

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

**MINUTES – March 7, 2007**

**Present:**

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

**Absent:**

Ronald Deaton	General Manager
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**Others Present:**

Sangeeta Bhatia	Retirement Plan Manager
Monette Carranceja	Assistant Retirement Plan Manager
Mark Blunk	Assistant Retirement Plan Manager
Vikki Burks	Recording Secretary
Sarah Bernstein	Pension Consulting Alliance
Neil Rue	Pension Consulting Alliance
Michael Wilkinson	Deputy City Attorney
Alan Manning	Assistant City Attorney

President Romero called the meeting to order at 9:35 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.

Ms. Bhatia introduced new Staff members; Programmer Analysts Betty Hill, and Caryn Hoang. President Romero welcomed them.

**1. Approval of Board Minutes of February 7, 2007**

Commissioner Hogan-Rowles pointed out there was a numbering error on page 1.2 of the Board package. She also requested the minutes indicate that LRS stands for Levi, Ray & Shoup Inc.

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

Ayes: Romero, Coffin, Moore, Hogan-Rowles, Vazquez and Canzano  
Nays: None

- 2. Summary Investment Returns as of January 31, 2007**
  - a) Market Value of Investment by Fund and Month as of January 31, 2007**
  - b) Market Value of the Retirement, Death & Disability Funds as of January 31, 2007**
  - c) Investment Returns as of January 31, 2007 – Revised**

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

Ayes: Romero, Coffin, Moore, Hogan-Rowles, Vazquez and Canzano  
Nays: None

- 3. Presentations – Emerging Market**
  - a) T. Rowe Price**

Mr. John D. Plowright, Vice-President, and Kurt Umbarger, Vice-President of T. Rowe Price approached the Board table. President Romero recognized the representatives of T. Rowe Price.

Mr. Plowright and Mr. Umbarger provided the Board with a presentation of their emerging Market portfolio.

Commissioner Hogan-Rowles asked what countries comprise the non-U.S. developed market. Mr. Umbarger responded it is the EAFE Index which includes developed markets of the world including Europe, Japan, Singapore, Hong Kong, Australia and New Zealand.

Commissioner Hogan-Rowles inquired which countries are considered the “Emerging Asia” market. Mr. Umbarger responded the countries include: India, Thailand, Indonesia, Malaysia, China and the Philippines. He stated Hong Kong and Singapore are considered developed countries in Asia.

Commissioner Hogan-Rowles inquired as to the reason emerging Europe, the Middle East and Africa are grouped together, noting they are all very different economies. Mr. Umbarger stated the grouping is based upon the Morgan Stanley Capital International (MSCI) indices. He added the regions were selected in order to create a comparable to Asia and Latin America in size and breadth of companies.

Commissioner Hogan-Rowles inquired about the reason for the healthcare sector's lagging considering it is a service needed by everyone. Mr. Umbarger stated that in emerging markets, the healthcare sector represents only a small portion of the opportunity set because most of the pharmaceutical corporations tend to be domiciled in developed markets. He added that in the past few years, the healthcare sector has lagged in the developed market countries as well. Mr. Umbarger noted there has been minimal growth among pharmaceutical companies and renewed competition caused by drugs coming off of patent.

Mr. Moore requested the representatives discuss the large cap pricing issue. Mr. Plowright responded large cap names have been a great source of liquidity within emerging markets for many newer investors who have come in during the past 12-24 months. He stated there has been deeper penetration within the small and mid-cap stocks by investors who historically have not had much exposure to emerging markets. Mr. Plowright indicated large caps have taken the brunt of the sell-off as such a lot of liquidity has come out of the emerging markets. He added this is creating opportunities T. Rowe Price is interested in. Mr. Plowright stated valuations are much closer to being on par with developed industrialized markets around the world.

In response to a question from Commissioner Hogan-Rowles, Mr. Plowright responded good opportunities still exist in emerging markets. He stated the economic growth levels and corporate earnings growth levels are lofty but there is a strong justification for the premiums placed on emerging market companies. Mr. Plowright added the companies are growing very quickly and benefiting from a number of demographic trends. He stated T. Rowe Price believes this is beneficial from a long-term investment view. Mr. Plowright stated, on a near-term view, emerging markets are likely to experience volatility during 2007.

Commissioner Hogan-Rowles inquired as to why Mr. Umbarger stated there may be a decreased demand on energy. Mr. Umbarger replied that in a slowing global economic environment, the aggregate demand for energies and commodities is likely to decline.

Commissioner Hogan-Rowles also inquired where the frontier emerging markets are. Mr. Umbarger stated Oman, Kazakhstan and Vietnam.

Ms. Coffin requested clarification on the overweighting in Latin America. Mr. Umbarger noted T. Rowe Price is not attempting to adjust the positions within the portfolio to be inline with the benchmark. He stated in the case of Latin America, many of the opportunities in Mexico and Brazil have been very promising so T. Rowe Price is comfortable with the overweighting there.

Mr. Vazquez inquired as to T. Rowe Price's maximum holding in one company. Mr. Umbarger responded that the portfolio has never held more than an 8% position in an individual company and they tend to remain at less than 5%.

