

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

MEETING – January 21, 2004

Present:

Javier Romero	President
Lilly Calvache	Vice President
Ron Vazquez	Chief Financial Officer
Dan Mirisola	Board Member
Michael Moore	Retiree Member
Gerard McCallum	Commissioner

Absent:

David H. Wiggs	General Manager
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Others Present:

Lesly Kuo	Acting Plan Manager
Vikki Burks	Recording Secretary
Sara Bernstein	PCA (Pension Consulting Alliance)
Mike Wilkinson	Deputy City Attorney

The meeting was called to order at 10:05 a.m. after the Pledge of Allegiance.

[Pledge of Allegiance]

Ms. Kuo indicated there was quorum of the Board.

President Romero reported items 1 and 2 were submitted for consent approval as follows:

- 1. Approval of Minutes for the December 17, 2003 Regular Board.**
- 2. Termination from Monthly Rolls as of January 2003:
Retirement Resolution for January 2003.
Termination from the January 2004 Family Allowance Roll:
Morris M. Guthrie – deceased.
Termination from the February 2004 Survivorship Roll:
Clara M. Jones - deceased.
Termination from the December 2003 Permanent Total Disability Roll:
Michael McCoy – deceased.**

Mr. Vazquez and Mr. Moore noted some changes on the minutes for December 17, 2003. Mr. Moore stated page 5 (5th paragraph) reads “to sell the Ford bond at 8.9%” should be corrected to read “to sell the correct Ford bond” (strike out 8.9%) and the sentence immediately following reads “they made the Plan” should read “they made the

Plan whole, the next line down reads “and is normally” should be corrected to read “and that is normally”, the third line from the bottom of the same paragraph reads “because what was issued” should read “the issue” and insert the word “was” before “whether or not” of the same sentence.

President Romero inquired if these changes are because Mr. Moore feels this is not what he had said at the meeting. Mr. Moore responded he thinks this is what he said and he certainly thinks this is what he meant to say, and if Ms. Burks has transcribed this and she is certain this is exactly how he said it, he is not trying to change the meaning, he is just trying to say what he thought was the intent he was making at the time. Mr. Moore added on page 7 first paragraph the 8th line down reads “and id” should be “and is” page 16 (2nd paragraph) 2nd line reads “level of timing transactions” should read “level of transactions” (strike out timing).

Mr. Vazquez noted his name was misspelled half of the time and would like these corrected from “Vasquez” to “Vazquez”. He mentioned on page 7 (2nd paragraph) there is a split paragraph which needs to be corrected, and on line 8 of the same paragraph it reads “so the” should read “so they” on page 16, (6th paragraph) reads “though of the idea” should read “thought of the idea” on page 18 (2nd paragraph) first sentence reads “Dr. Bernstein” and should read “Ms. Bernstein” and the 2nd sentence reads “PCA recommendation” should read “PCA’s recommendation,” the 4th paragraph starting with “Mr. Vazquez moved to differ” should read “to defer”.

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

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

President Romero inquired if there were any public comments.

Ms. Kuo indicated there was one request for comment for item 17, from Mr. Jack O’Connor of MFS.

- 3. Special Board Minutes of December 3, 2003 and December 10, 2003.**
- 4. Benefits Committee meeting of December 17, 2003.**
- 5. Report of Payment Authorizations as of December 2003.**
- 6. Short Term Investments as of December 31, 2003.**
- 7. Report on Long Term Investment as of November 30, 2003.**
- 8. Distribution of Securities by Type and Class as of November 30 2003.**

9. **Statement of Investments Owned as of November 30, 2003.**
- 10 **Equity Investments as of November 30, 2003.**
11. **Notice of Deaths as of December 2003.**
12. **Plan's Final Comprehensive Annual financial Report (CAFR) as of June 30, 2003.**

President Romero recommended items 3 through 12 be received and filed. Mr. Moore requested discussion regarding the highlights on the financial statements on page 12.6. He noted there is a statement indicating the "total net assets" decreased \$112,375,231, or 2%, and this is an issue he raised once before, a few months ago. He indicated there are differences between the representations of the overall performance of the fund in the accounting reports, versus the PCA report, which reported the overall retirement fund was up 2.9%. He stated he had received a phone call from Ms. Sangeeta Bhatia (Assistant Plan Manager) after he raised the issue some time back and the explanation she gave was rational at the time and he is not disputing it, but he has since spoken with Mr. Paul Angelo of the Segal Company (Plan Actuary), before the meeting today, to get a better sense of this and he believes the primary difference can be accounted for by the fact the primary number used in the Simpson & Simpson report is based upon a total look at the fund, which includes contribution from members and disbursements in the form of benefits and the PCA report doesn't include this. Mr. Moore stated what he would like, in writing, would be a simple reconciliation of the two, because this is the report sent out to the retirees on an annual basis and in a presentation he made to the retirees he used the numbers by PCA, and there is obviously a disconnect of 5% between these two and he would like to be able to more clearly explain this so he would like a simple reconciliation.

Ms. Calvache moved the above items 3 through 12 be received and filed. Seconded by Mr. Moore and carried unanimously after the following vote:

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

President Romero stated he would like to change the order of the agenda, as there is a manager who would have to leave soon, therefore he would like to discuss item 16 followed by items 18 and 17, then revert back to the regular sequence of the agenda.

16. **Consideration of Plan consultant's (PCA) memorandum regarding Regulatory Status of Large Growth/Value Finalists involved in the Mutual Fund investigation.**

President Romero recognized the consultant Ms. Sarah Bernstein of PCA (Pension Consulting Alliance) and clarified there is a report PCA sent, which was not included in the packet because the agenda was printed prior to receiving the update from PCA.

