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

MINUTES – November 1, 2006

Present:

Javier Romero	President
Ron Vazquez	Chief Financial Officer
Cindy Coffin	Board Member
Michael Moore	Retiree Member

Absent:

Ronald Deaton	General Manager
Forescee Hogan-Rowles	Commissioner
Eugene Canzano	Board Member

Others Present:

Sangeeta Bhatia	Retirement Plan Manager
Monette Carranceja	Assistant Retirement Plan Manager
Irene Colon	Recording Secretary
Sarah Bernstein	Pension Consulting Alliance
Mike 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.

1. **ING Life Insurance and Annuity Company Reaches Agreement with New York Attorney General and New Hampshire Securities Bureau**

2. **Pyramis Global Advisors (Fidelity) International Growth Discipline - Personnel Update**

Mr. Moore expressed he was not clear on the ING disclosure issue settled with the New York Attorney General.

Ms. June Kim (Investment Officer) approached the podium. President Romero recognized Ms. Kim.

Ms. Kim responded the issue did not have anything to do with the institutional side of the business. She explained that ING has a large defined contributions business and the files have been claimed against that side of the business. She added that the issue was regarding revenue sharing and disclosure of that information. Ms. Kim clarified that ING just wanted to inform the Board the issue had been resolved, they did not admit to any wrongdoing, and the case has been closed.

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

Ayes: Romero, Coffin, Moore, and Vazquez

Nays: None

3. International Manager Presentations

a) The Boston Company

Messrs. Robert Harkins, Vice President; Clifford Smith, Sr. Vice President and Sr. Portfolio Manager; and Lawrence Ivey, Vice President and Sr. Relationship Manager, of The Boston Company approached the Board table. President Romero recognized the representatives of The Boston Company.

The Boston Company representatives provided the Board with a presentation of their EAFE plus Canada value equity management portfolio review.

Mr. Vazquez requested Mr. Harkins define a full market cycle. Mr. Harkins explained that typically they look at a full market cycle as a period of three to five years.

President Romero inquired if Boston’s investment performance as of September 30, 2006, was inclusive of fees. Mr. Harkins responded it was on a gross basis. President Romero inquired if the figures inclusive of fees were available. Mr. Harkins stated he would follow up with President Romero with that information. President Romero inquired if Boston feels the underperforming stocks would turn around in the next market cycle. Mr. Smith responded that Boston’s expectation is that over a reasonable holding period, typically two years, they would see performance out of any security they introduce into the portfolio. He stated sometimes this happens a lot earlier in the holding period and, in some cases, can happen towards the longer end of the expected holding period. He added the potential for a turn in what investors are looking for in the market could happen sooner rather than later. President Romero inquired about the historic turnover on the portfolio. Mr. Smith responded that it ranges from 30% to 50%, and more recently has been 40%. Mr. Harkins commented it is very difficult to make a call as to when the markets are going to change. He explained that if you look at how long and strong a market run has been and the characteristic where the market has been rewarding those stocks that have done well and keep doing well; there is a bifurcation between that and a process like Boston’s. He stated their process is based on valuation and constantly redeploying into more compelling combinations of valuation, fundamentals, and momentum. Mr. Harkins indicated when the Boston team does their weekly stock review they attempt to keep a portfolio with characteristics positively exposed to valuation, fundamentals, quality measures, dividend yield, and things that over time will create a good chance to outperform. Mr. Smith added this was why Boston keeps a well-diversified portfolio, even where they build exposures that are different than the index.