Mr. Moore stated T. Rowe Price was sent a letter from the Board regarding Darfur, Sudan. He stated the Board members had not yet reviewed T. Rowe Price's response and requested the representatives discuss their response. Mr. Moore also requested information on any changes made to the portfolio regarding companies with business

operations in Sudan be addressed. He also noticed T. Rowe Price has increased holdings in Alliance Industries, a company conducting business in Sudan. Mr. Plowright responded T. Rowe Price has holdings in 3 securities: PetroChina, Sinopec and Alliance. These companies were identified by Staff as having business operations in Sudan. He stated this is an issue T. Rowe Price has been struggling with because they want to do the right thing, however, they also have an obligation to their shareholders. Mr. Plowright stated the Plan's account with T. Rowe Price is a commingled fund and there are other shareholders who do not believe divesting would be effective in implementing change. As an example of the divergence of opinion, Mr. Plowright noted PetroChina's parent company owns the rights to an oil field in Sudan and directly pays royalties to the Sudanese government. He stated some hope that by divesting from PetroChina, the parent company would in turn pull-out from Sudan. Mr. Plowright stated other investors believe if the parent company divested from Sudan, the oil field would revert back to the Sudanese government, and as a result, the government would receive the entire profit instead of only the royalties. He stated the call to divest is increasing by a large margin but more investors are in disagreement with divestment. Mr. Plowright commented several T. Rowe Price clients who support divesting are in separate accounts where it is incredibly easy to accommodate social restrictions. He stated a number of organizations go beyond the Sudan issue and place portfolio restrictions against investing in weapons of mass destruction, child labor and other valid social criteria. Mr. Plowright stated that in commingled accounts, anything in the index can be allowed in the portfolio. Mr. Plowright stated, he believes, T. Rowe Price will continue to be confronted with this issue. In the future, once the majority of clients are in support, T. Rowe Price may change their views. Mr. Plowright acknowledged at the moment T. Rowe Price is caught between obligations to differing shareholders, but stated his company shares the Board's concern. He added in the portfolios where T. Rowe Price is able to change the guidelines, they have done so.

Commissioner Hogan-Rowles stated Mr. Plowright's politically correct response was nice and inquired if genocide is not enough. She stated she understood where Mr. Plowright is coming from, however, this issue is not about whether people are dying because people are dying. Commissioner Hogan-Rowles stated the question is how much money do we want to make off of it and where do the royalties and money go. She stated while some in the investment community believe divestment is not effective, historically, divestment has been effective in other countries. Commissioner Hogan-Rowles commented she believes it comes down to the profit opportunities. Mr. Plowright responded on a personal level he agrees with Commissioner Hogan-Rowles and he believes this is a very difficult situation. He stated the Board will find him to be a very strong advocate within the T. Rowe Price company to make the changes. Mr. Plowright stated it is a matter of having several shareholders in favor of divesting, not just one. He noted he has had preliminary discussions with Staff regarding converting the Plan's commingled account into a separate account in order to facilitate the changes the Board would like to make. Mr. Plowright added if the Board decided to go with the separate account he would work to make the transition as smooth as possible. He expressed that he absolutely applauds the Board's efforts.

Commissioner Hogan-Rowles stated she heard Mayor Villaraigosa saying \$27 million had been divested from Sudan and inquired if any of this amount included the Plan's funds. Ms. Bhatia responded none of the three City of Los Angeles pension plans have

divested any funds. She stated she attended the press conference where Mayor Villaraigosa made the comments referring to \$27 million. Ms. Bhatia stated the press conference was regarding the adoption of a resolution put together by the City pension plans to indemnify Board members and Staff in the event of proceeding with divestment. She stated she believed the \$27 million Mayor Villaraigosa referenced was the sum of exposure the City pension plans have in Sudan.

Mr. Vazquez inquired as to the financial implications from switching the commingled T. Rowe Price account to a separate account. Ms. Bhatia stated the response letter Staff received from T. Rowe Price included the additional fees associated with the separate account. She stated Staff plans to present the letter and an estimate of the transition cost at the March 21, 2007 Governance Committee meeting. Mr. Plowright stated the commingled fund currently has approximately \$2.7 billion with approximately \$77 million belonging to the Plan.

Mr. Moore inquired as to the transition cost. Mr. Plowright stated it would be an in-kind transfer and he did not believe the fees would be too significant of an issue. He added the fees for the separate account would be less than in the commingled account; however, the separate account is charged administrative and custodian fees which are not incurred with a commingled account. Mr. Plowright stated he believes the drop in the separate account fees should approximately equal the additional cost in custodian fees. He proposed the transition into a separate account could be analysed in greater detail to devise a plan but did not anticipate it would be too onerous of a burden. Ms. Bhatia stated Staff would provide the Board with all of the fees associated with switching to a separate account.

Mr. Umbarger stated this is a position of on going discussion at T. Rowe Price in terms of holdings that have been identified by the taskforce. Commissioner Hogan-Rowles inquired if the taskforce Mr. Umbarger referred to is an internal T. Rowe Price taskforce. Mr. Plowright stated T. Rowe Price has been studying the results from several state plans. He informed the Board, that the State of Massachusetts is currently working on a divestment plan and noted the Illinois plan was recently found to be unconstitutional. Mr. Plowright stated within the investment community, there is uncertainty about where the divestment issue will land. He commented the State of California has created a more focused, manageable, and practical approach to the divestment issue. Mr. Plowright indicated the Illinois divestment plan was too broad in scope and overstepped parts of the constitution.

President Romero stated if T. Rowe Price could find alternative opportunities to generate the same returns outside of Sudan, then divesting should not be a problem with the other investors in the commingled fund. He stated this is a business decision T. Rowe Price has to make. President Romero expressed his concern at the Plan pursuing a separate account with T. Rowe Price, because the original Request for Proposal (RFP) specified the account would be commingled. He inquired, if the contract were converted to a separate account, should the Board also consider other managers and then make the decision as to which manager would be best for the Plan. He stated it may need to be discussed at the next meeting but he was unsure if giving the same money to the same manager in a separate account is necessarily the best option. He cautioned the Board should be conscious of that in evaluating the entire process.