Ms. Sarah Bernstein, of PCA, commented she is here to address the issues of two

managers who had been selected, but not yet approved, because of outstanding regulatory issues, which the Board had discussed a number of times. She proceeded to briefly summarize the PCA memo before the Board. She identified two options for the Board on trying to determine whether to hire Invesco and MFS or move forward with other alternatives. She noted the following options:

- a) to no longer consider either manager, based on the Board's dissatisfaction with the managers business models, ability and the issues having come up with mutual fund trading compliance practices
- b) to consider both managers and any manager who comes up on a case by case basis

Ms. Bernstein explained PCA believes either option is fine and depends on how the Board views the issues. She stated there are high quality managers the Board has already reviewed and could substitute for these if the Board so chooses. Ms. Bernstein noted PCA has laid out a couple of the potential trade-offs if the Board decides to hire either or both Invesco and MFS, and PCA does feel they are good managers and a pro would be the Board would speed up the process of investing the cash on the international side and for MFS it's not quite as urgent. She indicated PCA believes it is important for this Board to move forward one way or another, and go ahead with the recommendation and begin funding according to the targets set out by this Board. Ms. Bernstein explained the opinion of PCA is, if the Board were to continue with their selection of Invesco and MFS, they would recommend putting them on probation (or watch) until the regulatory issues are settled and over. She noted the memo outlines MFS being closer to quick settlement (possibly this week) and representatives from both managers are here to speak with the Board today to determine essentially how much overhang there is going to be and, if there will be any disruption to the investment practices of these firms with their regulatory issues unsettled, and this will give the Board a better view of whether they are changing and adapting their practices to address the issues, which have been brought before them. Ms. Bernstein reiterated the issue has been discussed a number of times and PCA believes the Board has to come to a decision and if the Board does decide to go with Invesco and MFS, to expect to have the managers on watch until the regulatory issues are settled, other than that, PCA feels both managers are high quality candidates and on the other side, the Board has gone through the process and PCA identified two replacements the Board likes, one on each side, T. Rowe Price as a quality substitute for MFS or Julius Baer for Invesco, should the Board prefer to select another manager. There being no further comment, President Romero moved on to item 18 and invited Ms. Bernstein to stay at the table for further discussion. He then recognized the representatives from Invesco.

Messrs. Mike Keough, Marketing Director and Charlie Brady, Chairman of InvesCap approached the table.

18. Consideration of nullifying the retirement Board's selection of Invesco International Manager (Developed Markets), in light of recently published news.

Mr. Keough introduced Mr. Charlie Brady as the chairman of InvesCap and noted he is Chairman of the whole company, worldwide, and is present to make a statement

regarding the issues brought forth.

Mr. Brady explained he is Chairman of InvesCap and is the founder of Invesco. He added he was the first and only employee, so he has more than a vested interest in Invesco itself. He stated the holding company owns both the institutional business, which is the group the Board is considering to be one of the managers, and the mutual fund group, which is a separate group, and this is the group charged with the violations of some regulatory matters. He stated the first Invesco knew of any problems was midsummer 2003 when they received a subpoena from the Attorney General of New York to provide trading information on one particular client and they cooperated with the Attorney General in providing this information, and realized it was a major inquiry, and rather than doing internal reviews, Invesco hired an external law firm to come in and handle the whole matter. Mr. Brady stated the law firm sent a number of people to the office in Denver and started making inquiries, checking the records and doing a heavy investigation while having people make statements about what went on, and this continued for a number of months. He reported Invesco provided approximately 100,000 pages of documentation, which Invesco reviewed themselves, and, in late November/early December, all of a sudden it was leaked to the paper Invesco was going to be charged by the SEC and the Attorney General of New York. He stated Invesco had a Board meeting, reviewing with the lawyers the internal investigation, and were told by these lawyers they found nothing and they strongly recommended Invesco defend themselves and, based on this, Invesco agreed to defend themselves and, in short, Invesco was charged and put out the public statement stating they found nothing wrong.

Mr. Brady informed the investigation still continues and Invesco hired two outside statistical analysts, one a former chief economist with the SEC, to look at the records and to see what if anything was there, along with hiring two PhD's (who had written extensively on market timing) to also look at their records, process, and the investigation. He explained somewhere after the first of the year, Invesco had found there had been some damage to some of their funds, based on trading. He added, based on these findings and information Invesco decided to make restitution, which would be the policy of anyone in a trust business and a public statement as issued, informing Invesco would make restitution and would change their position of trying to defend themselves and would cooperate with the authorities. He stated this is what is going on at this present time and the issue now is what are the damages.

Mr. Brady stated what Invesco found is, trading in and out of securities does not create the problem as it has to be combined with something else, it has to be combined with what is called stale pricing or late trading. He explained late trading is totally illegal and what was found was a pattern of late trading in their funds, facilitated by a couple of brokerage houses, which had already been mentioned in the press. He stated if anyone can recall back in the fall the Canary Management Company was charged, two people were named who were also guilty of late trading and those trades all came through those same firms. He clarified, for instance, in one of the Invesco funds they had 10 trades with this Canary Management firm, 2 trades with one firm and two with another (both of these firms being charged and found guilty of the late trading) and 6 trades with another firm not charged or involved in late trading. He noted what Invesco also found

was with the two charged with the late trading such firms had made a relative substantial profit and money was lost in the 6 trades that were not involved in the late trading, therefore it is pretty clear there was a pattern of abuse, but Invesco is a victim of this.

Mr. Brady stated Invesco's plan is to make full restitution, informing the regulatory institutions, who have agreed with Invesco and have been very cooperative. He indicated the legal actions have been put on hold for 90 days by agreement, and Invesco will resolve these legal issues. He reiterated the issues now facing Invesco are what are the damages and this is very complicated to calculate as one can see what a timer might have made in terms of profits, but it has a different impact on the fund itself and it has a very theoretical impact, and there is no agreement on what this number may be, and this is what Invesco is trying to calculate at this point in time. Mr. Brady stated the only damages Invesco has found, the only abuse, was linked with someone else taking an illegal act against Invesco and with this Invesco has found no record anywhere of anyone in their firm involved with this and no one benefited or earned any money from it, so, effectively Invesco has been permanently put in this position because of illegal acts perpetrated by other people at other firms who Invesco worked with on trades. He acknowledged this may not explain to the Board, as the Board has to stand the scrutiny of the public and Invesco understands this, but the truth is Invesco has found their error and will make it right and will settle the regulatory issues. Mr. Brady emphasized he feels Invesco is more of a victim than guilty of anything and with this he would greatly appreciate the Board still consider Invesco's appointment as the Board's Investment Manager.

