

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

MINUTES – February 15, 2006

Present:

Javier Romero	President
Lilly Calvache	Vice-President
Michael Moore	Retiree Member
Eugene Canzano	Board Member
Ron Vazquez	Chief Financial Officer
Forescee Hogan-Rowles	Commissioner

Absent:

Ronald Deaton	General Manager
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Others Present:

Sangeeta Bhatia	Retirement Plan Manager
Irene Colon	Recording Secretary
Neil Rue	Pension Consulting Alliance
Sarah Bernstein	Pension Consulting Alliance
Michael R. Wilkinson	Deputy City Attorney

President Romero called the meeting to order at 9:36 a.m. after the Pledge of Allegiance.

[Pledge of Allegiance]

Ms. Bhatia indicated a quorum of the Board was present.

PUBLIC COMMENTS

President Romero inquired if there were any public comments.

There were no public comments.

President Romero reported item 1 is submitted for consent approval as follows:

**1. Termination from Monthly Rolls as of February 2006:
Retirement Resolution for February 2006**

Mr. Moore moved adoption of the above item 1 on consent with the noted changes. Seconded by Mr. Canzano and carried unanimously after the following vote:

Ayes: Romero, Calvache, Canzano, Hogan-Rowles and
Moore

Nays: None

2. **Report of Payment Authorizations as of January 2006**
3. **Notice of Deaths for January 2006**
4. **Report on Status of Insurance**
5. **Summary of Investment Returns as of January 31, 2006**
6. a) **Market Values of Investments by Fund and Month as of January 31, 2006**
b) **Market Value of the Retirement, Death & Disability Fund as of January 31, 2006**

Mr. Moore noted that in item 4, the insurance status issues had been cleaned up and commended staff, the insurance departments, and the investment managers for their efforts. He commented the Board would speak with Loomis Sayles today for their one pending renewal of insurance.

Mr. Moore referred to the Summary of Investment Returns chart as of January 31, 2005, on page 5.1 of the agenda package, and requested the standards that were set and adopted a few meetings ago be placed on the bottom of the chart for reference.

Mr. Moore moved the above item 2 through 6 be received and filed. Seconded by Mr. Canzano and carried unanimously after the following vote:

Ayes: Romero, Calvache, Canzano, Hogan-Rowles and Moore

Nays: None

**7. Investment Manager Presentation – High Yield Fixed Income
- Loomis, Sayles**

Mr. Richard Bruder, CFA, Vice President/Client Portfolio Manager of Loomis Sayles approached the Board table. President Romero recognized Mr. Bruder.

Mr. Bruder indicated he was not fully involved in the insurance negotiations. However, there is a conference call set up for 4:00 p.m. this afternoon between Loomis Sayles's insurance department, the firm's outside insurance intermediary, and Mr. Neaman (DWP's Risk Management). He stated hopefully the insurance matters will be wrapped up at the conclusion of the conference call.

Mr. Bruder presented the Board with a presentation of the high yield fixed income portfolio.

Mr. Moore inquired about Loomis Sayles's turnover. Mr. Bruder responded he did not have the exact number for the portfolio, but generally Loomis is in the 30% to 45% range. President Romero inquired, with respect to the quality, how the Lehman Index and the WPERP portfolio compare. Mr. Bruder responded that the average quality of the portfolio is one grade higher than the Lehman high yield index. Mr. Moore noted, in

looking at the quality distribution chart, there is a fairly significant overweight in the higher grade bonds and an underweight in the Caa and lower grade. He then inquired if there was any reason the Board should be concerned about style drift. Mr. Bruder responded there was 14% in BBB and above, but some of those might be split rated. He explained a lot of that is some of our non-U.S. dollar holdings as well, which would be investment grade. He added, with regards to the BBB, most of the 14% are high yield substitutes. Mr. Bruder further added they may become high yield companies down the road, but Loomis thinks they offer value and may already be priced as high yield bonds. He stated one can get additional value by going into the lower tier of BBB and picking up names that are not in the index.

President Romero inquired who the client service representative is for Loomis Sayles. Mr. Bruder responded that he is a client portfolio manager that knows the products and is assigned to come to DWP and make sure the Board understands what the products are. He also stated if there are any concerns he would bring them back to Loomis to allow their portfolio managers to stay in the office and manage the money. President Romero expressed his reason for inquiring is his concern for resolving the insurance issues. Mr. Bruder left the Board meeting.

Mr. Vazquez joined the Board meeting at 10:20 a.m.

8. Revised insurance provisions for existing and future Investment Manager Contracts (deferred from December 21, 2005 and January 18, 2006.