The representatives of T. Rowe Price left the Board meeting

### **b. The Boston Company**

Ms. Carolyn Kedersha, Portfolio Manager; Mr. Lawrence Ivey, Vice-President and Mr. Robert Harkins, Vice-President for The Boston Company approached the Board table. President Romero recognized the representatives of The Boston Company.

The representatives provided a performance review of the emerging market portfolio managed by The Boston Company.

Commissioner Hogan-Rowles inquired if companies are being looked at for their asset base and not necessarily industry related. Ms. Kedersha responded companies are looked at on a valuation basis.

Commissioner Hogan-Rowles, referring to page 16 of the Boston Company presentation material, inquired as to the reason Norlisk Nickel Mining & Metallurgical Co. & Reliance Industries Ltd. were shown in bold. Ms. Kedersha explained the companies shown in bold were in the portfolio as of December 31, 2006.

Commissioner Hogan-Rowles inquired as to the performance of Weigiao Textile. Ms. Kedersha stated she believes there is potential in Weigiao Textile. Ms. Coffin inquired when better performance could be expected from Weigiao Textile because its performance has been kind of flat. Ms. Kedersha stated one stock was up 70% in 2006, however, three years ago the performance looked the same as Weigiao Textile's current performance. Ms. Kedersha explained the strategy is to not keep buying the expensive companies but rather to buy undiscovered gems. She added Weigiao Textile is a good company with a strong balance sheet and a very strong business model. Mr. Harkins added when looking at a company's valuation, The Boston Company is looking at the discount it is trading at relative to the company's own history, to its industry peers or to the broad market. Ms. Kedersha stated to begin with, the right stock has to be picked and secondly an investor must have the courage of conviction to add to the stock during down times.

Mr. Vazquez inquired as to the performance of Weigiao Textile and China Mobile during the past week. Ms. Kedersha stated Weigiao Textile performed reasonably well because it is not an over valued stock, however, China Mobile took a hit.

Ms. Bhatia commented as of January 31, 2007 the Plan's investment with The Boston Company has been underperforming by over 200 basis points. Mr. Harkins responded the underperformance has fully reversed itself and as of Monday they are outperforming. Ms. Bhatia stated she had not yet reviewed the information Mr. Harkins was referring to. Mr. Harkins agreed, stating Staff has not yet received that data, however, it speaks to the near term volatility the emerging markets are experiencing.

Mr. Moore requested the representatives address their response to the letter The Boston Company received from Staff regarding holdings with companies engaged in business operations in Darfur, Sudan. Mr. Ivey stated the issue in Sudan is important to

The Boston Company. He commented The Boston Company believes change is needed and has went out and hired a consultant to help them develop ideas, approaches and to determine what is going on in the marketplace. Mr. Ivey stated there are several different lists identifying companies as having business operations in Sudan, however each list uses its own criteria in determining what level of involvement constitutes inclusion on its respective list. He added it is difficult to ascertain which companies should be deemed negative contributors to Sudan. Mr. Ivey stated the Plan has two portfolios with The Boston Company. He stated the International Equity Developed Markets portfolio has no exposure to any company identified on the list Staff sent. Mr. Ivey noted in the Emerging Markets portfolio there is approximately \$1.2 million of exposure spread among two or three companies. He stated one option may be to switch to a separate account and replicate the same holdings as are in the current account less the three companies identified on the list. Mr. Ivey added this would offer a savings by allowing for in-kind transfers of some of the holdings. Mr. Harkins commented The Boston Company is willing to do whatever the Board's decides.

President Romero requested the representatives work with Staff on potential options. Ms. Bhatia stated Staff is planning to present the information at the next Governance Committee meeting so the Board can make an informed decision.

Mr. Harkins inquired as to the date of the next Governance Committee meeting. Ms. Bhatia stated depending on the response to quorum the next meeting would either be scheduled for March 21, 2007 or April 4, 2007.

The representatives of The Boston Company left the Board meeting.

President Romero called for a recess at 11:03am. The meeting reconvened at 11:15am.

#### **4. PCA's Quarterly Performance Review as of December 31, 2006**

Ms. Sarah Bernstein and Mr. Neil Rue of Pension Consulting Alliance (PCA) approached the Board table. President Romero recognized the representatives of PCA.

Mr. Rue provided the Board with a quarterly performance review of the portfolio as of December 31, 2006.

Mr. Vazquez inquired if the 1year net-of-fees total portfolio performance would be approximately 60 basis points. Mr. Rue stated he believed net-of-fees performance would be approximately 25 basis points. He explained all of the median numbers are reported gross-of-fees and it is important to compare the performance using the same criteria.

Mr. Vazquez inquired as to the distinction between the public and private real estate market. Mr. Rue explained private real estate is measured by the NCRIF benchmark, which is a collection of several hundred privately held properties throughout the country. He stated public real estate are securities of Real Estate Investment Trust (REITS) which trade on the various exchanges. Mr. Rue noted one of the major differences between private real estate and REITS is that a REIT is a corporation which tends to

have debt while private real estate is unlevered.

President Romero inquired to what extent did the Plan not being fully funded in the asset classes affect the performance. Mr. Rue responded it has had an affect, however, last year that was not the case. He noted during 2006 it did not affect the performance because the Plan is tilted toward domestic equity and non-U.S. equity, which performed very well as compared to the other asset classes the Plan, is currently not invested. Mr. Rue commented prior to 2006, real estate and private equity had performed very well.

In response to a comment made by Mr. Vazquez, Mr. Rue stated the chart on page 15 does not show how much domestic and international equity was overweighted.

