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

MEETING – JUNE 20, 2007

Present:

Eugene K. Canzano	Chairperson
Javier Romero	Committee Member
Mike Moore	Committee Member

Others Present:

Sangeeta Bhatia	Retirement Plan Manager
Ramonette Carranceja	Assistant Retirement Plan Manager
Michael R. Wilkinson	Deputy City Attorney
Jeremy Wolfson	Investment Officer
Irene Colón Gonzalez	Recording Secretary
Sarah Bernstein	Pension Consulting Alliance
Neil Rue	Pension Consulting Alliance

Chairperson Canzano called the Governance Committee Meeting to order at 10:33 am.

Ms. Bhatia indicated a quorum was present.

Chairperson Canzano inquired if there were any public comments. There were no public comments.

1. **Approval of Governance Committee Minutes of April 4, 2007 (deferred from June 6, 2007, Governance Committee Meeting)**

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

Ayes: Romero, Moore, and Canzano
Nays: None

2. **Discussion of Policy and Resolution relative to investments in Sudan and update on letters sent to managers and companies regarding their holdings in Sudan and possible action (continued from the June 6, 2007, Governance Committee Meeting)**

Ms. Bhatia stated, at the Governance Committee Meeting of June 6, 2007, Staff provided Committee Members with an update on the various offending companies that have business operations in Sudan based on two lists, the UC Board of Regents list and the Sudan Divestment Task Force list. Staff also provided an analysis of the explicit costs of divesting from the portfolios in which the Plan does have exposure and it was pointed out that they were all in commingled accounts. She continued, Staff provided information on the policy that was currently being followed by the other Los Angeles City pension plans. Ms. Bhatia noted there was also discussion regarding the best way to make an impact while still minimizing the effect on the Plan's pension portfolio. She stated they discussed the "shorting" strategy which Mr. Moore had noted he had found in reviewing the Sudan Divestment Task Force website. Ms. Bhatia added Pension Consulting Alliance (PCA) was asked to look into that strategy and provide their comments. She noted, basically, it would require positioning ourselves in such a way that we would create a "net-zero" position on holdings instead of actually divesting. Ms. Bhatia stated Staff had provided another update on the Plan's exposure to the various companies in the current package and noted that the exposure was a lot less than what had been reflected at the June 6th meeting; specifically, the Plan's exposure to ABB was about $9 million and ABB had now completely divested from doing business in Sudan and were subsequently removed from the list which has brought down the Plan's exposure to about $2.9 million in commingled emerging market manager's accounts. Ms. Bhatia stated Staff's memo points out that, despite the reduction in the current exposure, the explicit costs of divestment are still expected to be around $1 million; there is no reduction in the transition costs because of the nature of the countries that we are dealing with; and that, in evaluating the best way to proceed, the Committee should also evaluate the costs associated with commingled accounts. She noted that they must take the costs into context when developing the strategy on dealing with the Plan's exposure in Sudan. Ms. Bhatia stated PCA was there to speak to their memo and the results of their research on the shorting strategy and to provide their recommendation, which staff concurs with.

Chairman Canzano inquired of Ms. Bhatia and PCA if the process the three City pension plans have followed thus far has had an impact and reduced the amount of exposure and put more pressure on Sudan.

Sarah Bernstein of PCA stated she had not seen any qualitative analysis saying exactly what kind of public pressure is changing events in Sudan or on the investment side in Sudan. She added, her personal opinion was that this kind of public pressure, along with other kinds of public pressure, is helping to change the situation. Ms. Bernstein stated that it had just been brought to her attention regarding events happening on the ground in Sudan and the potential of U.N. troops going in, noting the whole situation is changing, not just through public pressure but it is also filtering down toward the broader actual situation on the ground. She added, what PCA did not note in the memo was one immediate action the Committee could take, even if the policy were amended to include the commingled fund exemption, is to write letters to any separate account managers the Plan has directing them to immediately divest within a six month period and not buy any positions that are affected going forward. Ms. Bernstein stated the Committee could take an action now, given the existing policy in place that would continue to put public pressure on this situation. In response to Mr. Romero's inquiry, Ms. Bernstein stated the Plan has some international separate accounts and noted the first step in their letter-writing process was to engage all the managers and the underlying companies and ask them what their position was. She added the next step in their policy was to seek divestiture and, while the current funds are in commingled funds, it is still under the