President Romero introduced item 8 and noted that Resolution 06-43 would adopt the revised insurance provisions. Ms. Bhatia indicated a new Resolution 06-43 had been passed out to the Board members and the only change made was the date on the last paragraph.

Mr. Moore moved approval of Resolution 06-43. Seconded by Ms. Calvache and carried unanimously after the following vote:

Ayes: Romero, Calvache, Canzano, Hogan-Rowles, Vazquez and Moore

Nays: None

9. Discussion on Proof of Insurance

President Romero introduced item 9 and inquired if any discussion was needed. There was no discussion.

10. WPERP Fourth Quarter 2005 Performance Report – PCA

Mr. Neil Rue and Ms. Sarah Bernstein of PCA approached the Board table. President Romero recognized the representatives from PCA.

Mr. Rue reported that as of December 31, 2005, WPERP's investment portfolio was

worth \$6.5 billion up from \$180 million from the previous year. For the quarter it was up approximately \$71 million.

Mr. Rue reported, for the quarter, the portfolio performed in line with the policy, but a little bit better gross of fees. The international equities and the domestic fixed income were the major contributors. WPERP's portfolio was up 6.5% for the year. The domestic equity portfolio produced good results across all the managers in aggregate, outperforming the benchmark by 130 basis points for the year. There was a big trade off with respect to international equities where the managers have been struggling across the board and underperformed by 370 basis points. The domestic fixed income portfolio added about 50 basis points for the year. He stated all the managers are performing in line or outperforming. For the fiscal year to date (7/01/05 to 12/31/05) the portfolio was slightly outperforming and was 5.6% versus 5.5% per the policy benchmark.

Mr. Rue highlighted how WPERP's performance is different from that of the peer fund. He stated on the international equity side, the typical peer fund was outperforming DWP by 50 basis points: the alternative asset class in both private equity and real estate had great returns for the calendar year, up approximately 20%.

Mr. Rue reviewed the economic environment for the quarter. He stated for the quarter there was a surge in returns of the financial assets in the returns through the last three months of 2005, which translated into pretty solid results with respect to the supplementary asset classes.

Mr. Rue reported that there is currently one years' worth of track record for the bulk of the investment managers. He stated virtually all the fixed income managers are outperforming the benchmark and with regards to the domestic equity side, the aggregate portfolio has performed fairly well for the year but it has been a mixed bag. The value managers have struggled, but offsetting that has been great performance from Fred Alger and Intech (growth managers). He stated with regards to the small cap there has been a tradeoff between excellent results from Earnest Partners and negative issues with The Bank of New York on the small growth side.

Mr. Moore indicated he was interested in the universe where WPERP's portfolio stands. He stated the fact that DWP's portfolio percentile ranking is very poor concerns him. However, he was not sure of which universe it is being compared with. Ms. Bernstein responded the universe DWP's portfolio is currently being compared against is their Master Trust Universe (all funds over \$1 billion+). She explained that Master Trust includes public funds, corporate funds, multi-employer Taft Hartley funds, and foundation and endowments. She explained there are a number of funds in there that have more aggressive asset allocations with much higher exposure to alternatives, hedge funds, etc., than a typical public fund. She indicated PCA would be adjusting their reporting to reflect the Public Funds Universe in order to have a better peer universe.

Mr. Moore inquired about comparisons with respect to risk. Mr. Rue responded that PCA should be able to provide at least one aggregate number and be able to plot the peer fund, which will not give a sense for the year, but it will for a longer term.

11. Resolution to place Bank of New York (Active Small Cap Investment Manager) on watch status

President Romero introduced item 11 and inquired if a representative from the Bank of New York was present. He stated, for the record, no Bank of New York representative was present at the Board meeting. President Romero inquired if Bank of New York was invited and informed this item would be on the Board agenda. Ms. Bhatia responded that Bank of New York was informed. President Romero inquired if Ms. Bhatia or staff had contacted the Bank of New York regarding their performance and, if so, what has been the feedback.