#### **5. Discussion of PCA's recommendation of policy benchmark to include Alternative Asset Classes and possible action**

Ms. Bernstein stated the policy benchmarks for both the Death Benefit and Disability Benefit is 100% fixed income. She stated in working with Staff, it has been determined the actual cash on hand on a quarterly basis is higher than that. Ms. Bernstein indicated PCA is recommending the Death Benefit policy allocation be revised to 96% fixed income and 4% cash and the Disability Benefit policy allocation be revised to 95% fixed income and 5% cash. She noted the recommendation is to adopt the same benchmark for the cash allocation in the Death and Disability Plans as the Retirement Plan, which is Citigroup T-Bills.

Commissioner Hogan-Rowles inquired as to Mr. Vazquez' opinion on the PCA recommendation. Mr. Vazquez stated he is in agreement with the PCA recommendation. He noted the recommended amount of cash is needed to handle the payouts and that having the allocation as if it were fully invested is not a fair benchmark to the cash flow needs of those programs. Ms. Bhatia stated the historical trend of what is needed for disbursements was studied and provided to PCA. She stated the cash is invested in the short-term investment fund and the benchmark is the Citigroup T-Bills.

Ms. Bernstein stated over the past year the Board has adopted a policy to start investing in Alternative asset classes. She stated the current total policy benchmark does not reflect the alternative asset classes. Ms. Bernstein stated PCA recommends the benchmarks for Alternative Investments be included in the overall asset classes and total policy benchmark. She noted PCA recommends the private equity and real estate benchmarks be included in the overall policy benchmark as of January 1, 2007 and the hedge funds be included as of March 1, 2007. She stated the recommended benchmarks are as follows: The NCRIEF benchmark for Real Estate; The PEPI benchmark for Private Equity; and the Russell 3000 + 3% for Hedge Funds.

Ms. Bernstein inquired if the Board was comfortable with the timing of including in the overall retirement policy benchmark the alternatives classes that are now being funded. Mr. Vazquez inquired of the 9% allocated to those classes what percentage has been funded. Ms. Bernstein responded the 1% hedge funds allocation is fully funded. Ms. Bhatia stated the private equity managers have been selected, however, they are funded via cash calls and are not currently funded at the full allocation. Ms. Bhatia

stated \$10 million has been invested in Prudential PRISA fund. Ms. Bernstein stated she believes private equity is below 1% in actual investment and noted it will take a couple of years before it is fully committed. Mr. Rue clarified the Plan is approximately between ½% and 1% funded in private equity and Real Estate and hedge funds are fully funded.

Mr. Vazquez stated he believes he would prefer to see a phase in of the new benchmarks to reflect the actual investment rather than applying all at January 1, 2007. Ms. Bernstein acknowledged Mr. Vazquez's preference was reasonable and she suggested PCA come back to the Board with a timetable, if the Board is comfortable with the proposed benchmarks. Mr. Rue noted PCA has done that with other clients when there is evolving policy allocations. He stated PCA would like the Board to still adopt these benchmarks and the proportional allocations will be brought back at a later date.

President Romero inquired if the Russell 3000 + 3% was the goal for the private equity allocation. Ms. Bernstein responded in the affirmative. President Romero commented he has had a discussion with Staff regarding this item and he questioned if it is easier to compare private equity by the Russell 3000. He stated he is also concerned because the PEPI benchmark is available only via subscription and the Plan's custodian, Mellon Bank (Mellon), also needs to keep track of the performance as well. President Romero stated Mellon does not have a subscription to the PEPI benchmark. Ms. Bhatia noted Mellon does not subscribe to the PEPI, but PCA does have access to it.

Ms. Bhatia noted PCA stated every six months a portfolio review would take place and she inquired if this was sufficient stating, actually reporting the comparison has been done more closely. She stated she believes it is a good idea to have the comparison conducted, however, the Board members need to be aware of how the private equity funds are performing in comparison to how they would have performed if they were not invested in private equity. Ms. Bhatia stated for that reason she believes the Russell 3000 + 3%, which was initially adopted, is the appropriate benchmark to be included in the policy benchmark. She noted the PEPI Index could be provided for comparison purposes but the target should be what was initially adopted in the guidelines.

Mr. Rue stated on page 15 of the PCA Quarterly Performance Review, private equity is reported for one quarter. He indicated the equity results are (-1.3) and the Russell 3000 + 3% is 5.4. Mr. Rue stated there are 600 basis points of underperformance in the asset class that is not really related to the asset class at all on a short-term basis. Mr. Rue mentioned the Russell 3000 + 3% is a good long-term basis benchmark, however, he is uncomfortable having a public benchmark as the bogey for private equity. He stated it will always be a huge factor and does not give any information particularly related to the remainder of the portfolio. Mr. Rue added PCA is attempting to line up the benchmark with what is going on in the portfolio. He stated that in the longer term, the goal is the Russell 3000 + 3%, but the PEPI will be more stable. In response to a comment by Mr. Moore, Mr. Rue noted the Russell 3000 + 3% would tell you nothing about your managers.

President Romero requested PCA to address the issue of the Plan's custodian, Mellon Bank, not subscribing to the PEPI benchmark. Ms. Bernstein stated custodians have

typically concentrated on the public security markets. She explained during the last 5 to 10 years they are slowly increasing their review and analytics on private equity markets. Ms. Bernstein commented PCA provides a private equity portfolio review every six months because custodian banks typically do not subscribe to venture economics and have additional analysis available.

Mr. Michael Ferguson, Vice-President and Relationship Manager of Mellon, approached the podium. President Romero recognized Mr. Ferguson.