Committee's purview to direct Staff to send letters to all the managers stating, "This is our current policy, and please divest from anything you have and do not purchase any stocks that are on the list going forward." She added if any of the managers were in the process or thinking of adding stocks where they presently do not have any holdings in Sudan, the Committee is taking an additional active step supporting the general direction the Committee is interested in moving.

Chairman Canzano asked Ms. Bernstein if she thought the companies that pulled out of Sudan were responding to public pressure. Ms. Bernstein stated she thought it was certainly an element in their decision.

Chairman Canzano asked for Ms. Bhatia's opinion. Ms. Bhatia stated she agreed with Ms. Bernstein but felt it was too early to see results associated with this form of pressure. She noted that Staff had followed up with the Plan's managers several times and, as a result, these managers have felt a need to explain their position as far as investments in Sudan and she felt the collective effort on the part of the other pension plans and other investors has also made a difference.

Mr. Moore added that another place the effects are showing is in the Sudan government's agreement to the U.N. combined forces with the African Union. He felt this was probably from pressure from the Chinese Government which is concerned about this issue and its potential impact on the Olympics. Mr. Moore stated there may be some things going on behind the scenes, which has led to the government's agreement with the U.N. troops.

Mr. Romero stated he agreed and noted in reading *The Fund Fire*, he had found that weekly it notes that another state is divesting who has considerably more assets then us invested in that region. He commented that he felt all the letters sent to the money managers is making an impact and putting a considerable amount of pressure on them. Mr. Romero remarked that he commended Commissioner Hogan-Rowles for bringing this before the Board because he felt that this made him, personally, more aware of what was going on. He agreed their exposure was limited and he was not sure divesting a small amount would warrant us divesting and agreed with PCA's recommendation on continuing with the letter-writing.

In response to Mr. Romero's inquiry, Ms. Bhatia observed that there is a concern with divesting from the commingled accounts, which was discussed at length at the last meeting. She also noted, in terms of the impact on the Plan's portfolio, the Plan's exposure is around $2.9 million and they are expecting costs of divesting to be at least $1 million or more, without looking at some of the infrastructure requirements that would be necessary to open a separate account in those countries, which was also discussed at the last meeting. Ms. Bhatia also stated that at the last meeting, the question arose as to what was acceptable to the Mayor's Office in terms of a policy, and this was discussed in connection with the shorting strategy, and also if the commingled accounts were exempted from these policies. She explained that Mr. Wolfson contacted the other City pension plans and was informed that periodic updates are provided to the Mayor's Office. She noted, in addition, we were provided a copy of the other pension plan's policy which does indicate exemption from commingled accounts. Ms. Bhatia stated this appeared to be acceptable to the Mayor's Office. She stated when writing the letter to the Mayor we should provide him with a copy of our policy which should clearly indicate exactly what we are doing in terms of the commingled accounts and felt that it now would be a good time to revisit the policy in terms of that change.

Chairman Canzano stated he was aware that there were three options that were discussed in the policy and he believed that converting commingled accounts to separately managed accounts where we would have to take out about $3 million of assets in Sudan/Darfur at a cost of $1 million plus is probably not within the purview of their fiduciary responsibility to make that kind of expenditure. He added that he felt that that option was one that they could not, in good conscience, carry out. Chairman Canzano asked for input and additional information from the Staff and PCA on the shorting strategy and the costs associated with it, adding it appears to be an effective strategy to put pressure, but was unclear on the costs to do so. He commented that he would like to keep in mind the directive from the Mayor to divest but with the caveat that they keep in mind their fiduciary responsibilities and added that if there was a way they could comply and do so in a fiduciarily responsible way, he would like to explore the potential option of a shorting strategy.