Ms. Bernstein elaborated on PCA's memo regarding the recommendation to place Bank of New York on the watch list. She stated the memo talks about the firm's staff changes and the fact that PCA talked to Bank of New York about their current situation in terms of staffing and their performance. She explained there is not a huge amount of additional information outside of what is in the memo, which is included in the Board package. President Romero inquired if the rationale behind Bank of New York's underperformance was directly related to the staff changes. Ms. Bernstein responded it was purely coincidental. She expressed her feelings that it would be prudent to give the firm some time because the whole team has not been decimated. However, there have been resignations by a couple of analysts who contributed to the firm's earlier performance and there have been a couple of client departures. Ms. Bernstein stated PCA recommends placing Bank of New York on watch for six months to a year depending on how the next couple of quarters play out. She reported that Bank of New York has been underperforming in this field over the last couple of quarters by a significant margin. President Romero noted, with respect to personnel changes, there was a similar issue with Merrill Lynch (passive strategy). He then inquired if the Board is notified of money managing firm staff changes on a regular basis. Ms. Bhatia responded that staff was not notified by Bank of New York about the personnel changes. President Romero suggested this be made a requirement. Ms. Bhatia stated it is a requirement. President Romero commented he would like for this to be addressed with the Bank of New York. Ms. Bernstein suggested the Board clarify if clients need notify the Board of any personnel changes be they portfolio managers, or any professional staff, such as junior analyst, which was the case with Bank of New York.

Mr. Rue clarified that the only reason Bank of New York should be placed on probation is strictly performance related. Commissioner Hogan-Rowles inquired if it was PCA's experience that six months is enough time to tell if a company should remain or be replaced, or do they think the Board really needs to give Bank of New York up to 12 months. Mr. Rue responded it would be a tough exercise to go through. However, the process needs to get started because the portfolio will be in jeopardy if things are not rectified. He stated what PCA would like to see, regardless of the current turnover, is Bank of New York recovering all the lost performance and start outperforming the index. But if this does not happen, the probability is that at the end of the 12 months the Board would have to let the firm go.

President Romero inquired if PCA is aware of other plans that have put investment managers on watch for small cap. Ms. Bernstein responded she did not know of any off hand, but there have been clients that chose to pull out of that particular product.

Commissioner Hogan-Rowles inquired, if the Board decided to remove Bank of New York within the next couple of quarters, what would be the proper time to remove and replace the firm. Ms. Bernstein responded that once the Board decides to remove a manager, a new search is initiated. Also, if there are two managers within the same mandate, the Board may decide to give all the money to one manager. But no action is taken unless the Board is certain they want to go that route. Ms. Bernstein recommended the Board pay close attention to Bank of New York at each quarterly performance report, and PCA will be looking very closely at what is happening at the staff level, organizational level, and performance level. She stated PCA would then provide the Board with their detailed perspective on the firm's progress. Mr. Vazquez inquired, in the essence of time, if it would be possible to start the search for an additional portfolio manager as early as today with the understanding that the funds Bank of New York has under management will be transferred to a new manager. He added if six months down the road Bank of New York is still doing terrible then we would not have to spend an additional six months trying to get a new manager in place.

Mr. Vazquez noted, according to PCA's report, Bank of New York has \$1.5 billion under management in the small cap growth equity asset class. He stated during the period of time the firm has been managing the Plan's portfolio, over \$200 million in assets has been lost. He then inquired if this meant clients have pulled out. Ms. Bernstein responded in the affirmative, adding it could also mean the clients simply reduced exposure. She stated typically when a firm is placed on probation it is for a year. But the Board can start the process with the thought in mind to transfer or reduce the assets in six months. She stated this is a small amount of money to have within one subcategory of the domestic equity; therefore the Board may not want to do that. Mr. Rue commented he would be careful about doing that in this space, because this is a place where the manager can add value, it is very volatile, and Bank of New York could be up 5% by next month. He stated PCA will give a status report on Bank of New York to the Board on a regular basis and it will be plugged into the performance report. He added, as of March 31, 2006, there will be a new page in the performance report saying "Managers on Probation". It will list Bank of New York and reflect how they have performed since being placed on probation. Mr. Rue recommended, for the time being, the Board should communicate to Bank of New York that they are being placed on watch and begin making the hard decisions six months out.

Ms. Bhatia commented that staff has been really diligent in monitoring compliance with the guidelines, which is how the issues with Bank of New York came up. She stated it is likely staff will be aware of Bank of New York's current performance before the six months and report that to the Board before the next quarterly performance is held.

Commissioner Hogan-Rowles inquired why the Board should be patient with Bank of New York when it is already known that approximately 13% of their client base has left, and DWP has approximately \$100 million invested with them. Mr. Rue responded that he could not provide a good answer regarding when or why the \$200 million loss in assets happened over the last year. He reported Bank of New York's performance in the beginning of the 4th quarter had a big down spike month, but it is not like their performance has been dragging for a whole year. Mr. Rue indicated PCA has a bias of moving slower on firing managers than faster, He stated there is academic research which reflects one does not want to pull the trigger on managers too quickly.