Mr. Ferguson stated at the Plan's request, Mellon can look at the private equities and see what they can do to assist the Plan. He added Mellon would rely on PCA to bring certain things that Mellon does not currently have access to, to the Plan's attention. Mr. Ferguson stated it is not a request Mellon receives all the time.

Mr. Vazquez inquired as to the subscription cost to the PEPI. Mr. Rue stated he was unsure but believes it is approximately \$20,000-\$25,000 annually.

Ms. Bhatia inquired how widely adopted is the PEPI benchmark if Mellon does not subscribe to it. Ms. Bernstein stated she does not know the exact answer. She added as private equity has grown as a part of public and institutional funds, it is becoming more and more studied. Ms. Bernstein noted most custodians do not use venture economics, which is the most widely used peer group comparison for all venture economics. She stated it has not been necessary to the custodians business. Ms. Bernstein added every private equity fund they looked at compares itself to venture. She stated she does not have a statistic on Thompson's Financial but PCA has looked at it and determined it to be the most accessible and useful private equity benchmark that does not do internal rate of returns (IRRs) but does time rated returns. Ms. Bernstein stated she believes in 5 to 10 years there will be more and more pressure to have these kind of returns show up that provide more direct comparison of private equities.

Mr. Vazquez inquired if Ms. Bernstein stated that for the long term we would go back to the Russell 3000 + 3%. Ms. Bernstein responded the recommendation is on the quarterly reviews rolled up into the policy benchmark for the 4% private equity the PEPI benchmark and the Russell 3000 + 3% for hedge fund-of-funds and the NCRIF for the real estate allocation. She stated in the PCA regular portfolio reviews the Russell 3000 + 3% and the vintage year peer group analysis from Venture Economics would also be looked at. Mr. Rue stated in terms of monitoring the private equity portfolio, the Board would pay more attention to the semi-annual reports because the metrics are different. He stated the quarterly and one-year numbers are like place holders and do not reflect the IRR the managers are producing. Mr. Rue stated the semi-annual private equity report would include the information the Board needs to really assess the progress of the private equity portfolio.

Mr. Canzano inquired of Mellon the benchmark they use to measure private equities. Mr. Ferguson stated it depends on what the Plan is looking for and the consultant's recommendation. He commented Mellon would show the Plan what benchmarks they have and let the Board or Staff make the decision from what was available. Mr. Ferguson stated Mellon would rely on PCA for benchmarks because PCA works with

the Plan on that.

Mr. Canzano inquired if PCA was aware of any benchmarks Mellon has which may be reasonably comparable to the PEPI. Mr. Rue stated other plan custodians use the Russell 3000 + 3%, Cambridge, Venture Economics and none of them are great. He stated he believes Mellon is relying on other vendors to report the other benchmarks such as Cambridge and Venture Economics. The custodian then feeds the number through their reporting system so it appears in their report. Mr. Ferguson concurred with Mr. Rue. Mr. Rue stated the standard practice is that the custodian does not create their own benchmark. He added there is a spectrum of benchmarks PCA subscribes to and the Russell 3000 + 3% is not the only benchmark utilized. Mr. Rue stated PCA is attempting to align the benchmark so it does not confuse the rest of the portfolio in the quarterly reports.

Mr. Canzano inquired if the Plan agreed to the PEPI benchmark, would it be normal and appropriate for PCA to provide the information to Mellon and then have Mellon use those figures in reports. Mr. Rue stated to the extent that the action adhered to copyright rules, PCA would probably show where the source came from. He stated there would be some sort of a verification process.

Mr. Vazquez inquired if PCA could simply provide the PEPI data to Mellon bank. Mr. Rue responded in the affirmative. Ms. Bhatia noted the information is provided every six months and suggested since the Plan is not completely invested in private equity that the decision of which benchmark to select is brought back to the Board. She also suggested the Russell 3000 + 3% be used in the interim. Ms. Bhatia described one of the main concerns is the PEPI is not readily available and the Plan is not completely invested in private equity so the funds would need to be weighted. Mr. Rue stated Mr. Vazquez suggested changing the policy to reflect the Plan's weightings regardless of what the benchmarks are. He stated the policy weightings would be much smaller than what is currently reflected. Ms. Bhatia suggested policy weightings and the Russell 3000 + 3% be used.

Mr. Ferguson returned to the audience.

Mr. Rue stated the PEPI and the Russell 3000 + 3% could both be shown in the portfolio reviews. He stated from an attribution perspective he would like the freedom to use the PEPI benchmark because if he has to provide information on a short-term basis and other benchmarks may confuse the matter. Ms. Bhatia informed the Board that Staff does not have access to the PEPI and will not be able to monitor this. In addition, Staff would be relying on reports provided through Mellon.

Ms. Bhatia stated if the Board Members are comfortable adopting the Death and Disability Benefit Plan asset allocation targets, a resolution incorporating the changes to the investment guidelines along with the other changes can be brought back. Mr. Moore clarified if the Board was adopting all of the recommendations with the amendment regarding Plan weightings. Mr. Rue stated PCA would present the Board with a proposal regarding the Plan weightings.

Mr. Moore moved adoption of the Death and Disability Benefit Plan asset allocation target as recommended by PCA. Seconded by Mr. Canzano and carried unanimously after the following vote:

Ayes: Romero, Coffin, Moore, Hogan-Rowles, Vazquez and Canzano  
Nays: None

**07-52          6. Discussion of PCA's recommendation to put Wells Capital Management on watch status due to senior personnel changes and possible action**

President Romero introduced item 6 and inquired if there was any discussion. There was no discussion.