Mr. Moore pointed out that the Board is considering a divestment of some of the companies doing business with Sudan and are in the process of evaluating the situation. He noted several of Boston's holdings are on the list of a number of institutions evaluating these companies. Mr. Moore inquired about Boston's perspective with regards to, if these were to be divested, what impact it would have on the portfolio, what interest is being expressed by other public pension funds, and the firm's own thoughts on this issue. Mr. Harkins responded that Boston Company prepared a memo several quarters ago, which included an expansive list based on work done by a consultant (KD Associates) they hired. He stated that 8% of the universe was on their list, but it was a very broad definition. He added that how the client arrives at their specific definition will determine the impact range. Mr. Harkins stated, based on the broadest definition, it was about 8% of the universe. He further stated that one of the other considerations is that a lot of the companies are in petroleum and infrastructure, which are companies with true economic value and are an important part of any portfolio. Mr. Harkins stated Illinois seems to be taking very firm solid actions early on to divest, while others are waiting to see if the UN is going to step in and end the problem or writing the companies themselves. Therefore, the response is all over the board. Mr. Smith responded, from a portfolio standpoint, Boston can accommodate restrictions to the investable universe, which they do for socially responsible mandates and could do the same for the Department if the Board identifies companies they deem to be inappropriately involved in a certain area. He added that the range of impact would depend on how broad the list is.

The representatives of The Boston Company left the Board meeting.

b) Pyramis Global Advisors (Fidelity)

Messrs. Michael Strong, Institutional Portfolio Manager and Arthur Greenwood, Relationship Manager, of Pyramis Global Advisors approached the Board table. President Romero recognized the representatives of Pyramis Global Advisors.

The Pyramis representatives provided the Board with a presentation of their international growth strategy portfolio review.

Mr. Vazquez inquired, with regards to the employee who resigned from Pyramis, would the employees being reassigned in his place need to learn the investment philosophy. Mr. Strong responded that both replacement employees were experienced international equity managers and have a similar style as that of the resigning manager. He stated both of the new managers are very familiar with all of the stocks in the portfolio and he does not anticipate extensive changes to the portfolio. Mr. Strong explained that part of the selection process in determining who the new managers would be was looking at the total resources available and who would most neatly fit into the existing portfolio style.

Mr. Vazquez referred to page 11 of the Pyramis booklet where it reflects an overweight in retailing by 2.4% and on the previous page shows it at 0.9%. Mr. Strong explained that the previous page reflects the average position during the total 12 months being reviewed and the 2.4% reflects the actual position as of September 30, 2006.

President Romero inquired of Ms. Bhatia if Fidelity was identified as having investments in Darfur. Ms. Bhatia responded that the investments in Darfur were identified in the emerging market commingled accounts. Mr. Moore commented it depends on which list one is looking at, because the broader list includes a number of holdings they have including ABB, Total, Royal Dutch and Siemens -- all of which have been mentioned. He then requested the representatives convey their concerns or the extent to which they have looked at this issue. Mr. Greenwood stated that Pyramis' experience has been similar to the Boston Company's, in that every week there have been additional and broader inquiries with respect to Sudanese investments. He further stated, from an investment manager perspective, it is helpful to have the definition and specificity of the impacted investments the client wants screened. Mr. Greenwood noted the specific arrangement the Department currently has with Fidelity is an investor in the commingled pool, which cannot be customized in any manner, but a separate account structure can be customized. Mr. Strong added that Pyramis currently runs a Sudan free portfolio for one of their public plan clients. He stated it would be impossible to say whether or not that kind of restricted portfolio will harm or enhance the performance because there will be certain times during the economic cycle when companies perform strongly or not so well. However, there will certainly be impacts over time of not investing in those stocks.

The representatives of Pyramis Global Advisors left the Board meeting.

c) Invesco

Ms. Sandra Dzinski, Marketing Director; Ms. Michele Garren, Portfolio Manager; and Mr. Christian Ulrich, of Invesco approached the Board table. President Romero recognized the representatives of Invesco.

The Invesco representatives provided the Board with a presentation of their international equity portfolio review.

The representatives of Invesco left the meeting.

4. Actuarial valuation and review of the Retirement Fund as of June 30, 2006: presentation by The Segal Company

Mr. Paul Angelo of The Segal Company approached the Board table. President Romero recognized Mr. Angelo.