Commissioner Hogan-Rowles inquired if PCA has seen this kind of situation with Bank of New York in the past or is this the first time. Mr. Rue responded that PCA does not have a lot of history with Bank of New York as an asset manager, nor with this particular product. Mr. Moore commented that the Board was happy with Bank of New York's style and informational ratio during their review. Mr. Rue pointed out that Mr. John Lui, who presented before the Board during the interview is still the portfolio manager. Commissioner Hogan-Rowles inquired if anyone has spoken to him about this issue. Ms. Bhatia responded that staff contacted Bank of New York; however it is sometimes difficult to get a phone call returned. She reiterated the firm is aware this issue is being discussed today. Mr. Rue indicated PCA had spoken to Mr. Lui who focused in on the analyst transition and the fact that he is training a couple of new employees. He stated Mr. Lui did not necessarily admit this was the cause of the under performance. Commissioner Hogan-Rowles expressed that PCA needs to give Bank of New York a message that if the Retirement Plan staff calls, then Mr. Lui needs to return their phone call and not just go through PCA. She stated Bank of New York has a responsibility that if staff sees a red flag and wants answers to report to the Board then they need to respect staff's calls just as much as they would respect PCA's. Ms. Bhatia clarified that Bank of New York does return staff's call, but only after the fact. Ms. Bernstein suggested having Bank of New York attend a Board meeting over the next quarter to give a presentation and give the Board a chance to talk to the firm directly. Mr. Rue suggested having the firm come before the Board again at the end of their probationary period to allow them to make their case one more time. He also suggested having Bank of New York respond to the probationary letter the Retirement Office staff sends in writing. Mr. Rue told the Board to keep in mind WPERP's portfolio has a lot of outside managers and it would be lucky if none of them were ever placed on probation. Bank of New York just happened to be the first one.

Ms. Bhatia commented that basically this is a short term performance issue and the performance needs to be reviewed over a longer period of time to give Bank of New York a chance to recover. She added there is also a cost to change managers.

Ms. June Kim, Retirement Office Investment Officer, approached the podium. President Romero recognized Ms. Kim.

Ms. Kim indicated Bank of New York has been trailing the benchmark for the past six months and their January numbers are down significantly. She added Invesco has also been underperforming, and as of January they have gone beyond the short-term criteria. Ms. Kim stated a couple of the other managers that are doing poorly have not passed the year mark yet. The Board thanked Ms. Kim and she returned to the audience.

Mr. Moore moved the approval of Resolution 06-44. Seconded by Ms. Calvache and carried unanimously after the following vote:

Ayes: Romero, Calvache, Canzano, Hogan-Rowles, Vazquez and Moore

Nays: None

12. Resolution to authorize the Plan to invest assets for the Death and Disability Funds in the Montgomery Commingled Fund with changes to the guidelines previously adopted by the Board

Mr. Rue informed the Board that items 12 and 13 were related. He stated item 12 relates specifically to the Death and Disability Portfolios managed by the Montgomery fund, which is the same commingled fund used for both plans. Since this is a commingled fund it is like a mutual fund where guidelines can be changed without the approval of the Retirement Board. He indicated Wells made a minor yet important change to invest in a different type of bond called a 144A bond for up to 10% of the portfolio. He explained that a 144A bond can either be registered or unregistered with the SEC. Mr. Rue expressed that PCA does not have concerns with the 144As that are registered with the SEC, but with the ones that are unregistered. He stated the way Wells guidelines are written it can invest in either type up to 10%. On the high yield side Loomis Sayles and Wells Capital have been given a lot of latitude to invest in unregistered bonds, but the Death and Disability portfolios are investment grade portfolios. The question is how the Board wants to react specifically to this issue with respect to the commingled funds in the Death and Disability Plan. In his memo, Mr. Rue listed options as: searching for another firm, or begin monitoring how much unregistered 144As are actually owned and if it gets beyond a certain limit telling Wells this is not something the Board wants. He stated the guidelines combine both types of 144As. President Romero inquired how one would monitor the unregistered ones. Mr. Rue responded that they would have to ask Wells Capital to make that part of their reporting process to staff. Ms. Bhatia responded Wells would have to report back to staff regarding the content of the fund.

President Romero commented that one of the reasons for going into a commingled fund was the cheaper fees. Mr. Rue added it was also due to the ease of management with the smaller Death and Disability accounts. President Romero continued by stating one of the downfalls of being in a commingled fund is that it prohibits separate guidelines. Ms. Bhatia stated the guidelines were reviewed and the Board was comfortable with them. She added, based on this, we entered into the contract with Wells Capital for the management of funds in the Disability and Death Benefit funds. She reported, since then, Wells has made changes in the content of the fund as far as what they would be investing in. Ms. Bhatia informed the Board they do not really have much of a choice today because they do not have control over Well's guidelines. However, the Board does need to make a decision as to whether to stay with that fund, knowing the risk factor has changed as a result of the change Wells Capital is making. She stated, unless the funds are switched to another vehicle, which will better meet the objective of liquidity as well as risks, then the only other choice is to accept the changes. From there staff can research and come back with an option if there is one.

