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

**MINUTES – OCTOBER 9, 2002**

**Present:**

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| Javier Romero | President |
| Dan Mirisola | Vice-President |
| Lilly Calvache | Board Member |
| Ron Vasquez | Chief Financial Officer |

**Absent:**

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| David H. Wiggs | General Manager |
| Norma Bertrand | Board Member |
| Anne E. Cho | Commissioner |

**Others Present:**

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| Duamel Vellon | Retirement Plan Manager |
| Sangeeta Bhatia | Assistant Retirement Plan Manager |
| Silvia Tesseneer | Recording Secretary |
| Mike Wilkinson | Deputy City Attorney |
| Allan Emkin | Pension Consulting Alliance |

President Romero called the meeting to order at 10:09 am after the Pledge of Allegiance.

[Pledge of Allegiance]

**PUBLIC COMMENTS**
President Romero inquired if there were any public comments and there were none.

Mr. Allan Emkin approached the table.

Mr. Vellon indicated the first item on the agenda was the consideration of a resolution pursuant to the actions of the Board October 3, 2002. He reported resolution 03-22 erroneously shows the date "October 13, 2002", and it should read "October 3, 2002". He added the draft resolution was submitted to the Board for consideration. Mr. Romero inquired if there were any questions and there were none. Ms. Calvache then moved approval of resolution 03-22 as corrected. Seconded by Mr. Mirisola and carried unanimously after the following vote:

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

Mr. Vellon indicated there was a second draft resolution (Number 03-23), showing the word "Invesmtne" and it should read "Investment". He added, under Item No. 3, "Large Core" the amount should read $620 million instead of $325 million; and the total listed $3.1 billion, on the same line, should correctly read $620 million. He stated the Board could possibly select between Options 2 and 3 as recommended by the Consultant and the final selection will be included in the final resolution. Mr. Vasquez pointed a misspelling on the resolution (ITEM 2) and it should correctly read “Russell” instead of “Russel”.

Mr. Allan Emkin Rue (PCA) approached the table.

1. **Consideration of Board Resolution authorizing implementation of the Plan’s investment of 40% of its assets in Domestic Equities, consistent with the Plan’s Consultant’s recommendations and in accordance with the new asset allocation structure adopted by the Board.**

President Romero recognized Mr. Emkin.

Mr. Emkin reported PCA’s job is to provide the Board with enough information and recommendations to modify and/or adopt the right asset structure and make good decisions. He indicated he would discuss domestic equity and benchmarks, the portfolio as it exist today, historic performance good/bad, and risk. Mr. Mirisola suggested the tape of this meeting be available to the Board members who could not attend. He asked Mr. Emkin to state the page number throughout his presentation, so interested Board members can follow along.

Mr. Emkin reported between 1978 and August 2002 two equity indices, the S&P 500 (an index of large U.S. stocks) and the Russell 3000 (an index of U.S. stocks including both large and small stocks), show stocks dramatically outperform bonds by two to one, over the long term, both equities performing similarly. Mr. Vazquez inquired about the makeup of the Russell 3000. Mr. Emkin described the Russell 3000 as the 3,000 largest U.S. companies, weighted in terms of their market capitalization available for investment (securities held by individual owners, not readily available in the market, are excluded). He added 2,000 small stocks are included in the Russell 3000 and there are also 1,000 large stocks represented.

Mr. Emkin expressed the most important issue, in terms of pension planning, is not the nominal return, but the real rate of return, which implies increases at purchasing power over time. He reported between 1979 and 2002, equity markets were twice as volatile as bonds, but provided a higher rate of return.

Mr. Emkin discussed the characteristics of domestic equity, stating the U.S. equity market is not homogenous and different stocks are affected by different economic factors. He added the two key variables are company size (large vs. small) and company type (value vs. growth). He described a growth company as currently having no earnings, but has the potential for growth. He expressed all PCA’s recommendations are based upon these concepts and are not unique, but rather generally accepted, industrywide.

Mr. Emkin reported a large company is 57 times bigger than a small company, but the earnings growth of small companies is twice that of large companies, which makes the argument of why small stocks are more attractive. He further discussed the relative performance of small vs. large stocks, stating it tended to be cyclical. Mr. Vazquez inquired what the largest small company and smallest large company was considered worth. Mr. Emkin estimated $2 billion capitalization is the mid point between large and small.

Mr. Emkin compared growth versus value, breaking it down into four different fundamental variables: company size, price, sales, and earnings growth. He explained a growth stock as twice as large, having the same earnings, but twice as expensive, its price has much higher P/E than value stock and much higher sales and earnings growth. He further reported data indicated, over long periods of time, there would not be a difference in return between growth and value. He illustrated, through various charts, how the markets are cyclical and style is impacted, and for this reason PCA recommends diversification.