Mr. Angelo presented the Board with the annual actuarial valuation and review of the Retirement Fund as of June 30, 2006. He stated the Plan has an assumed rate of return of 8% and the market value beat the assumed return. However, when mixed in with the returns over the previous 4 years under the smoothing method, the rate of return is 4.81%, which is substantially less than the assumed 8%. He stated there were also less salary increases, which decreased the Plan's required contribution. Mr. Angelo explained that when the market tends to go up the actual value will tend to lag behind, and when the market tends to go down the actual value will lag behind, but now from above. He stated because the returns have been good for the last few years the two numbers have crossed. Mr. Angelo reported that last year the actuarial value was larger than the market value and the cost was being calculated based on an asset value bigger than the market as a result of the losses being spread over into future years. He added that now it is just about at break even.

Mr. Angelo commented the contributions are substantially less than the benefits being paid. He indicated when the asset allocation study is performed by PCA, this is one of the things they will take into account. He explained the fund has to maintain enough cash generated from the investments to be sure that, combined with the contributions, the Department is able to make the benefit payments.

Mr. Angelo reported that out of a $6.5 billion fund the total loss on investments was approximately $200 million (on a smooth basis), the total gain was $22 million, and all the other assumptions had a very small impact. Mr. Vazquez inquired if the actuarial valuation of assets differed from the market value of assets. Mr. Angelo responded that the actuarial value of assets is the five year smoothing, whereas the market value would be raw numbers.

Mr. Angelo reported that due to the salary experience 0.4 % was taken off the actuarial required rate, the investment gain loss added 3.5% to the contribution rate, and the other gains and losses was a net .07%.

Mr. Angelo commented that approximately four years ago the Department adopted a policy to pay off the unfunded liability over a fixed period. He explained that all the gains and losses were being spread over a shorter period and the Board adopted a policy wherein each year they identify what happened since the last year and fund that over a separate piece. In 2004, when the policy was adopted, there was an initial unfunded liability of $170 million being paid off over 15 years and there is currently 13 years left. He added there has also been an investment loss into the next two years and the unfunded liability changed with each new valuation.

Mr. Angelo informed the Board that the principle action would be to go over the contribution rates, adopt the report, and make a decision whether to adopt those as the contribution rates that would provide the bill to the employer. He explained there is a six month lag and the rates that are to be adopted go into effect on July 1, 2007.

Mr. Moore requested Segal Company include a table reflecting the unrecognized return.

Mr. Moore inquired if the15-year amortization through Department contributions and 8% performance of the fund eliminates the unfunded liability over time. Mr. Angelo responded in the affirmative, stating the 8% performance of the fund is the one that can be counted on.

Mr. Moore referred to page 31 of the Segal booklet to the annual required contribution, actual contributions, and the percentage that was paid on each. He then inquired, given a percentage that is assumed to yield the dollar amount of 141.5, when we miss it is it because something intervened. Mr. Angelo responded it was primarily due to a timing issue. He stated Segal calculates it in theory that the contribution is going to be made on payroll from July 1 to July 1. However, in practice, it is applied to a payroll that is January 1 to January 1. Mr. Angelo explained that the pension cost shown is calculated by the auditors by taking the contribution rate and applying it to their judgment of the applicable payroll.

President Romero called for a break at 11:34 a.m.

The Board meeting reconvened at 11:46 a.m.

President Romero inquired if the new contribution would come back before the Board through a resolution. Ms. Bhatia responded it would be better to adopt the report by motion and she could bring back a resolution to ratify the motion.

Mr. Vazquez moved the adoption of the actuarial valuation and review of the Retirement Fund as of June 30, 2006. Seconded by Mr. Moore and carried unanimously after the following vote:

Ayes: Romero, Coffin, Moore, and Vazquez

Nays: None

President Romero inquired of Attorney Wilkinson if Board Agenda item 4 should be worded differently. Attorney Wilkinson responded it would be better if the item included the phrase “and action”; however, since part of the evaluation and review would be the approval of the actuarial report then it would not be fatal for the Board to pass a motion.