Ms. Calvache referred to page 12.1 of the agenda package, wherein it states, "Unregistered securities are not readily marketable since they can only be traced among qualified buyers" and inquired what this meant. Mr. Abarro responded they are defined under the SEC rules and called qualified institutional buyers (QIB). He explained that qualified buyers have requirements as to the amount of assets they have and how long they have been in business. He further explained that these are mostly institutional

buyers and sellers like brokerage firms and pension funds so it is a very limited type of market, but high end. Ms. Calvache noted the memo also states that the unregistered investors have little or no legal protection. Ms. Bhatia responded that this was the nature of the security. Mr. Abarro commented, in the case of those securities without registration rights, if there was a loss, the investor practically has no recourse because he has to prove that the issuer of the bonds intentionally and maliciously intended to deceive or misinform the investor. So it is very difficult to contemplate filing a lawsuit or class action lawsuit. Consequently, if money is lost in those types of bonds, it will be gone for good. Commissioner Hogan-Rowles inquired about the investment policy on this type of risk. Ms. Bernstein responded she did not think the investment policy includes exclusion or inclusion of no registration rights issue. She stated this issue is before the Board and needs clarification. Mr. Rue clarified that right now unregistered 144A bonds are being excluded out of the core fixed income portfolios. Commissioner Hogan-Rowles expressed that in a typical situation the Board would not elect to get into the unregistered bonds. Mr. Abarro commented the Board should keep in mind that these are Death and Disability Funds and the Plan cannot afford to take a big hit on those funds. Ms. Bhatia stated that basically the Plan needs the liquidity and these types of securities are illiquid by nature. She reiterated the fact that with commingled vehicles one does not have control over the change in the guidelines because of the nature of the investment vehicle. Ms. Bhatia stated, staff was just informed three weeks ago via email, and the changes will take place at the end of this month. She stated it is almost ratification action of the Board saying "we do not like it but go ahead with it". She further stated that an alternative is for staff to come back before the Board and recommend switching funds. Ms. Bhatia indicated she and Mr. Abarro had already informed Sandra Willen of Wells Capital that they are very uncomfortable with the change in the guidelines. She added, unless the money is switched right away there is nothing else that can be done. Commissioner Hogan-Rowles inquired if the Board has a right to move the money to another fund. Ms. Bhatia responded in the affirmative.

Mr. Moore inquired why Wells is making this change when the commingled fund is offered as a core fund and it is obviously much more risky than a typical core fund. He commented Wells gave an explanation that a lot more of this sort of paper is being issued and they want to be able to take advantage of it, but since it is unrated then it's not really core either. Mr. Rue responded that the commingled fund guideline states they will invest up to 10% in 144A bonds that are registered with SEC and/or 144A bonds that are unregistered. He explained the corporate bond segment in the total core fixed income bond area is about 18% to 20%. Investment grade 144A's that are registered with SEC totals out to about 30% of that. Mr. Rue stated a big segment within the corporate issuance these days is coming from 144As whether or not they are registered or rated. Consequently, the manager would say this is a big opportunity set within the corporate sector and has to be played into somehow. He pointed out the managers allowed themselves to go into unregistered 144As on an opportunistic basis by structuring the guidelines like this. He stated it would have been okay if they just would have said registered 144As, and they might not even violate the guideline if they went into registered 144As to the tune of 10%. Mr. Rue pointed out it is a question if the Board is upset enough to end the relationship right now. Mr. Moore inquired if the unregistered 144As were rated. Mr. Rue responded, to his knowledge, 144As can be rated, and there is a huge component that is. He indicated he has asked around and it is very difficult to obtain information on unregistered 144As from a market standpoint.

He stated the potential is that one could have a portfolio that is 10% unregistered 144As based on the way Wells has written their guidelines. Commissioner Hogan-Rowles noted Mr. Rue is already admitting that based on his research there is not a lot of information in the market about unregistered bonds. Also, the entire paragraph on page 12.1 of the agenda package conveys the Board would be stepping into a market we really do not know about. She expressed that based on the memo it would be smarter if the Board were not in unregistered 144A's at this point in time. Commissioner Hogan-Rowles stated she did not know what is involved in moving the funds, but the Board has a responsibility to adhere to the policies that are already in place. She added if this had come before the Board and they had a chance to make a decision, they would not have chosen this investment. Mr. Rue responded this issue is clearly a risk tolerance question for the Board to resolve.

