where in the City Charter does it state the City Attorney's office has the authority to interpret the Charter. Attorney Wilkinson responded the City Attorney is the Board's lawyer for everything. Discussion continued

among the Board members. Mr. Wiggs suggested filing a declaratory action judgment to protect the Board. Mr. Mirisola responded Attorney Weisz Jones previously stated she would not file any action for a judgement in determination of what the Charter states. After more discussion it was the consensus to defer Agenda item 16.

Mr. Mirisola moved, with regards to Agenda item 18, to have the City Attorney's office forward the Retirement Board's concerns to their fiduciary counsel for another opinion. Seconded by Mr. Romero and carried after the following vote:

Ayes: Romero, Mirisola, Calvache, Wong and Moore.

Nays: Wiggs

**17. Reconsideration of issuance of Request for Proposal (RFP) on September 17, 2003 relative to the Plan's Bank custodian services (currently provided by Bank of New York-Western Trust – contract expires February 2004).**

Mr. Vellon explained Agenda item 17 pertains to the Board's decision to issue an RFP for bank custodian services. He added a representative from the Bank of New York (BNY) has submitted a temporary proposal, extending the existing custody service contract 6 months after February 2004. He further stated BNY proposal was intended not to have the Board rush the RFP process, while they are attempting to hire new investment managers.

Mr. Romero expressed, in retrospect, this was a good idea for the Board to have more time. He moved the Board submit a Request for Information (RFI), as opposed to an RFP, to get some prices to see if the Board is paying the right amount of money for services rendered and to extend the contract 6 months. Seconded by Mr. Wong and carried unanimously after the following vote:

Ayes: Romero, Mirisola, Calvache, Wong, Wiggs and Moore.

Nays: None

**18. Consideration of number of Retirement Board member votes required for an official act of the Retirement Board.**

Item 18 was discussed under item 16 (above) and the Board directed to obtain input from the Board's fiduciary counsel.

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

**a) Legal Opinions**

Mr. Vellon stated the legal opinions had already been discussed.

**b) DWP Plan Newsletter for retirees (November 1, 2003 Edition).**

Mr. Vellon reported the Board members had already received a copy of the November 1, 2003 Newsletter for DWP retirees

**c) Update on Retirement Plan Remodeling.**

Mr. Vellon informed the Board the remodeling of the Retirement Plan office is moving along quickly at this time.

**d) Letter of November 4, 2003 from Invesco relative the mutual funds issue.**

Mr. Vellon indicated a letter was received from Invesco, concerning their situation regarding mutual fund issues and investigations. He stated although Invesco representatives do not feel they will have any mutual fund issues, today in the news there was an indication the SEC investigation may continue to expand into Invesco.

**e) General Items**

Bank of America possible restitution fund (Re: Nations Funds)

Mr. Vellon noted the agenda packet includes news to the effect Bank of America is going to set up a restitution fund affecting the Nation's Fund, which the Department uses as a STIF (short term investment fund). He stated there may be a possibility of having a recovery fund set by Bank of America and he would inform the Board of any further development.

The Segal Company staff change

Mr. Vellon stated the Segal Company reported a staff change.

President Calvache welcomed Ms. Lesley Kuo (Plan Investment Officer) to the Retirement Plan office.

The Board meeting was adjourned at 12:09 p.m.

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JAVIER ROMERO  
President

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DUAMEL VELLON  
Secretary

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VIKKI BURKS  
Recording Secretary