Mr. Moore expressed his appreciation of Mr. Brady's statement in which he stated it is very difficult to calculate what restitution will be appropriate, as Invesco will be getting into some pretty esoteric statistics at this point, but the issue he is focused on is based upon a listing prepared at thestreet.com where they screen all the major funds and looked at them in terms of redemption as a percentage end of the year assets. He stated both Invesco and MFS were the predominant funds at the top 15 lists. He then gave a brief listing of some of Invesco's funds in this list and the percentage trades relative to all trades. Mr. Moore stated the difficulty he is having is he can't understand how this much can't be considered damaging to the long term investors and also raises questions about the extent of which there were efforts to try and control this.

Mr. Brady stated the bulk of the transactions in the Invesco complex were sector funds and these funds are actually set up for active asset allocation. He noted this is what the client expects and this is the reason they are set up this way, because there are a lot of people who have models and basically sell under the technology fund one day and go into finance fund the next day, based on the perceived values, and this is not really a problem, so long as it is under a controlled level. He added the problem with the regulatory agency is Invesco wrote a Prospectus stating Invesco would limit this to four times a year, but the next paragraph gives Invesco the right to exceed this, and this is the part which is in contention. He noted the SEC is concerned the second part was not strong, open or visible enough. He indicates it would appear, the way the press reads this, as if Invesco singled out 15 people and said they could trade their funds and it is just the opposite of this as Invesco allowed all people who were asset allocators to

trade in the funds, so long as they were not disruptive, and as a matter of fact, there were 29,000 people who traded more than four times, so it was the policy to let this happen, so long as it was not abusive and it was the 15 people who were abusive and Invesco put restrictions on those 15, and so they got singled out as if Invesco let them do something when, in reality, Invesco was restricting what they did. Mr. Brady stated all of the sector funds are largely set up for people to do exactly this and this is one of the reasons one gets this kind of trading and one does not really pickup excess volume because this is the normal course of action.

Mr. Keough reported the trading in and out of the funds doesn't necessarily translate to an equivalent amount of buying and selling of stock in the portfolio and, for instance, if looking at just one of the funds on the list, such as the Dynamics Fund, looking at this portfolio's turnover for roughly the same period of time, it was approximately 90%, which is probably what some of the institutional managers the Board has interviewed have experienced, so even though Invesco does not argue with these statistics, when one looks at the actual activities of the buying and selling of stocks in the fund, and generation of transaction cost, which one could be perceive as being detrimental, it doesn't always translate to A equals B.

Mr. Brady emphasized one needs to understand most of the actual impact was 2-3% of the usual size of the fund, even though the turnover rates look higher. He indicated the actual amount of this, going in and out of cash, is 2-3% of the fund and mutual funds, by definition, which allow trading any day, have an impact when cash comes in, and it can be either a positive or negative impact, depending on what happens the next day and one can't really tell. Mr. Brady reported what timers do is simply add money to the cash, and they do not necessarily get the money invested, because the next day it might likely go out of the fund. He stated Invesco has learned a lot recently, because of this issue; they have learned about things they did not know they had to protect themselves against, which they will now have to protect themselves.

Mr. Brady stated the reason Invesco put the 15 people he had referred to in the special category is because Invesco made them tell them what they were going to do and denied them the right to come in and out of the fund when Invesco thought it would be detrimental to the fund in their opinion and what Invesco was trying to do was control it, but what they found was they were not able to control the late trading. He noted Invesco did not understand there was such an issue and the late trading is what has created the loss and this is what Invesco has to make restitution for, therefore what he expects to happen is they will calculate with the SEC some number, based on what the both agree is what the damage and will make restitution to these people, and then Invesco will plan to go after these third parties and sue them and will recover the money for their own firm, but Invesco has to make the people whole first.

Mr. Moore inquired about points raised by the Plan's consultant, PCA, given the fact Invesco is in the process of negotiating a settlement and because of involvement with subsequent litigation, this could be distracting to management, and depending on what level of restitution is ultimately agreed on, Invesco may take a fairly significant hit. Mr. Brady stated in conversations with regulators, and now that Invesco has found the problem and agreed to facilitate this, Invesco has turned over every fact they could find

themselves, therefore this is going much faster than one thinks and the SEC has told Invesco they could finish in three weeks, but they haven't been able to get to it yet because the SEC has other cases they are dealing with, so once they can get to it, it will be a matter of a few weeks and this is not tying up the staff at Invesco. He added, virtually everything Invesco is doing is being done by outside people Invesco has retained. He mentioned Invesco has retained almost 12 different law firms and two sets of statisticians to work on this, so there is a great deal of work being done but none of it being done by the internal staff.

Mr. Brady explained, going forward, when this is finally concluded, Invesco plans to prepare a report in-house which will be a full and final report. He indicated he believes at this point there are no legal issues, but just bad business judgment and he clearly needs to know who these people are exactly and this leads back to the question of who knew what and when did they know it. He stated Invesco has also engaged a totally separate legal firm to come in immediately and start examining all the policies worldwide, across every type of investment including the institutional business, and will review every policy Invesco has as it pertains to risk and any kind of violations like this, which one can ultimately think about. Mr. Brady expressed Invesco is determined to find out the truth about what happened and why, and will find out if there are any areas they need to improve where something could happen in the future and this is a commitment Invesco is very strong on. He reiterated the regulatory issue would not bog down Invesco Managers and will be concluded quicker than anticipated.

Mr. Moore inquired if the financial impact will be great. Mr. Brady stated Invesco is spending a great deal of money on legal fees, which will be covered by the insurance. He added, the restitution Invesco has to make to the fund will be recuperated by the lawsuit Invesco will bring against the firms already mentioned in the press (he did not want to comment names for the record). He suggested it could be found out and it will be substantial and the firms in question do have money and the only thing which might affect the financial of Invesco is there will be a fine or penalty and this will be the amount of financial impact. He stated Invesco is a relative large company, having much credit with many banks in the world of \$1 billion, and he is sure they will be able to write the check for this, but more importantly this is just embarrassing, it should not have happened and, as the founder of Invesco, he is very embarrassed about this and to have something like this (of this magnitude) after 30 years of running a good business is very tough and hard to take. He noted Invesco would deal with, learn from it and will get past it and move forward a better organization.

President Romero stated he himself was one of the trustees having great concern with the late trading and market timing issues especially as the SEC themselves weren't sure as to the legalities of the situation, but now they have come up with new rules and guidelines, which, perhaps should have been put in place long before these issues arose. He commented he admired Mr. Brady for taking the time to come and personally address the issue and concerns this Board has. He added there were many, and this has now made him a little more comfortable with Invesco. President Romero informed the Board he had changed his mind, based on Mr. Brady's explanation, and requested Board reconsider their position regarding Invesco.