Mr. Vazquez moved to adopt Resolution 07-52. Seconded by Commissioner Hogan-Rowles and carried unanimously after the following vote:

Ayes: Romero, Coffin, Moore, Hogan-Rowles, Vazquez and Canzano  
Nays: None

**7. Discussion of additional incremental costs relative to the transition of Other Post Retirement Benefit assets transferred in-kind to Investment Manager, Wells Capital, and possible action**

President Romero introduced item 7 and inquired if there was any discussion.

Mr. Vazquez noted PCA stated the transition went smoothly and Wells Capital Management (Wells) performed well in managing the costs and there were no significant operational issues. Mr. Rue agreed with Mr. Vazquez's comments.

President Romero stated he was confused because historically in-kind transfers are done without a transition cost. He noted in this case the assets were given to the new manager and the manager re-sold them. President Romero stated the manager would normally sell during the initial transition so he is confused and requested Wells address the issue. Mr. Rue stated he believes President Romero was correct in his sequencing of events. He stated he believes there was some miscommunication in terms of how the transition was going to unfold. Mr. Rue stated he did not want to speak for Wells, but stated Wells would comment the intention was to trade the securities once they received them. Ms. Bhatia agreed with Mr. Rue, and stated Staff was told Wells intended to sell the securities once they were received.

President Romero inquired as to why it was not executed during the transition. Mr. Rue commented the way it was done implies that Wells is the better fixed-income trader than State Street Capital (State Street). He stated an argument could be made that Wells, being a fixed-income manager who is trading all day long in a fixed income market, is the better fixed income trader. Mr. Rue noted State Street farms out some of the fixed income transitions and in his view it is acceptable that Wells traded the fixed income

securities.

President Romero inquired as to why all of the securities were not traded. Mr. Rue responded the reason why all of the securities were not traded is because Wells is not an equity trader.

Ms. Sandra Willen, Managing Director of Wells Capital Management, approached the podium. President Romero recognized Ms. Willen.

Ms. Willen stated it was Wells' understanding from the beginning that the 40% of the Other Post Employment Benefit (OPEB) assets were being allocated to a core strategy until the complete asset allocation study was completed. She stated Wells believed the idea was for Wells to restructure so that the portfolio was still structured within the Plan's guidelines and the Lehman Aggregate benchmark. Ms. Willen stated it was Wells' understanding that the assets that were transferred in-kind would not stay intact as short duration agency bonds. She stated Wells worked with Staff and alluded to the fact that these assets were very negotiable securities. Ms. Willen stated Wells has a great deal of experience with those types of securities and the goal was to minimize the Plan's market risk of the Lehman Aggregate. She explained, on January 5, 2007 when Wells had the securities and could trade, they immediately made sure the duration of the portfolio was consistent with the Lehman Aggregate. Ms. Willen stated the assets were sold very quickly and reinvested in the securities that are in the Plan's portfolio. She added Wells buys securities in the portfolio to add to the positions the Plan already has, so the ability to have control of the assets and moving them meant that the actions were being done with the Plan's best interest in mind. Ms. Willen stated the transaction costs were part of the cost included. She offered to address any further questions.

Ms. Willen returned to the audience. Ms. Bernstein left the Board meeting.

**07-53            8. Discussion and review of watch status of investment manager and possible action**

Mr. Vazquez inquired if PCA was recommending BlackRock, Inc. (formerly Merrill Lynch Investment Managers, LLC) be taken off of watch status. Mr. Rue responded in the affirmative.

Mr. Vazquez moved approval of Resolution 07-53. Seconded by Mr. Moore and carried unanimously after the following vote:

Ayes: Romero, Coffin, Moore, Hogan-Rowles, Vazquez and Canzano  
Nays: None

**9. Discussion of proposal for asset liability study by PCA and possible action**

President Romero called for a recess at 12:15 pm. Mr. Vazquez did not return after the recess. The meeting reconvened at 12:29 pm.

Mr. Bob McCrory, Executive Vice-President of EFI Actuaries, Inc (EFI) approached the

Board table. President Romero recognized Mr. McCrory.

Mr. Rue and Mr. McCrory provided the Board with a presentation regarding the proposed asset liability project.

Mr. Moore noted the proposed asset liability study appeared to put a lot of emphasis on items of interest to the Board such as how much risk, volatility and funding levels, etc. He inquired where in the process is the other part going to come in and is it going to be as rigorous a process as his expectations are that it should be. Mr. Rue responded in the affirmative. He explained the process would be rigorous and depending on Board preference, could either be done in a series of three presentations or one special meeting where all of the information was presented.

Mr. Moore inquired if the asset liability study is driven by the Board's stated comfort zone or is it driven by a more statistical assessment of how the market and asset classes have behaved over time. Mr. Rue stated PCA creates the asset class assumptions every year. He explained PCA has recently went through the process and the asset class assumptions are back at the office. Mr. Rue stated those assumptions would be integrated into the model. He explained it is a little different because the traditional asset class assumptions are based upon a "perfect world" assumption. Mr. Rue stated those assumptions are then taken and put into the EFI system which randomly simulates adjusted history thousands of times, to come up with the right asset class mix. He indicated the EFI system relies less on mean variance assumptions than in the past. Mr. McCrory stated normally distributed returns are not utilized because returns are not normally distributed. Mr. Rue stated correlations are not stable and added there are a variety of things on the asset side that the EFI modeling system helps address. Mr. McCrory noted the liability side is simulated in a similar manner. He noted as the Consumer Price Index (CPI) is simulated, the payrolls and Other Post Employment Benefits (OPEB) cost increases would be simulated as well. Mr. McCrory stated everything possible would be built into the model.