Mr. Moore inquired what the cost would be to move the money from one player to another. Mr. Rue responded he did not have a quick answer to that. But the bigger question is how big of a player is the WPERP in Well's commingled fund. He stated if the Plan is a material percentage of the commingled fund then Wells is going to have to take time to liquidate positions to cash the investment out. Ms. Bernstein commented that she did not think DWP's investment was a significant portion in the overall commingled fund. Mr. Rue stated he did not know the answer and did not know how big the commingled fund is. Ms. June Kim approached the podium and clarified the commingled fund is \$720 million. Mr. Rue stated that DWP is only 10% of that. He stated there may be some trading aspect that happens but in general they probably do not hold 10% of their portfolio in cash. He indicated if Wells has to sell some bonds there is going to be a little bit of market impact issues associated with getting out of the fund. Mr. Moore inquired if the Board informs Wells of their great discomfort with this issue and the probability that they are going to quickly remove the funds, would the firm be likely to change their guidelines or stick to their position. Mr. Rue responded he did not know, but it was his guess that Wells would not change their guidelines. Ms. Bernstein commented it would not hurt to see what response will be given.

President Romero agreed with Mr. Moore in that if there is an opportunity to save money in transition costs, market impact, etc., they should inquire and maybe there will not be an issue. He then inquired if Wells had another fund to move the money into. Mr. Rue responded the idea would be for Wells to change their guideline language to say something like, "maximum of 10% in registered 144As, and a caveat clause on the unregistered. However, Wells will still request some exposure to unregistered 144As. Ms. Bernstein commented that up to 2% is very different than being able to have 10%. Ms. Bhatia reiterated that the guidelines for a commingled fund cannot be dictated. She stated this had already been discussed with Ms. Willen, so if the guidelines say 10% then that is what it is going to be. Ms. Bhatia suggested other options be looked into and brought back before the Board. In the meantime, the funds are already being invested, so ratification is needed. Commissioner Hogan Rowles expressed she did not feel comfortable ratifying something she did not agree with. Ms. Bhatia responded that the only other alternative is to withdraw the money; otherwise it will be invested in the manner Wells has chosen anyway. Commissioner Hogan Rowles inquired what the maximum cost would be to withdraw the money. Mr. Rue explained it would be a contract process on DWP's side, but what the Board is asking for is to get out of the fund in two weeks based on a decision that would be made today. He added, this was

probably a reasonable amount of time. Mr. Rue informed the Board if they wanted to make a hard fast decision to be out of the fund by the end of the month due to the guideline issue, they could probably transition this fairly smoothly. Mr. Moore inquired if there were any other concerns besides market impact. Mr. Rue responded that needs a answer which includes many variables such as bid ask spreads in the bonds and price movements on the bonds. President Romero commented that potential costs with market impact and opportunity costs is something the Plan's custodian bank could give estimates of, similar to the estimates they gave when the portfolio was initially traded. He expressed he did not want to rush too quickly on this because of the costs to the Plan. He stated he did not feel it is currently a huge risk and the item should be placed on the next meeting's agenda and hopefully there will be more answers to some of the questions at that time. Mr. Rue agreed that the Board did not need to rush because the investment principal would not be at huge risk over the next couple of months. However, the Board could keep it in the back of their minds that they need to move in a direction to get out of it in the next three to six months. Mr. Moore suggested a more aggressive approach of having staff prepare a resolution for the next Board meeting to move the money out of the fund as of the date of that meeting in case changes cannot be worked out to the satisfaction of the Board in further conversations with Wells.

Mr. Rue noted that staff has indicated they need ratification from the Board if they are going to stay in the fund for two to four weeks for contract purposes. Mr. Moore inquired if this was really necessary. Ms. Bhatia responded the ratification was necessary unless the money was pulled out overnight. She informed the Board there was \$34.7 million for the Disability Fund and \$29.5 million for the Death Benefit Fund, which is approximately \$65 million out of the entire fund of \$720 million. Mr. Vazquez commented it was his recollection that while dealing with the Retirement funds, the Death and Disability funds were left over and were of a size that would not be attractively placed with a core fixed income manager at \$60 million. He stated, as an accommodation, Wells suggested putting the two funds into their commingled fund. He then inquired if ING has a similar vehicle the money could be moved into. Mr. Rue responded he was not sure but it would be investigated. He reminded the Board that DWP was receiving a little bit of a fee break because of their total relationship with Wells.