Mr. Vazquez noted Mr. Brady's statement regarding Invesco's institutional business was separate from Invesco's mutual fund business and he inquired if there was an investigation into the institutional part of it as was the mutual fund. Mr. Brady responded in the negative. Mr. Vazquez inquired what the impact has been in terms of the institutional clients and assets under management. Mr. Brady responded it has been limited; losing one major account, and that being a sub-advisory. He indicated the irony to this is, this is the firm Invesco will be taking legal action against. Mr. Keough added, consistent with PCA's comment in their memo, the typical institutional client response has been to put Invesco on "watch" if there is great concern about the issues and continue to see how things unfold and so far, most clients have been comfortable with Invesco. Mr. Vazquez inquired what is PCA's position with clients having Invesco as a manager at this time. Ms. Bernstein reiterated PCA's stance, as stated in their memo, and as Mr. Keough had just mentioned, was to put Invesco on "watch". She added PCA has not recommended any client fire Invesco or MFS, and this is the only situation PCA has encountered because it was mid-search in which PCA had to deal with it slightly differently.

President Romero stated this Board took a very extensive approach into interviewing and doing an incredible amount of due diligence. He noted a lot of hard work was involved into resolving who the Board felt was the best managers for this Plan and he did not think this has changed. He indicated the issue of market timing and late trading happened to be a major concern, as charges were being brought about by the SEC and Attorney General at a time when this Board was choosing new managers for the Plan. He explained some of the managers the Board chose happened to be named in the resulting issues, causing lots of confusion for this Board. He reiterated he was more comfortable concerning these issues and felt both Invesco and MFS were still the best managers for this Plan and he recommended continuation of the two as Plan managers. Ms. Calvache stated she too was comfortable with this selection.

Mr. Moore stated an issue surfacing now (and troubling him more than the trading issue) is the directed brokerage as it relates to the institutional side of the business and inquired if Invesco has a stance of this. Mr. Brady responded Invesco has a position but does not have a stance on, but when the security act was rewritten in 1975, he personally thought to himself, the back door has been left open with this soft dollar, because this gives one a safe harbor for research and this was a way to take the soft dollar issue and leave it wide open. He stated the best way to deal with this whole issue is to make everybody put out all their perspectives on the front page, what their total all in cost are, for example, 1.21% and don't regulate them, let them compete on this basis alone. Mr. Brady added he thinks there will be a big change and it will change the distribution system tremendously in the mutual fund area, and will affect the soft dollars in the institutional side. He mentioned the SEC left this door open and they should close this door, but Invesco's position would be whatever the SEC does, Invesco would be willing to support it, yet it would change the economics of business, but, to the extent the SEC would put regulations in place than do away with it, Invesco would be very happy and comply.

Mr. Vazquez moved following through with the selection of Invesco as a manager and contract negotiations be resumed and the mandate be funded as soon as contract

matters are satisfactorily resolved and to put Invesco on “watch,” as recommended by the Plan’s consultant PCA and to have PCA keep the Board advised as things happen. Seconded by Mr. Mirisola and carried by majority after the following vote:

Ayes: Romero, Vazquez, Mirisola, McCallum and Calvache
Nays: Moore

Mr. Brady and Mr. Keough thanked the Board for their consideration and continued support and were excused by President Romero.

17. Reconsideration of Board actions relative to the selection of MFS for the management of a portion of the Plan’s Domestic Equity portfolio:

- a) Consideration of Resolution to rescind MFS (Contract No 140) as manager of the Plan’s Domestic Equity Investment Portfolio.**
- b) Consideration of Resolution relative to the selection of an investment management firm in connection with the Plan’s Domestic Equity Investment Portfolio, Replacing MFS.**

President Romero suggested, since the Board was on the subject of reconsideration of Plan managers, to take next item 17 regarding MFS. He invited Mr. Jack O’Connor, of MFS, to approach the table.

Mr. O’Connor stated for the record this was the fourth time a representative from MFS has appeared before the Board and expressed appreciation for the Board’s patience during this troubling issue. He informed Board members MFS has been upfront regarding the issues at hand and are very much cooperating with the SEC and expect resolution shortly, possibly in a matter of days. Mr. O’Connor agreed with the sentiment outlined by the representative of Invesco indicating first and foremost this is an industry issue and is not the first time and probably not the last time the investment industry is investigated by regulatory bodies, and many things the SEC has come upon needs to be corrected and MFS is very much in support of all this.

Mr. O’Connor stated in the past meeting he had explained MFS has done a number of things during the past year to prevent such issues from occurring in the future and will continue to work with the SEC in identifying the best ways to handle these types of situations. He reiterated it is an industry issue as well as a firm issue, but what it’s not about is the large cap value team at MFS and in their institutional business. He indicated the Board had established criteria with the Plan’s consultant PCA and made a decision about a good manager, and MFS encourages the Board to continue with this process and again MFS thanks the Board for their time, patience and consideration.

Mr. Vazquez inquired what impact this has had on MFS institutional clients and funds under management. Mr. O’Connor responded minimal impact, adding MFS has continued to be involved in a number of searches with plan sponsors and of these there was one search were it was a sub-advisory opportunity and it was terminated because of the issue in the market place and this has been the only significant one. He mentioned, from an institutional standpoint impact, MFS has had to make sure they have communicated to their clients on a very frequent basis, keeping them up to date,

but again it is on the retail side of the business having the impact and MFS' separate account business has not been impacted by this.

Mr. Moore stated it's pretty obvious how this is going to go, based on the last discussion. He commented, in reviewing over the firms for possible replacement, he could certainly understand why this Board had selected MFS as they have an excellent record and program and assuming the Board does go ahead and approve MFS, he looks forward to going ahead and working with them, but indicated he does not support going forward with MFS for the same reason he could not support Invesco, as it is very troubling to him regarding these issues and Boards, such as this one, have a responsibility to draw a line with respect to the standards these managers are to be held to. He concluded he would be voting against going forward with MFS.