President Romero inquired as to why a commingled asset liability study would be assumed because the Pension Plan may absorb the risk of the OPEB and the funds are supposed to be separated. Mr. Rue stated it does not have to be assumed but it could be an outcome. Mr. McCrory stated EFI would do the asset liability study independently for both the Plan funds and the OPEB funds, as well as a combined one. Mr. Rue noted the Los Angeles City Employees' Retirement System (LACERS), Fire and Police Pensions and the City of Cincinnati have health benefits bundled as part of their retirement plans. He noted the Board has a unique opportunity to study the information and decide if the benefits should be combined.

President Romero stated during the last asset liability study he was led to believe it was a state-of-the art project. He inquired if, considering the cost of \$140,000, the proposed asset liability study provides that much more information than the one conducted in 2002. He also stated the Plan's existing contract with PCA, includes a requirement for an asset liability study for the Plan at no additional cost. President Romero noted if the Board were to go along with the proposed asset liability study an extra fee would be incurred without any credit for the asset liability study already paid for in the contract. Mr. Rue responded if the Board preferred, PCA would recreate the asset liability study

done in 2002 at no additional charge.

President Romero stated it needed to be discussed if there is a significant difference in the asset liability study conducted in 2002 as opposed to what is currently being proposed. He also requested to know the impact of the OPEB funds inclusion if the proposed asset liability study was conducted and if the 2002 model of asset liability study was performed. Mr. Rue responded if the Board decided to proceed with the 2002 model of the asset liability study, the fee is already included in the contract. He stated he could not determine if the asset allocation would be significantly different if the Plan goes in either direction. Mr. Rue stated he was trying to convey that there are features in the EFI model that do not exist in the other model in terms of setting your own risk tolerance. He explained the proposed model has a very intuitive approach to coming up and having the Board articulate the Plan's risk tolerance in a way that clearly lays out what the policy portfolio is going to be. Mr. Rue stated in standard industry practice the linkage is not as robust as the EFI model. He added the cost for the EFI model and the historical asset liability model for the OPEB funds would still be a six-figure number.

Commissioner Hogan-Rowles inquired if the Plan could receive the EFI model asset liability study at a reduced rate by including a credit for the historical model which was paid for in the PCA contract. Mr. Rue commented the Plan's actuary at the time, The Segal Company, charged the Plan to do the liability work in 2002 and there were incremental costs that were approximately \$10,000 to \$15,000. Mr. Rue noted with two plans, The Segal Company may charge an additional \$30,000 to \$50,000 in incremental costs associated with the standard asset liability study. He stated when considering what The Segal Company may charge in incremental cost for the standard asset liability study, the additional cost for the EFI model becomes somewhat not as significant.

Commissioner Hogan-Rowles requested PCA provide the Board with a matrix indicating the differences in cost and features between the standard asset allocation study and the proposed EFI model. Ms. Bhatia noted she has spoken with the City Attorney and the proposed asset allocation study appears to be a separate agreement. She stated she was unsure if this was a project-only proposal. Commissioner Hogan-Rowles inquired if this process would require a Request for Proposal (RFP). Attorney Wilkinson stated he did not believe this contract would require an RFP; however, the Board could have Staff conduct a lower level search of other companies.

President Romero stated he was concerned because PCA listed only eight pension plans that have used the system. He inquired if that meant there are many more pension plans that have used the traditional process and also received good results. He noted he was just trying to understand if the EFI model was worth the additional expense. Mr. Moore stated there is not a more important decision the Board can make than the asset allocation. He commented if the EFI model is a much more sophisticated approach given the impact the asset allocation study has on the Plan, he believes the Board should select the best model available.

Mr. Canzano requested a price breakdown between the cost for the Plan and the OPEB benefits for the proposed asset allocation study, because it was agreed the Plan would not incur any cost associated with the OPEB benefits. Ms. Bhatia stated the Department of Water and Power would have to be billed. Mr. Canzano stated when the issue is

revisited he would like to know the amount that the Department would reimburse the Plan.

Mr. Moore inquired if there was a listing of the types of decision factors the Board could work with. Mr. McCrory stated a standard list has been built into the program, however, he could add anything the Board wanted.

Commissioner Hogan-Rowles inquired as to why the The Segal Company (the Plan's actuary) is not being asked to conduct the study. Mr. McCrory stated most actuaries can do some form of cost projection and it varies a lot in their ability to perform simulation work. He stated no other actuary can do the decision factor process because EFI has a patent on it. Ms. Bhatia added during the last study, it was The Segal Company who provided the liability projections to come up with an asset liability study. She stated it was not specific to the EFI model, but noted the actuary does play a role in providing the input for the study. Mr. McCrory stated EFI would receive the member data from The Segal Company. He stated EFI would create their own duplicate valuation system; check the The Segal Company's liabilities and costs against what EFI came up with; reconcile any differences and then proceed with the simulations and projections. Mr. McCrory stated this process could be considered a mini-audit. He stated only once has EFI found a significant difference between the numbers the original actuary and EFI produced.

Commissioner Hogan-Rowles inquired as to how accurate the model is based on past experience. Mr. Rue stated Mr. McCrory is very precise with respect to the liability aspects, however, the asset side is fraught with error. He stated there is a track record of PCA's forecast of an asset class and the actual performance. Mr. McCrory stated he performed a forecast of a city's property tax levy in 1988 going out until 2004. He indicated his forecast was within .02 of the actual levy. Mr. McCrory stated there would be uncertainty but the asset liability study is important for the Board and the Department in terms of decisions that will be made.

President Romero inquired if EFI looks at an unlimited number of "what if" scenarios or would there be additional cost after a certain number of simulations have been conducted. Mr. McCrory stated EFI would need to know upfront if the Board wanted something special looked at because it is much easier to include the request initially than after the model is built. He stated the simulations include all different kinds of economic scenarios.