Mr. Vazquez agreed with President Romero that Well's change in the guidelines was something the Board should not quickly react to. He stated he did not anticipate Wells going overboard in their investment in this particular vehicle. He recommended the Board express their concerns, but he would rather the Board take their time and know where they are going with the monies and what it will cost to get out immediately as opposed to over a period of time.

Commissioner Hogan-Rowles inquired if Wells were to walk through the door and make this kind of recommendation would the Board say "yes, we want it". She stated it is her understanding that the Board would most likely vote "no". Hence, it seems illogical to suggest it is now okay. Commissioner Hogan-Rowles expressed she was in complete agreement if the Board wants to come back in two weeks with a resolution informing Well's that if they do not remove the unregistered bonds out of the commingled vehicle, which is what the Board agreed to in the first place, then the monies would be transferred to another fund. She stated she feels there is a cost benefit ratio that needs to be looked at and if these bonds are as unsecured as the memo conveys then the

Board needs to be logical and say this does not adhere to what we normally do under normal circumstances. Commissioner Hogan-Rowles suggested the Board could then make a decision based on the cost of maybe \$1 million to change. However, when one is talking about \$65 million worth of money, it is a small cost compared to what could be lost down the road if these securities do not work out. Commissioner Hogan-Rowles stated she was in agreement with Mr. Moore in calling Wells to find out if they will change the guidelines. If not, staff should come back with a plan to move the funds within the next two to four weeks maximum.

Mr. Moore inquired of Attorney Wilkinson if the Board does not act on Resolution 06-45 ratifying the investment guideline changes that were already made would it make any difference since Wells has had this right all along without the Board's consent. He stated if the Board does not act on this it would be another way of expressing the fact we do not like the change. Meanwhile Wells continues to invest the way they intend to, staff has a quick dialogue with them, and subsequently at the next Board meeting staff comes back to us in consultation with PCA and recommend the next step. Attorney Wilkinson responded he had not seen the information from Wells and would need more feedback from Ms. Bhatia on the exact wording. Ms. Bhatia responded Wells was to invest in accordance with certain guidelines. She stated Wells is now changing the guidelines and they are not the same as when DWP entered the contract. The resolution definitely needs to be ratified if we are going to go forward. She informed the Board that even if the resolution is not acted upon, by default, the funds are invested and we would be going along with whatever Wells is doing unless the money is pulled out. President Romero inquired if it was critical the Board act on this. Ms. Bhatia responded that the resolution states the action being taken is due to the time limit that we have been thrown. However, the resolution does give staff direction to move forward in finding another vehicle. She expressed her opinion that the Board should act on the resolution, otherwise we would be in limbo and not in compliance. She added it is by default that we are currently in the fund. Attorney Wilkinson indicated he had not reviewed the information and did not want to give the Board a quick and incorrect recommendation on what the legal response is for not signing the ratification.

Mr. Vazquez inquired what the contract says with regards to Wells independently changing the guidelines and what the Board's obligation is. Ms. Bhatia responded it is a commingled fund. However, the Board has been completely involved with every step of the investment process including the approval of the commingled fund guidelines. She stated we do not really have much control over commingled funds, which is the nature of the investment that was chosen for the Death and Disability Funds. Consequently, Wells is free to make changes to the guidelines and inform us, which is what they have done. She added Wells did not really give sufficient notice. Mr. Vazquez inquired if the guidelines were part of the contract with Wells. Ms. Bhatia responded the guidelines are part of the contract with Wells because that is the commingled fund the Board chose with the associated guidelines. Mr. Vazquez commented if the Wells contract states they will invest our money according to these guidelines, then he did not see how they could independently change the guidelines and not be in breach of contract. Ms. Bhatia explained it is a commingled fund and not a separate account. Mr. Vazquez noted that DWP's contract with Well's specifies they can only invest in these particular securities. Ms. Bhatia responded that the Plan's guidelines do not really apply to the commingled fund and it was the commingled fund guidelines that were brought before the Board for

approval. She stated it was felt that those guidelines would serve the purpose of the Disability and Death Benefit Funds. She stated basically the Board had to approve the guidelines, but we do not have control over the fund guidelines.

Mr. Mike Fergusson of Mellon Financial approached the podium. President Romero recognized Mr. Fergusson.

Mr. Fergusson explained that normally with these contracts the guidelines are attachments and can be easily amended. He stated he has not seen the contract, but this would allow Wells to make changes because they would be changing an attachment to the agreement and not the agreement itself. Commissioner Hogan-Rowles inquired if the change could be made without the Retirement Board's approval. Mr. Fergusson responded the letter Wells sent is a notification of the change. Attorney Wilkinson commented that in a worst case situation the fund could be removed if the Board cannot live with the changes. President Romero inquired if the Board had to take action today. Attorney Wilkinson responded in the negative.