5. Actuarial valuation and review of the Disability Fund as of June 30, 2006: presentation by The Segal Company

Mr. Angelo pointed out a letter from Segal on page 5.1 of the Board agenda packet regarding the actuarial valuation and review of the Disability Fund as well as a presentation booklet.

Mr. Angelo reported the total reserve for the disability benefits has decreased from $45.7 million on June 30, 2004, to $37 million, member contributions amounted to about $400,000 on June 30, 2006, and the Department contributions amounted to approximately $5.1 million for both the 2004-2005 and 2005-2006 fiscal years. He also reported the contributions to the Temporary Disability Benefit Fund have been less than the outgoing benefit payments, and as a result the reserve has gone from a positive number to a negative number. He added, the reserve was $6 million two years ago in 2004 and now has a negative balance of $2 million. Mr. Angelo explained this does not mean there is no cash flow and the benefits are not getting paid, but from an accounting standpoint it shows a cumulative deficit. He further explained there is a target return based upon the amount of expected claims each year and the goal is to have the reserve equal 20% of that. He stated the recommended contribution is a combination of the immediate expected claims plus an amount to get you to the targeted reserve. Mr.

Angelo noted that two years ago the contribution rate for the Temporary Disability Benefit Fund was set at $0.74 per $100 of compensation. If the same funding policies from two years ago are maintained, that number would go up to $1.55 per $100 due to an increase in the rate of claims and because of a credit from having a reserve bigger than the target. However, now the reserve is less than the target, producing an additional cost to reach the target reserve.

Mr. Angelo informed the Board that if they choose to stay with the current policy it would increase the contribution rate from $0.74 per $100 to $1.55 per $100. He stated Segal has developed some alternatives, but they are not recommending they are better or worst. Mr. Angelo indicated the first recommendation is moving the deadline out two years to lower the contribution to $1.45, and the second recommendation is that the Board considers authorizing a review of the policies used to fund that plan to bring it up to date. He added that one of the things needing to be addressed is what the terminal period should be.

Mr. Angelo reported, with regards to the Permanent Total Disability benefits, there are reserves well in excess of the targeted amount. As a result, the employer contribution rate for that fund is recommended at zero, and has been for many years. Mr. Angelo pointed out that the main item for Board consideration is the Temporary Benefit Fund.

Mr. Angelo reiterated Segal's recommendation of adopting the current policy of $1.55 and reviewing the policies. He stated if the Board wanted to stay with the insurance company claim reserve kind of approaches there is a Segal employee who could go through the reserving factors and targets. In addition, he urges the Board to look at funding it like a pension plan by taking the population date, project the benefits out, and perform a level of funding, normal cost, and amortization cost. Also, if the Board ever decided to merge the Plans, the funding would be on a consistent basis and would avoid a cost impact.

Mr. Angelo explained the letter from Segal included in the Board package notes the target is $240 million the fund is currently at negative $2 million, and suggests an alternative of transferring $10 million, putting the fund at $8 million, and producing a credit and a lower cost. President Romero commented this was not a significant amount and he would rather leave it at $1.55. He noted there had been some concerns expressed in the past by Attorney Weisz-Jones regarding moving money from fund to fund with the way the Plan is written. He added the May 21, 2003 Board minutes indicates this. Mr. Vazquez pointed out that the prior employee monthly contribution is $354,000 based on $0.74 contribution rate and would be $742,000 at a contribution rate of $1.55. He stated it would go up approximately $400,000 per month, which is over $4 million a year. He indicated he wanted to revisit what the options are, what it means in terms of funding the benefits for the members, and what options are available to ensure the Board is not compromising the payment of the benefits. He added there may be an option that would help levelize the annualized contributions by the Department. Mr. Vazquez expressed he would prefer deferring the adoption of the valuation, and at the next Board meeting review the options and what they mean. He stated, in the meantime, he would look at what the potential impact of this would be on the Department's net income levels and need for rate increases. President Romero stated he distinctly recalls Attorney Weisz-Jones indicating this was a potential meet and confer issue due to the way the Plan is written with regards to transferring money from one fund to the other. He requested Attorney Wilkinson look into that. Mr. Vazquez mentioned that the transferring of money from one fund to the other had been done before. Mr. Moore requested, since Segal 's report did not reflect what was going on in terms of why the numbers are changing, if staff could provide the Board with that information. Ms. Bhatia responded that staff does not keep track of the reasons for the claims going up. However, a couple of things staff observed was an increase in employees and the amount paid out is based on the payroll covered, which has also increased; therefore the amount of the benefits has increased. She stated, as far as statistical information pertaining to the types of claims, the Retirement Office does not have the ability to keep track of the nature of claims.