Mr. Emkin explained the importance of choosing a benchmark as it determines how the portfolio is structured, measured, how well diversified it is and how it affects the risk and return. He listed issues involved in benchmark selection as coverage, liquidity, acceptance by investors, methodology, objective selection criteria, transparency and public availability. He continued by comparing the widely used asset class benchmarks Russell 3000, S&P 500, and Wilshire 5000. He stated PCA recommended Russell 3000, which accounts for more than 98% of the total market capitalization. He noted this index was an internal selection process by “decision rules” (so one cannot arbitrarily put a stock in or out of an index), and it is publicly available, had defined inclusion criteria with a level of subjectivity, market cap weight and high level of sponsorship.

Mr. Emkin characterized DWP’s “current active/passive” type portfolio structure as “down the middle” and he wanted to go on record stating this is something PCA would never recommend. He reiterated institutional portfolios should be managed either actively or passively. He indicated data supports if one is completely “passive” it is very hard to beat the benchmark. He advised, however, a portion of the portfolio should be indexed, since it is a very cost effective, liquid way of getting exposure to the broad market and is a great holding place for assets being held aside for later decisions.

Mr. Emkin compared the various equity managers and how they perform over time. Mr. Vazquez inquired about the meaning of large core as opposed to large value and large growth. Mr. Emkin responded large core has the characteristics of the broad market and would not have a specific value or growth style, but have both large value and growth in their portfolio. He stated PCA always recommends active managers for small stocks and exposure to large and small, value and growth, and active and passive.

Mr. Emkin introduced “style maps” (used to analyze structural biases) explaining where a portfolio fits in terms of capitalization and style. He stated one plots individual stocks, managers, and benchmarks, giving a picture of how the portfolio looks. He expressed PCA would help create a portfolio for the Plan, utilizing style maps and the importance of the Board’s understanding of how the maps work.
Mr. Emkin reviewed LADWP’s domestic equity portfolio stating when growth was in favor there was nominal exposure to it. He compared the performance of LADWP’s fund with various indices over various periods of time. He stated LADWP’s portfolio has lagged dramatically since the late 1970’s, underperforming the broad market and just in the past two years has done well. He explained in layman’s terms, if the entire portfolio were indexed there would have been a higher rate of return, and the existing managers did not add value over the long term.

Mr. Emkin expressed his belief there is potential for added value through active management, but he feels the potential is much greater in small stocks rather than large. He noted the current portfolio biases would cause performance to deviate dramatically from the benchmark and PCA recommends getting rid of bets against: small cap, pure growth, and value. He advised the Plan must become well diversified.

Mr. Vazquez inquired if, according to the chart provided by PCA, LADWP performance is almost right on top of the Russell 3000 and is that not the most diversified position. Mr. Emkin responded LADWP does not have any exposure to small stocks, pure growth or pure value, so the numbers were not reached in the most diversified way.

Ms. Bhatia inquired what the "median" fund is. Mr. Emkin explained it is the average active manager account and the charts show how well they did. Mr. Mirisola commented, since he became part of the Board, the managers have wanted to change the benchmark about four times, stating it would look more like the Russell 2000 or 1000 to make their numbers look better in the performance reports. He added he appreciated Mr. Emkin's process, because there will be a single benchmark to expect the managers to live up to. Mr. Emkin expressed PCA's philosophy, as a firm, is they work for LADWP and recommend making the decisions on what the benchmarks are, the levels of risk, etc. He indicated the plan money managers must be told what LADWP is looking for and through this process managers who don't produce results will be eliminated.

Mr. Emkin explained the initial structural considerations start with adopting an asset class benchmark and PCA's recommend the Russell 3000 index. He suggested using domestic equity as a holding place for real estate and alternative allocations and to decide on an active/passive structure. Mr. Vazquez inquired if the plan underperforms the Russell 3000, will it be due to the incorrect asset allocation or due to performance of the managers. Mr. Emkin responded PCA recommends the portfolio be "style neutral" and the risk should be similar to the risk of the whole market, therefore value added (or lost) would be due to the manager's added value (or loss) and the managers could specifically be held responsible. Mr. Emkin indicated what LADWP's peer group's portfolio (in California) consisted of, stating all of the peer plans have a significant percentage of their domestic equity assets passively managed.

President Romero called for a 15-minute recess at 11:30 a.m.

[Recess]

The meeting reconvened at 11:41 a.m.

Mr. Emkin provided four options to implement the plan's portfolio structure ranging from 92% passive (Option 1) to 92% active (Option 4). He reported Option one consists of small stocks (8% of the portfolio) actively managed and everything else passively managed, and Option 4 consists of 92% active and only 8% passive having 9 managers, neither of which PCA recommend. He stated PCA recommend either Option 2 or 3. He described Option 2 consists of 50% passive, 7 managers, [1 index manager, 2 large value managers, 2 large growth managers, $600 million reserve for future real estate and alternative investments, which would be passive (part of index manager) and 2 additional managers (one small growth and one small value)]. He stated if the Board was more comfortable with active management, PCA recommended Option 3 consisting of 70% active, 30% passive, 8 managers, and everything else being the same as Option 2, with the addition of one "large core" active manager.