Mr. Moore commented he would like to understand the mechanics of shorting before he dismisses this as a strategy. He stated the questions he had were related to costs and stated that PCA had mentioned in their report that the approach that was taken by the Boston Foundation utilized "swap agreements" because it was a cheaper way to go than straight "shorting," Mr. Moore added PCA gave the apparent costs as approximately 70 basis points, which in this case would mean about $18,000 a year if they were using the same technique with respect to what the Plan has in the portfolio which is a lot less than the $1 million it would cost to go to separate accounts. Mr. Moore asked PCA to explain how the swap agreement works.

Ms. Bernstein stated, in this particular case, the costs stated in their memo was the estimate given by Goldman-Sachs on what they are doing for the Boston Foundation. She added their memo was emphasizing that we were not selling the stock so we are still not divesting and you are guaranteeing some kind of loss without having the opportunity to have those stocks available to put in alternative positions. Ms. Bernstein explained the difference between a swap and shorting the stock directly is in the swap you do not sell the stock, you sell an option. She stated the banking firm guarantees the client, in this case the London Inter-Bank Offered Rate (LIBOR), or a certain amount of the interest rate and then you are responsible for paying them whatever the increase is above that – if the stock goes up then the option is going to be in the money and you will owe them money and it will be very different than the amount of margin call if you had shorted the stock itself. Ms. Bernstein stated one of the things they did not include is the setup costs for getting through the WPERP'S own operation for approval with your risk management team and with Staff to set up something that is brand new to the operation as an individual entity. She stated, from her perspective, it is a lot less costly but it also does not get us what our directive from the Mayor was – which was to divest. Ms. Bernstein added we would not be profiting from that stock which means we will have a net-zero balance – balancing out whatever we gain in the portfolio. Mr. Moore stated no sale was actually taking place. Ms. Bernstein replied in the affirmative adding we will still be holding the stock. Mr. Moore asked, typically, when they put together a swap, are they finding someone else on the other side of the deal; if not, they could be taking on a pretty big risk. Ms. Bernstein responded, they are taking on the risk – they are giving you LIBOR and it is going to go up or down. She added between the WPERP and whoever is giving it to us – they are setting up the swap where they are going to pay you an interest rate and they are taking on the risk. In response to Mr. Moore's question, Neil Rue, PCA, stated the swap's dealer is probably making choices internally about what kind of exposures they want and maybe they want the exposure to PetroChina because they have been a great performing security. He added they do manage their entire book of business and they probably have swap agreements that are a mirror image of a swap that we would enter into. Mr. Moore clarified that if they do that, there is no actual sale because one of the things they had discussed at the last meeting was that if you do the actual short strategy, there is a sale just as though we had taken those stocks out of the commingled funds and sold them – there is a sale of stock when you sell short. Mr. Rue pointed out that a swap and a short sale share in common the same thing in the sense that we will have to meet margin calls so we would have to pay cash if the stock does well, regardless of what structure we have. He continued explaining that one is just a net return and one is a gross return on the stock and if the stock does well we would have to feed it cash, you would have to write a check and you would have to admit to those losses which could be millions of dollars. Mr. Rue added people will begin to ask why you are taking losses while you still own the stock. Ms. Bernstein explained that that was the purpose of the Boston Foundation's effort and they do not have the fiduciary constraints the Plan has – they are saying they are an ethical, socially responsible investing foundation and are ready to take those kind of losses in order to reduce their exposure to the Sudan. Mr. Moore clarified that it is not really a loss in the sense that you have the other stock still invested in the commingled account, noting it was really an option and you just have certain carrying costs. The challenge will be getting the swaps contract in place, which is a big assumption for a public fund. Mr. Moore stated, "You are just cutting a contract," and clarified that we were not losing any funds as you would in a short position. Mr. Rue applied in the affirmative. Mr. Moore asked if one could take the funds gained from the short and invest it elsewhere in something comparable. Mr. Rue responded in the affirmative. Mr. Moore inquired if there was any benefit from going with a simple short as opposed to a swap. Mr. Rue responded the concepts were the same – the point is to eliminate economic impact and/or stating I do not want to deal with this country anymore, however, you still have to deal with the government's issues facing these companies because you still own the stocks. He added you still have a relationship with these companies going through this engagement and are not divesting. He explained, you can eliminate the economic relationship but the whole intent of divestment is to sever the relationship and you are not doing that in this structure. He noted he did not know if this really meets the overriding intent of the Mayor's directive to divest.