President Romero stated he does appreciate Mr. Moore's comment and this is the value of the Board, being able to have diverse input from every member and this does bring up issues, and things possibly not thought of by individual Board members and therefore he values Mr. Moore's input as well as the rest of the members.

Ms. Calvache moved to proceed consistent with the motion brought forth by Mr. Vazquez for item 16 regarding Invesco. Seconded by Mr. Vazquez and carried by majority after the following vote:

Ayes: Romero, Vazquez, Mirisola, McCallum and Calvache

Nays: Moore

Mr. Vazquez stated, for the record, he was against going forward with Invesco and MFS at previous meetings and it really had to do with the recommendation by the Plan's consultant PCA, which was to look elsewhere. He noted his change was based on new advice from PCA, suggests taking this action would not be prudent and would be as acceptable as going with another firm.

President Romero suggested moving on with the regular items beginning with item 13 and the regular order of the agenda resumed.

13. Consideration of retroactive disability payment of \$8,955.66 for Mr. Patrick Millon (for the period May 29, 1992 to January 22, 1995 Subject to Workmen's Compensation office reimbursement (to the Plan) of \$8,593.94.

Ms. Calvache inquired if the retirement office, after careful auditing, feels comfortable with the amount being recommended. Ms. Kuo responded in the affirmative. Ms. Calvache moved approval of item 13. Seconded by Mr. Vazquez and carried unanimously after the following vote:

Ayes: Romero, Vazquez, Mirisola, McCallum, Moore and Calvache

Nays: None

14. Consideration of Plan Investment Manager's failed trade relative to the sale October 23, 2003, of a bond not held in Plan Portfolio (Ford Motor Cusip No.

345370BJ8) and subsequent sale of a DWP owned bond (Ford Motor Cusip No. 345370BV1) on October 30, 2003, using the lower price of October 23, 2003.

President Romero explained item 14 represents the consideration of a Plan Investment Manager's fail trade, relative to the sale of a bond not held in the Plan portfolio on October 23, 2003 and the subsequent sale of a bond, owned by the Plan, on October 30, 2003. He noted TCW's past opinion was their action conformed to industry standard and they did nothing wrong. He explained the Board directed a member from Mr. Vazquez, staff, along with Ms. Kuo, of the retirement office, look into this as a committee. He indicated this Committee found TCW did not follow industry standard practices and money is owed to the Plan portfolio. President Romero expressed his gratitude to the Plan Manager and staff for all their effort and hard work in resolving this problem and in his opinion, a significant finding, which could possible lead to other errors with further audits. He stated he would like to give notice to TCW as to how they will proceed in handling this, before the Board turns this over to lead counsel for any potential litigation.

Mr. Wilkinson inquired if there was an additional report not in the agenda. President Romero stated a report was handed out prior to the meeting as it was given to Plan staff after the agenda had already been printed (a copy was furnished to Mr. Wilkinson).

Mr. Moore stated he concurred with the statements by President Romero with respect to efforts of staff and the great job in handling and finding this significant problem. Mr. Vazquez added acknowledgement of Mr. Mario Ignacio as well for his tremendous efforts. President Romero reiterated, for the record, his acknowledgement of the Plan Manager, Mr. Duamel Vellon for bringing this to the Board's attention.

President Romero inquired of Ms. Kuo if the direction the Board is taking with respect to the issue with TCW was clear. Ms. Kuo responded affirmatively. President Romero then inquired if Mr. Wilkinson agreed, no further action need to take place. Mr. Wilkinson responded in the affirmative.

15. Consideration of Plan actuary's (The Segal Company) Annual Actuarial valuation and review as of July 1, 2003.

President Romero stated, for the record, the death benefits report just handed out by Mr. Angelo is not on the agenda and is for informational purposes at this time. He asked Board members to please review this report on their own and if they have any questions they can call Mr. Angelo and have them come to a Board meeting to address those questions. President Romero then acknowledged Mr. Paul Angelo of the Segal Company, the Plan's actuary.

Mr. Angelo reminded the Board the Death Fund actuarial report will be on the next agenda and it is a "status quo" sort of report, meaning, continue what the Board is doing and if they need the Segal Company to be in attendance, let them know, otherwise the Board can pretty much move on this without them.

Mr. Angelo started out by informing the Board they should be looking at the notebook that reads "Actuary Valuation and Review as of July 1, 2003". He stated section one is really all the Board needs to read, along with page 12. Mr. Angelo explained the actuarial value of assets did not earn the assumed rate of return, which was 8.00%; instead it only earned 0.97%, resulting in a loss of \$399.5 million to the Plan. He indicated there were other losses, because of salary increases greater than what was assumed, involving recent contracts with special payments. Mr. Angelo noted the revised smoothing asset technique was adopted by the Board on December 17, 2003 and if Segal simply follows and applies the amount of assets, and because it is applied two years retroactive, it is basically locking in the gains and deferring the losses over the next two years and this is why this shows a relatively high actuarial value of assets, compared to the market value and it's also why it caused the large decrease in the employer cost, down to the 8.45% actuarial cost. He noted any time one has the actuarial value of assets bigger than the market value, again deferring losses, those losses are going to show up in a predictable way and under the asset smoothing method, the asset reserve represents deferred losses and the Plan has \$570 million of losses being deferred over the next four years. He indicated if nothing else happens and if everything goes along as scheduled, this will increase the Plan's contribution rate to 12.41% of pay. He noted in discussions last month, it was stated the ultimate contribution rate would have been above 20%.

Mr. Angelo stated the funding policy of this Plan is the contribution rate based on normal cost (year by year cost of the Plan) plus or minus an adjustment for the funded status, and for the last few years, because the Plan had a surplus, this surplus is amortized (take a credit for the surplus over 15 years) and this has reduced the contribution rate to a level lower than the normal cost, and this is exactly what would happen if one just uses the actuarial value of assets. He added there is an irony in the actuarial value right now, because it is so much greater than the market value, it's actually larger than the Plan's liability and because it's based on were the Plan was two years ago, it states there is a surplus, and there really is not a surplus. He noted, knowing how the actual value works over the next three years the \$570 million in losses, there will not be a surplus, so Segal urges the Board to consider the prudence of setting the funding level this year as though the Plan has a surplus, even though this is what the Plans' policy states, because of the special situation Segal finds the Plan in, the Board knows about these deferred losses and for this reason Segal is making an exceptional recommendation, an exception to the regular stated policy, and this would be done for this year and carefully reviewed next year. He added this is not a change in the Plan's permanent policy, the recommendation is to fall back to basic pension "101" which states the basic cost of the Plan is the normal cost, there is so much going on with unfunded liability, the volatility in the assets and the recent change, Segal is suggesting to pull it off the table for this year and direct the departments contribution rate as based on the normal cost, basically pay for this year and give the dust another year to settle.