President Romero stated another question is if the Board would feel comfortable with a 2% limit. Commissioner Hogan-Rowles expressed she would advocate "no" based upon the information in the memo because she is uncomfortable with the bonds not being subject to expert review by the SEC. President Romero suggested, based on counsel's advice, the Board not take action, but pursue various scenarios with Wells Capital and then decide what to do. Mr. Moore suggested PCA and staff also provide the Board with a cost estimate of what it will cost to get out and what alternatives are available to resolve the issue. Ms. Bhatia requested the Board make a motion on their decision for the record.

Mr. Moore moved for the record that the Board pursue various scenarios with Wells Capital and that PCA and staff provide the Board with a cost estimate of what it will cost to get out and what alternatives are available to resolve the issue. Seconded by Commissioner Hogan-Rowles and carried unanimously after the following vote:

Ayes: Romero, Calvache, Canzano, Hogan-Rowles, Vazquez and Moore

Nays: None

Ms. Calvache inquired if Wells would be willing to come before the Board and discuss this issue. Mr. Rue responded PCA would quickly find out whether or not they are open to discussion regarding this. But most likely they will say these things are cast in stone. Commissioner Hogan-Rowles inquired of PCA, in terms of procedure, will each Board member be notified as to the outcome once they have talked to Wells or will the Board have to wait until the next Board meeting. Attorney Wilkinson responded that having conversations outside of the Board is prohibited by the Brown Act. He stated it would have to be presented as part of the Board agenda package and be agendized.

13. Discussion of Wells Capital Management's Request to Invest in Unregistered 144A Securities in the Plan's Active Core Fixed Income Portfolio

Mr. Rue stated item 13 is the same issue as item 12 except that it is a separate account and the Board can control the guidelines. He suggested giving Wells Capital a small percentage of exposure, but it was up to the risk tolerance of the Board. He stated if the Board does not wish to have these types of securities in their portfolio they can say no and that will not get in the guidelines and business will move on as usual. President Romero inquired if the City invests in 144A unregistered bonds, and if so, what percentage. Ms. Kim responded that Fire and Police Pensions and LACERS do not have restrictions with regards to 144A bonds. Mr. Rue stated those pension plans are not as precise on their guidelines. Ms. Kim added their guidelines do not clearly state “no 144A’s registration rights”, but rather keeps it open to the fund manager’s discretion.

Mr. Vazquez referred to page 13.4 of the agenda package to a report by PCA giving the Board two options to address the 144A without registration rights with regards to the active core fixed income portfolio. He then moved the Board adopt option 1, which prohibits the use of 144As without registration rights. Seconded by Commissioner Hogan-Rowles and carried unanimously after the following vote:

Ayes: Romero, Calvache, Canzano, Hogan-Rowles, Vazquez and Moore

Nays: None

President Romero inquired how the Plan is affected from a financial aspect of not investing in unregistered securities and if it is historically higher risk/higher returns. Mr. Rue reiterated that it is hard to acquire information on unregistered 144A securities. He stated the logic for people going into these is that they are not liquid and are private placements. This does not mean they are unrated or risky, but one cannot trade out of them if an issue comes up. He stated one could probably get a modest incremental yield of 5 to 10 basis points for that. Mr. Moore inquired what the typical term is for these. Mr. Rue responded he did not know, but he would follow up and provide him with some characteristics if he could.

Mr. Vazquez inquired if there were such investment vehicles in the high yield portfolio. Mr. Abarro responded in the affirmative, adding there is a 25% maximum.

14. Retirement Plan Manager’s Comments

a) DWP Plan Newsletter for Retirees (February 1, 2006, Edition)

President Romero suggested creating an avenue in which Board members can have some input as to what goes into the newsletter. He stated in the past the newsletter was a little more evolved and it is important the Board knows the content of what is going out to the members. Ms. Bhatia responded that staff could send Board members a draft of the newsletter before it is sent out. She reminded the Board that the newsletter is always dated the first of the month. Mr. Moore suggested creating a communications or public affairs committee. He stated the City’s retirement system has more useful communications being sent out.

General Items

Ms. Bhatia reported, with regards to the Retirement Board Election, she would either be bringing back the election calendar that fits into the timeline indicated by the Plan or an extension of terms. She added she would let the Board know at the next Board meeting.

Ms. Bhatia reported the Plan was recently reimbursed approximately \$200,000 in connection with staff's monitoring of the investment guidelines.

JAVIER ROMERO
President

SANGEETA BHATIA
Secretary

IRENE COLON
Recording Secretary