Mr. Moore commented that if they were to do it as a short he assumed that it would be more expensive than the 70 basis point estimate. Ms. Bernstein responded the Plan would need to set up a brokerage account to do the shorting while swaps are easier to execute.

Mr. Moore stated that he did not have any more questions. In response to Chairman Canzano's query, Mr. Romero stated he did not have any more questions, but based on the information he had heard, he was only comfortable going with Option 1, which is to exempt the commingled funds from divestment in Sudan-related stocks.

Chairman Canzano asked Counsel, if they were to make a decision as a Board to exclude commingled and index funds as part of their policy, then come up with a strategy such as a swap or the shorting strategy to put pressure on the companies doing business in Sudan, would they be violating their own policy by taking that extra step. Deputy City Attorney Wilkinson responded if they wish to take steps outside what they have set in the policy, they would first have to amend the policy. He also noted that Mr. Wyatt, their fiduciary counsel, was unable to be present, and requested that any decisions wait until Mr. Wyatt is available.

Chairman Canzano stated he felt it would be prudent to have Commissioner Hogan-Rowles and fiduciary counsel present before they took any major actions. He added that he felt that at this point, this item should go to the full Board with the Committee recommending Option 1. Mr. Moore asked for clarification. Chairman Canzano replied that this item should be dually agendized for both the Governance Committee and the Regular Board Meeting.

Mr. Moore agreed and asked Staff for clarification that if they go with Option 1, which exempts the commingled, the index and the alternative investments in real estate, then that means we should also be sending out letters to all managers stating that we have adopted a divestment policy and we do not want any of the companies noted to be purchased by any of the managers. He added, in addition, we should send a second letter to the managers and companies, which would include the second category on the Sudan Divestment Task Force, noting that some of our managers do have holdings in those companies. Mr. Moore stated that he would be interested in knowing which of our managers have holdings included in this second category and asked Staff to provide that information. Mr. Romero suggested developing a City of Los Angeles Pension Task Force which would include all three pension plans and stated we could send a joint letter from the three plans describing the amount of assets we hold combined noting this may have more weight in the eyes of the money managers and individual companies. Chairman Canzano and Mr. Moore agreed and Chairman Canzano asked if Staff could coordinate this with the other pension plans.

Ms. Bhatia clarified that Staff would be bringing this back and would have it dually agendized on both the Governance Committee and Regular Board Meeting agendas. She informed the Committee that Commissioner Hogan-Rowles may not be available for the next meeting. Chairman Canzano stated they will agendize it subject to her availability adding he was not comfortable taking an action without her. Mr. Romero stated that he felt that they could still move forward with discussing the joint letter from the three pension plans.

Mr. Moore asked if it would be appropriate to contact Commission Hogan-Rowles to update her on the situation. Deputy City Attorney reminded the Committee that if another Committee Member contacted her, it would constitute a meeting and be in violation of the Brown Act. Staff was directed to contact the Commissioner and provide her with an update.

Chairman Canzano clarified that the Committee present was in favor of adopting Option 1, which would amend the Plan to exclude commingled, index and real estate and to continue to send letters. He stated it was important to note that the Plan's exposure has been reduced from $11 million to under $3 million so the pressure that is being put out across the country is, in fact, having an effect.

The meeting was adjourned at 11:13 pm.

EUGENE CANZANO Chairperson	SANGEETA BHATIA Secretary

IRENE COLÓN GONZALEZ
Recording Secretary