Mr. Angelo stated the contribution is developed by taking the normal cost in total, offset it by the employee contribution, producing a net normal cost number (10.89% this is the beginning year number), and looking at the accrued liability and comparing it to the assets (and this is where the surplus over-funding of \$86 million is produced). He clarified again, when one has \$570 million of losses not recognized, this makes one

look quizzically at this supposed over-funded position. He mentioned, if one follows the mechanics of the rule, one would take the \$86 million, amortize it over 15 years, giving a credit of 2.76% of pay, combining these and add 4% to get to the middle of the year (this is an actuary problem) producing the 8.45%. Mr. Angelo reiterated the policy for the Plan and the Segal Company is recommending the Board consider the 8.45% rate as this is reflection of surplus which all know will move away in the next four year, and the Board adopt a employer contribution rate of just the normal cost which is 11.33%, which is basically the 10.89%, plus .4% to make it a middle of the year contribution calculation.

Mr. Vazquez stated the concern was the expense the Department would need to book and the impact on income, which was taken care of and the Department does now have the additional cash to increase the employer contribution as required, and this does not affect net income it just affects cash, so the Board is comfortable with the recommendation and with the actuarial report.

Mr. Vazquez moved adoption of resolution 04-70 with the inclusion of the 11.33% employer contribution rate. Seconded by Mr. Moore and carried unanimously after the following vote:

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

19. Discussion and possible action for 1099R.

President Romero stated there was a letter sent out to the retirees last week and he wasn't in total agreement with the letter, but compromised his belief because he felt the retirees should receive something prior to the holidays, so this is why he agreed to the letter. He stated he is very much aware of everyone's concern and has received e-mails from retirees indicating there was some displeasure with this, but he felt there was failure to disclose e-mails and calls from retirees stating they saw what the intent of the Board was and they were fine with this. President Romero mentioned some of the e-mails from the retirees stated they prefer the Board not change the payment dates or go back to the 11, to leave it alone and possibly even have their January check sent December 22 before the holidays. He noted he was not suggesting to this Board to do either of these, he just wanted to let the Board know the contents of the e-mails he's been receiving and it is something to consider. President Romero explained how the Board has been discussing what the cost possibly could have been, but there is also a cost one can't put a price on or factor out and that is, there are some retirees who are waiting for their checks to pay their bills, buy their medications, have a little extra cash for the holidays and this is perhaps a few days less of having to wait for their medication or whatever. He noted there might be some benefit to possibly keeping things the way they are and letting them receive their checks earlier and this is something one can't quantify on paper, there is no formula for the benefits of receiving checks early. He stated this for the sake of disclosure and this needs to be in the minutes and the Board made aware of it. President Romero noted he is open to whatever the Board wants to do and how they want to remedy the situation.

Mr. Moore stated with all due respect, he still disagrees on this issue. While there clearly was a benefit, in the case of Sundays and holidays, payment of funds would be available early. He noted this benefit was compromised greatly by the fact the last payment wasn't mailed 24 hours later. This would have been the only thing necessary to obviate all of these problems and the fact it was done without any notice not only to this Board and to the retirees who have been put in a very difficult situation. Mr. Moore explained some retirees may not have a significant impact but others, putting them in a potential penalty situation with the IRS. Retirees in the lower end of the income scale may be denied benefits they otherwise may get from social programs. This is a very real problem. He mentioned, in reviewing the actuary's report and in looking at the demographic chart, those with low incomes are typically the beneficiaries, the spouses of deceased left with 50% pension and many of them qualify for the lifeline rates and many other low-income social programs. He suspected many of these are women who trying very hard to make ends meet. Given the fact it has been determined by the finance and accounting and retirement staff that issuing the 1099 on a 12-month basis rather than a 13-month basis won't be feasible. He noted the next best thing to do is change the payment schedule for this calendar year, so there are only 11 payments in this calendar year of 2004, and this would not offset to a substantial extent the higher taxes the retiree's will pay for 2003, though it will not offset some of the circumstances many of these people are going to face by going into a higher tax bracket, etc.

Mr. Moore stated he would make this in the form of a motion to 1) amend payment schedule for this current calendar year 2004 to reflect an 11 month basis 2) prepare a letter on either Retirement stationary or Department of Water & Power stationary, basically stating because of the way payments were distributed the incomes are inflated in the 1099's representing 13 month salary rather than the 12 months, which is how it should normally be calculated for a) persons who are threatened with a cut-off of social programs because their income appears higher than it really is or b) persons put into a penalty situation with the IRS 3) and, when the 1099's go out, a letter should go out with this giving a thorough explanation as to why this happened, what the impact is to the retiree's, how the situation will be handled this coming year with respect to 11 month pay-out rather than 12. This way they will understand what they are seeing in their year to date numbers of their check stubs. He indicated with these measures in place he feels the Board will go as far as they can reasonably go in addressing the impact on retiree's and recognizing some will not be compensated for the hits they will take on this.

President Romero expressed his concern of having the Board understand this 13 payments, should the Board have decide to go the other way, was a one time event and again the benefit of having a one time payment versus a lifetime of retirees being able to get their check earlier than expected before the holiday and as stated earlier the Board could send it out on the 22nd of December so they can have their check before Christmas and this can go on 'till the end of the Plan. He noted this is a chance to make something, which can be perceived as negative to even achieve a further positive. President Romero stated he is willing to go wherever this Board wants to go, but he believes there is a good chance to make some long time benefit for the retiree's.

Mr. Vazquez noted, for clarification, the motion by Mr. Moore regarding the 11

payments, the payment due January 1, 2005 would be paid on January 1 or after, and this would keep it to 11 months of payment. He stated this situation should have never happened to the extent this was known about in time for this Board to take an action and change it, and commented the Board should have been notified, so action could have been taken, and this is the real problem he is having regarding the 13 payments. Mr. Vazquez expressed he seconds the motion by Mr. Moore and do agree a letter should go out with the 1099R's explaining the situation and any actions being taken by this Board today.