President Romero noted that in 2003, the Retirement Board discussed reducing the Department's rate of assumption. He then inquired if the Board took action on this. Ms. Bhatia responded in the affirmative. She explained it was based on the fact that the nature of the investments in these funds is fixed income investments, and therefore the actuarial assumption rate was changed from 8% to 5%. Mr. Angelo responded this has relatively little impact because the reserves are not a present value the way they are in the pension plan. He explained that the main place the interest comes into play is when trying to figure out how to use the surplus to offset the current cost. Mr. Angelo indicated the 5% did increase the cost to the Plan but does not have nearly the kind of impact one would get on a pension plan. President Romero inquired if the Department's contribution rate lowered at that time. Mr. Angelo responded the rate did go up substantially, but he would be hard-pressed to say how much that was due to the interest rate change and it was primarily due to the higher level of claims and the combining of the extended temporary with the regular temporary. Ms. Bhatia added that the claims are not based on an actuarial valuation of the claim, but as they are incurred. President Romero noted that it was stated there was a 30% increase in cost from last year, and inquired if the new addition of employees had been at a 30% increase. Ms. Bhatia responded she would have to research that. She stated she did not think it was 30%; however, salaries have gone up. Mr. Angelo reminded the Board that the rate is per $100 of compensation, therefore, hiring more employees would not make the rate go up because there would be more cost and more payroll to spread it over.

The Board decided to defer item 5 for a month. Mr. Angelo inquired what level of review and analysis the Board would like Segal to perform because it may take more than a month. Mr. Vazquez requested a more modern and comprehensible analysis. President Romero reiterated his concerns of being more cautious and looking at the legal and meet and confer issues. He expressed that if everything was okay on that end he would be in support of Segal's recommendation. Mr. Angelo commented that the legal issue Attorney Weisz –Jones was referring to may have been that money could not be moved between the Death Benefit, Disability, and Retirement funds. Mr. Vazquez requested that staff provide the Board with what options there are in lieu of the $1.55 contribution rate, without having to change the actuarial recommendation.

Mr. Angelo returned to the audience.

6. Discussion and possible action on extension of contract for MFS Institutional Advisors, Inc. (Domestic Equity Large Cap Value Manager)

Ms. Bernstein and Ms. Kim approached the Board table. President Romero recognized Ms. Bernstein and Ms. Kim.

Ms. Kim informed the Board that representatives from MFS were present in the audience to address any of the their questions. She reported the MFS contract was due to expire at the end of November, and staff performed a due diligence review and have been monitoring MFS's performance and account. Ms. Kim stated, at this time, both PCA and staff recommend the MFS contract be extended for three years. She explained the extension would be under the same terms as the existing contract with the revised insurance requirements.

Mr. Vazquez referred to page 6.1 of the agenda packet to the comparison of the MFS annualized return versus the benchmark. He then inquired if their annualized return was on a gross or net basis. Ms. Kim responded they were all gross. Mr. Vazquez inquired what it would be on a net basis. Ms. Kim responded that the annual fees the Department pays for MFS is approximately 32 basis points, so the net basis would be 0.32% less.