Mr. Romero inquired if there were any questions or comments. Ms. Bhatia stated Staff would bring this item back along with the requested information.

Mr. Rue returned to the audience. Mr. McCrory left the meeting.

**10. Retirement Plan Manager's Comments**  
**a) DWP Plan Newsletter for Retirees (March 1, 2007)**  
**b) General Items**

Ms. Bhatia stated the contract negotiations with James Evans & Associates (JEA) regarding the computer implementation were very positive. She indicated significant

progress had been made but noted there were a couple of contract issues such as agreeing on the language of the escrow terms. Ms. Bhatia stated Staff is working with the City Attorney and JEA's attorney to resolve this matter. Ms. Bhatia commented JEA indicated in their Request for Information (RFI) response that they would seek reimbursement for certain out-of-pocket expenses. She stated JEA is expected to provide documentation and the details for the out-of-pocket expenses that are approximately \$25,000. Ms. Bhatia noted Staff believes it is reasonable to add this amount to the contract fee and stated it would be brought before the Board at a later date for approval.

Ms. Bhatia stated there was an issue with non-compliance of the Plan's guidelines from ING. She stated the non-compliance was due to the holdings of 144-A securities. Ms. Bhatia stated there will be a report for the Board at an upcoming Board meeting.

Ms. Bhatia stated the actuarial experience study which was brought before the Board at the February 21, 2007 Regular Board meeting was not adopted and several questions were brought up. She stated one of the main questions was, if there were changes to the current retirement allowance would it be considered a meet and confer issue even though there were no changes in benefits. Ms. Bhatia stated Staff has worked with the City Attorney's office and preliminary information indicates it is not a meet and confer issue. She stated she has had on going conversations with President Romero in connection with other information that could be provided to the Board to help make the decision.

Ms. Bhatia stated Staff and PCA had previously brought before the Board the approach to keeping the OPEB assets and Retirement Plan assets separate by means of the unitization method by Mellon Bank. She indicated Staff has had a couple of months to try out the unitization method and it is not working. Ms. Bhatia stated it has been difficult to properly keep the tracking. She stated Staff will be going with the segregated custody accounting. President Romero inquired whether it was difficult to distinguish the OPEB funds from the Plan's funds under the unitization method. Ms. Bhatia responded in the affirmative, explaining any withdrawal for retirement purposes are spread over the OPEB side based on market values held. She stated after a while each of the accounts gets inequitably credited and deducted from. Ms. Bhatia noted Staff has discussed the issue with Mellon Bank and with the two managers involved, BlackRock and Wells. She explained Mellon, BlackRock and Wells were all agreeable to providing Staff with separate information for the OPEB and Plan funds.

President Romero inquired if Ms. Bhatia expects a problem, once the new asset allocation policy is determined and asked how is the new process going to reflect if it is spread around 18 managers. Ms. Bhatia responded the managers would need to be on board as far as the separate tracking so that Mellon can reflect it. She added there are a lot of accounts, however, since the separate accounting is a requirement, the segregated accounting is probably the only option.

President Romero inquired if Staff would receive monthly reports. Ms. Bhatia responded in the affirmative. She added there would be a lot more work.

Ms. Bhatia stated Staff has received response letters from the investment managers

regarding their holdings in Sudan. She indicated Staff would be bringing these letters before the Board.

Mr. Moore requested to know the status of the issue with JEA regarding the company turning over the code to Staff in the event they decided to no longer service the American market. Ms. Carranceja stated JEA has agreed to a provision that reads "Water and Power has the right to receive the escrow materials in the case that the contractor (JEA) ceases to offer products and services within the territories of the United States". She explained the Department has escrow language and the provision regarding obtaining the code was added to the language. Mr. Moore inquired if the escrow would include the programming and the documentation. Attorney Wilkinson added the escrow account is very important and it would be accessed only during the most extreme cases such as if JEA could not maintain the system and Staff needed to hire another software firm to carry out essential duties.

Mr. Canzano, referring to the actuarial study and the possibility of meet and confer, stated he believes anything that affects how much money a Plan participant receives at retirement is a meet and confer issue. He stated the actuarial tables presented indicate a retiree's monthly retirement benefit would be \$3 or \$4 lower per \$1,000. Mr. Canzano commented he would find it hard to believe this is not a meet and confer issue because the retiree would receive a lower benefit if the Board implements the recommendation. He stated should this issue move on a fast track. He believes the meet and confer issue must be addressed.

Ms. Bhatia explained she has requested The Segal Company to provide details on the impact of the other options. She stated Staff is working with the City Attorney's office and looking at alternative ways to implement the recommended changes based on the actuary's experience study. Ms. Bhatia stated she would bring additional information back to the Board. She added the entire benefit over the lifetime of the member does not change and that is what the meet and confer decision is based upon. Ms. Bhatia stated the formula and the total benefit have not changed. Mr. Canzano responded he would want to investigate the position of a member who is already retired under the old assumptions would be receiving a larger monthly cash benefit than a member who retires under the new assumptions even though actuarially they have the same benefit.

## **11. Future agenda items**

There were no future agenda items.

## **12. CLOSED SESSION PURSUANT TO GOVERNMENT CODE SECTION 54946.9(a) – CONFERENCE WITH LEGAL COUNSEL REGARDING EXISTING LITIGATION – WATER AND POWER EMPLOYEES' RETIREMENT PLAN V. AOL TIME WARNER ET AL**

Item 12 was a closed session item and the audience was requested to leave.

The Board meeting was adjourned at 2:39 pm.

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JAVIER ROMERO  
President

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SANGEETA BHATIA  
Secretary

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VIKKI BURKS  
Recording Secretary