President Romero stated should the Board decide to go this route, he moved staff write the letter and get approval by the Board and if this is not possible, due to time constraints, then perhaps it can work the same way as before, a retiree representative, someone from management and himself. He indicated the process last time was too much in a hurry to send something out, just to send it, and it really wasn't given much thought, and he would have preferred to have the full Board approve that letter.

Ms. Calvache stated she had already spoken to Mr. Vazquez regarding the issues she had. She noted when she was made aware of the letter, which was going to be sent out to the retirees, she requested a copy and no one seemed to have a copy to be given to her, not even staff in Retirement had a copy when she spoke to Ms. Kuo and she found this to be a big problem. Ms. Calvache further added the other concern was after speaking with Mr. Vazquez, she had an issue with a paragraph in the letter and she wanted to make some changes and when she asked Mr. Vazquez if she could have input, he told her no, because attorney Wilkinson advised this would be in violation of the Brown Act. She commented if this letter is coming from the full Board as it states "Board of Administration of Water & Power Retirement Plan" she also felt the letter should have been sent to the Board and the Board should have been consulted before sending it out. Ms. Calvache indicated she did not intend to have a long drawn out meeting for it, but at least consult the full Board before the letter was sent out, thereby giving Board members the ability for agreement with the statements in the letter. She reiterated what President Romero stated, which is if a letter is going to be sent out by the Board, all the Board members should be in agreement with the letter.

Mr. Moore expressed appreciation for Ms. Calvache's desire for input on the letter and probably the whole Board feels the same way, but Mr. Vazquez was under extreme pressure to get something out to the retiree's quickly and he made a major effort to do this and consulted with both himself and President Romero, this being less than a quorum and he thinks Mr. Vazquez made an excellent effort and succeeded in capturing in what was the majority view of the Board as expressed in the last meeting, and given the time constraints believes this is how he had to do it and this Board may be in this position again if staff is going to try and get this current letter out in a timely way with the 1099R's. He mentioned he would feel very comfortable with Mr. Vazquez having the lead on this again, because he felt he did a good job on the last letter. Mr. Moore noted clearly there is need for Mr. Vazquez to touch base with more Board members, just to make sure he feels he is getting the sense of what the Board wants, without having a formal Board meeting which requires notice rescheduling and so forth and this can be very difficult.

Ms. Calvache agreed Mr. Vazquez was great to handle this and thanked him for doing the amount of work within a short time and everyone knows this, but she still felt before the letter was sent out, Board members should have been sent an e-mail copy of it before it hit the print shop. Mr. Vazquez stated when the Board suggested their wishes for him to take the lead on the letter at the last Board meeting, he contacted the City Attorney stating he would like to send a draft of this to all the Board members so all can have input and it was advised by Attorney Wilkinson against this as it would be a violation of the Brown Act, therefore he chose to limit the input on the letter to President Romero and Mr. Moore as the retiree member and this is how this transpired. He noted President Romero just now stated he would like the retirement office to take the lead on this letter with approval from the Board or a retiree representative and one from management. Mr. Vazquez indicated the Board needs to resolve this matter right now, so as to get it out as soon as possible. Ms. Calvache stated this was fine with her just provide a copy of the letter.

Mr. Mirisola stated under these circumstances it was a rush item and it was delegated to Mr. Vazquez and, in support of Mr. Vazquez, he agreed the job was well done and thanked him and running with it but as far this Board not having input on it, he felt the Board made the decision to delegate it to Mr. Vazquez with extreme trust a good letter would be written, and he is not very clear on what the problems were which President Romero was having with the letter.

President Romero stated he did not want to get into the specifics of the letter, but he was uncomfortable with the letter sent out and prefers a better process for this next time. Mr. Mirisola elaborated an error was made and the Board approved 12 payments and although he had some sort of heads up on this, he didn't understand how the Board got there and it wasn't really relayed what the ramifications would be and it was truly a mistake and the Board did not intend to issue 13 checks, this Board needs to fix it and move on and as much as he likes the idea of giving the 12th payment in December, he does not know or for that matter no one knows how to correct to the retirees the error other than to go with Mr. Moore's idea of the 11 payments. He noted as far as future letters he too would like to be included in them as well and seeing, as there have conflicts so far, the whole Board needs to be in on all letters and approve letters coming from the Board as a single voice of the Board.

President Romero reiterated he directs staff to develop the letter and if a special Board meeting needs to be held, so be it or if the Board is comfortable with the three he mentioned earlier he was comfortable with this as well. He indicated he did not think it was fair to discuss errors without having a report from the Plan Manager, he didn't think it was fair on the Plan manager and for this reason he will not discuss any details until he receives his report and allows the Board to do a complete analysis of what did and didn't happen.

Mr. Moore stated he would break his motion into pieces taking them one at a time. Mr. Moore moved agreement of 11 payments during the calendar year 2004 in order to compensate retirees for the tax increase they will be taking in the year 2003. Seconded by Mr. Vazquez and carried unanimously after the following vote:

Ayes: Romero, Moore, Vazquez, Mirisola, McCallum and Calvache

Nays: None

Mr. Moore moved a letter be prepared on either Department or Retirement Board stationary explaining the situation with respect to retirees receiving more income this past year and consequently being disqualified from social programs or being put in an IRS penalty situation and this letter be made available to all retirees and this letter can be prepared by staff as there is a little more time to produce this letter and be brought to the Board for approval. Seconded by Mr. Vazquez and carried unanimously after the following vote:

Ayes: Romero, Moore, Vazquez, Mirisola, McCallum and Calvache

Nays: None

Mr. Vazquez requested this be scheduled as an agenda item for the next meeting.

Mr. Moore inquired of staff what the possibility would be of having a meeting prior to the 1099R's going out. Ms. Kuo informed the Board the 1099's are planned to go out tomorrow January 22, 2004. Mr. Moore inquired if on an emergency basis or defer to a later point in time to incorporate a letter with the 1099's how late can they go out and still comply with the law. Ms. Kuo stated it has to go out by January 30, and received by February 2, 2004. Ms. Kuo also informed the Board her concern is that the retirement office is receiving many calls with regards to the letter already sent out and there is much confusion with the retirees. Mr. Vazquez indicated this letter would be a follow-up to this notification, letting retirees know what the outcome was and what the Board is trying to do to alleviate problems.