Mr. Vazquez referred to page 6.3 in the conclusion of the memo to a sentence stating MFS has not managed the assets for a full market cycle. He inquired what is considered a full market cycle. Ms. Bernstein responded that a full market cycle is typically three to five years. Ms. Bhatia added that MFS was funded a little later than when the contract started.

Mr. Moore moved the approval of extending the MFS contract for three years. Seconded by Mr. Vazquez and carried unanimously after the following vote:

Ayes: Romero, Coffin, Moore, and Vazquez

Nays: None

Ms. Carolyn Lucey of MFS approached the podium. President Romero recognized Ms. Lucey.

Ms. Lucey thanked the Board for their consideration and expressed that MFS values their relationship with the Department.

7. PCA's memo regarding Real Estate Investments Strategy

Ms. Bernstein stated that the Los Angeles City Employees' Retirement System and Fire and Police Pensions are considering purchasing a building or having one constructed. She stated, due to the Retirement Office's staffing needs, a question arose on whether DWP should do something similar or join the other two pension plans. Ms. Bernstein noted there was a memo included in the agenda packet from the real estate consultant giving their general advice on such a consideration. She stated typically PCA would not recommend a retirement plan of DWP's size invest a percentage into their own building.

President Romero commented that his thought was to expand the Retirement Office, reduce the risk by going into it with two other pension plans, and that the potential of the Department leasing space would be guaranteed rental for the Plan. Mr. Moore agreed with PCA about not getting involved in individual real estate deals. He stated he also did not like the idea of the Board putting themselves in a position where they may have to negotiate with the Chief Administrative Officer with respect to the rent. Mr. Moore expressed he would rather go with existing, new Department, or leased facilities.

8. Appointment of an "alternate" to the Governance Committee

President Romero appointed Ms. Coffin as the alternate member to the Governance Committee.

9. Retirement Plan Manager's Comments

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

b) General Items

<u>Other Post Employment Benefits (OPEB)</u>

Ms. Bhatia informed the Board members that staff is working on the details of the transfer of the OPEB assets with the finance group of the Department, as well as Mellon Bank. She stated staff will be bringing the amendments to the current agreement, including the custody agreement and any amendment to fees being proposed before the Board. Ms. Bhatia reported that staff would also be working with PCA in connection with the manner in which those assets would have to be allocated. She stated this transfer is expected to happen at the end 2006 or beginning of 2007.

Mr. Vazquez inquired if the transfer of the funds for the post retirement healthcare costs would affect the PCA contract. Ms. Bernstein responded that if PCA is required to do more work for the Department then they would put in some budgetary addition to cover it. Mr. Moore commented that PCA provided the Board with some numbers that were part of the original paperwork. Ms. Bernstein added that the transfer of the funds would be in addition to the existing core contract.

<u>LRS</u>

Ms. Bhatia stated there was one employee assigned by ITS, Mark Townsend (Assistant Director), to oversee the project for the new computer system. She stated the Retirement Office has also been involved in interviews to try to get the team together. Ms. Bhatia added that staff is still trying to work out the office space issue with the Department's management.

<u>Macias Gini & O'Connell</u>

Ms. Bhatia reported there had been challenges in working with the new auditors, Macias, Gini, & O'Connel. She explained staff expected to have an annual report presented to the Board. She indicated the deadline would be met for the City

Controller's Office; however, there have been some issues as far as lack of proper coordination by the auditors. Mr. Moore expressed he was troubled that the Audit Committee meeting was deferred because the auditors had not yet completed their report. He stated what troubled him even more is when the firm was selected, the Retirement Board informed Macias, Gini & O'Connell they wanted them to attend the Audit Committee meetings so they could get their input. He stated this has not happened and the auditors have totally ignored the Board's concerns. Ms. Bhatia informed the Board that staff would be bringing back the annual report after they provide the draft report to the City Controller's Office. President Romero requested an Audit Committee meeting be scheduled to discuss this issue.

The Board meeting was adjourned at 12:42 p.m.

JAVIER ROMERO
President

SANGEETA BHATIA
Secretary

IRENE COLON
Recording Secretary