Ms. Calvache suggested if everyone feels comfortable and due to time constraints having Mr. Vazquez, Mr. Moore and President Romero draft the letter, but before it's sent out, send a copy to the Board members. Attorney Wilkinson advised, if the Board wants to review this will be a meeting and notice would have to be sent out, and a 24-hour notice is fine for a special meeting. Ms. Calvache inquired if the letter is going out from the whole Board shouldn't they all agree on it. Attorney Wilkinson noted that was a policy issue, he is just advising, based on the Brown Act. Mr. Mirisola suggested giving staff the approval to relate the findings Mr. Vazquez investigated regarding how the 13 payments will be reported etc and give staff authority to relate this to anybody who does call. Mr. Moore stated his concern was giving this information to all retirees, because one letter was already sent. He suggested this can be done in a way, which would make the whole Board comfortable, and this would be to give authority to himself, President Romero and Mr. Vazquez to draft the letter and the letter only needs to be factual in terms of reporting what has just concluded in this meeting. He noted it does not have to make any characterization with respect to the motivation to the way this was handled, it can be dealt with later when the Plan Manager is back and the Board has his report and they can discuss it with him but he thinks the key things needing to be reported to the retirees, does not have to have any characterization which would make any one uncomfortable. Mr. Moore indicated the letter just needs to be direct by simply letting the retirees know this is the situation they now face and this is the best the Board could do and leave it at that, because this is what the retirees are really interested in,

what is the Board going to do, and again this can be done without any issues with respect to tone, speculation or anything else. President Romero stated he is in full support of this.

Mr. Vazquez suggested Mr. Moore draft this letter with review by himself and President Romero. Ms. Calvache and Mr. Mirisola inquired if copies could be received before it hits the print shop. Attorney Wilkinson noted concern of other people being involved in editing and shaping the letter. Mr. Vazquez interrupted and indicated once the three who are drafting the letter are comfortable this is what they will be sending out they will mail it to the members.

Mr. Vazquez moved Mr. Moore draft the letter with President Romero and himself, have it mailed out by this Friday January 29, 2004, and send copies to the Board members for their information. Seconded by Ms. Calvache and carried unanimously after the following vote:

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

President Romero acknowledged Mr. Nick Friesen, retiree.

Mr. Friesen approached the podium and stated he empathized and sympathized with Ms. Calvache and other Board members concerns that any action taken by the Board members should include their full input on. He commended Mr. Vazquez for the letter he received the day before and felt it was received in a timely manner and very well written. Mr. Friesen stated, upon receiving the letter it struck him as unusual from two points, 1) the contents of the letter were issues regarding the Retirement Plan yet the letter was not from the Retirement Plan but from the Department of Water & Power Board of Commissioners and 2) the letter was unsigned and he felt this was a very significant issue but in the overall scheme of things there are two other issues more significant, which were alluded to in the letter but have not been dealt with at this meeting today and this is the pursuit of possible remedies with the IRS. He inquired if this has been done and, if so, what are the results, because this is a key importance to each of the retirees. He mentioned the other issue which has been alluded to at this meeting but not resolved is the actions of staff, when was it learned of this potential problem, when was the Board notified and what was done about it and what he can see is evidently nothing. Mr. Friesen thanked the Board and retired to the audience.

President Romero indicated Mr. Vazquez would give an update on item 1, and on item 2 once the Plan Manager gets back he will submit a report and there will be a separate agenda item at that time once the report is done to discuss in detail. Mr. Vazquez stated he had contacted the accounting firm of Price Waterhouse Coopers to look at this issue to see if there were any avenues to be able to only report 12 payments for 2003 and did the same with the fiduciary counsel of Klausner & Kaufman and both firms took different approaches to their researches and the outcome is the IRS rules with regard to "Constructive Receipt" for cash basis taxpayers are totally inflexible and there is no latitude whatsoever, legally, to do anything but report the 13 payments.

President Romero inquired if everyone was clear on these issues and if there were any more comments. There being none he proceeded to the next item.

20. Retirement Plan Manager's comments.

- a) **Legal Opinions**
- b) **DWP Plan Newsletter for retirees (January 1, 2004 Edition).**
- c) **General Items**

President Romero explained item 20 represents the Retirement Plan Manager's comments and he did not know if Merrill Lynch's developments fall under this or will it be in the next meeting, but there are information items PCA will address later on.

Personnel Changes-Merrill Lynch

President Romero acknowledged Mr. Joe Silver from Merrill Lynch.

Mr. Silver approached the podium and stated he notified President Romero at the end of last week, Mr. Frank Salerno Chief Operating Officer of Merrill Lynch's America Institutional Business announced his resignation last week for personal reasons and Mr. Jaime Case, head of distribution for the institutional group has taken over the responsibilities. He noted there is no impact or affect as to any of the investment teams and they will continue as they have been, reporting to the CIO, Mr. Brian Fullerton. Mr. Silver mentioned a press release was forwarded to both President Romero and Mr. Vellon yesterday (January 20, 2004) and an official letter will be sent out today to all Board members. President Romero stated PCA would follow up with a letter of recommendation on the next agenda.

Agenda item for Auditing Services

Mr. Mirisola inquired of Ms. Kuo on the December 17, 2003 minutes, page 9 first paragraph, Mr. Vazquez requested an item be put on a Board agenda regarding conducting separate audits of investments and to see the scope and layout of precisely what the Board would be looking at in an audit. President Romero explained this item would be deferred to the Plan Manager because he is the only one who knows what the scope is and as he is not here. He expressed his preference for waiting and see when he will be prepared to discuss the information on the audit. President Romero thanked Mr. Mirisola for the reminder and suggested Ms. Kuo remind Mr. Vellon this item is still pending, so whenever he's ready to bring it to the Board. Ms. Kuo responded in the affirmative.

Board Agendas to reflect "Future Agenda items" as standard item

Mr. Mirisola reminded items slated for future agenda's be put on the agenda.

The Board meeting was adjourned at 11:45 a.m.

JAVIER ROMERO
President

DUAMEL VELLON
Secretary

Vikki Burks
Recording Secretary