Mr. Wilkinson inquired if the $600 million reserve for future real estate and alternatives is in addition to the big picture top-level allocation to alternative investment or real estate. Mr. Emkin responded it represented the same exact money allocated to these two asset classes. He suggested constraining the number of managers is less expensive, reduces the potential for redundancy and PCA staff recommend coming up with an arbitrary number of investment managers. He stated, under the Board's direction, once the number of managers is decided, PCA will issue RFPs for all the appropriate mandates, will develop contracts and guidelines, gather data and calculate statistics and submit a list of finalist the Board can interview and make a selection from.

Mr. Emkin outlined PCA's recommendations of: adopting the Russell 3000 index (using the Russell 1000/Russell 2000 structure), incorporating both active and passive management (selecting Option 2 more passive or 3 more active), and instructing PCA to begin the RFP process. President Romero requested pros and cons for selecting Option 2 versus 3. Mr. Emkin explained the benefits of Option 2 as a little cheaper, less risky, less likely to underperform the broad asset class, and the negative being it is less likely to significantly outperform the asset class because more of the money is tracking the benchmark. He stated the difference between Option 2 and 3 is based on how confident the Board feels with active management. He urged the Board to consider it is easier and less expensive to go from passive to active than vice versa. Mr. Vellon interjected, for the record, draft resolution 03-23 included in the agenda packet contained the recommendations Mr. Emkin has outlined.

Mr. Vazquez inquired about the cost to get from where the Plan is to where the Board wants to be and is the cost significantly different between Option 2 and 3. Mr. Emkin responded the more pure an active an option is, the more costly makeup in terms of management and transaction fees, because active managers trade more and charge more than an index fund. He explained once "all" decisions regarding domestic equity are made, PCA would look at the existing portfolio and recommend a transitional strategy figuring out what the most cost efficient way to go from point A to Z. Mr. Vazquez inquired, based on the volatility of this market and it being in a bubble, is now a good time to implement a transition. Mr. Emkin expressed it would be better doing it now than two years ago, since the market is more reasonably priced today and a transition is long overdue, because the portfolio needs to be restructured to diminish the level of risk it currently has. President Romero inquired if there is a large value and growth exposure in Option 3, why recommend two managers for each one as opposed to one. Mr. Emkin responded the reasons as the size of the portfolio and people do things differently, which gives the plan more diversification within the style.

Discussion ensued regarding which structural design option is more appropriate for the Plan. Mr. Mirisola indicated he favors Option 2. Mr. Vazquez agreed, stating it had more in indexed funds and this would make it easier to move to Option 3 later, if desired. He added Option 2 represents a more conservative approach on the

Boards part.  Ms. Calvache indicated she also favors the more passive Option 2, for the same reason of it being easier to move to Option 3 in the future, if this was the Board's desire.  President Romero stated he preferred Option 3 for the reason of having a core manager to add more value, but, for the sake of starting out and maintaining cohesiveness among the Board members he would also agree to Option 2 as a starting point.

Mr. Vazquez inquired what the timeframe was for RFPs, selection of managers to interview and transitioning. Mr. Emkin responded PCA has already started drafting the RFP, which should hit the streets within two weeks.  President Romero inquired about the advertising method.  Mr. Emkin stated it was up to the Board and once the word was out it would be "self-advertisement".  A discussion ensued regarding the DWP prerequisite for advertisement and completion and the need for delineating manager selection criteria. After some more discussion, Vice President Mirisola moved approval of Resolution 03-23 recognizing PCA Option 2 would be shown as the selected domestic equity portfolio structure.  Seconded by Mr. Vazquez and carried unanimously after the following vote:

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

Discussion ensued regarding the timeframe managers would have to respond to the RFP, the number of bids expected and the PCA staff to direct the managers' inquiries to, in case they continue calling for general information.

Mr. Vellon indicated another matter on the table was the RFP for the selection of attorneys.  He explained the Board wanted to interview the six respondents reported at the last meeting, but an additional RFP response was received after the deadline. He noted the law firm corresponded with the Board alleging they could not access the RFP through the Plan's web page and contacted a phone number in the Retirement Office, before the deadline, but never received a hard-copy RFP they requested.  Mr. Vasquez expressed he would not favor including this particular law firm.  Other members wondered if the technical web page problems may justify consideration.  Mr. Vellon suggested to include this matter in a future agenda for Board consideration and it was the consensus to so proceed.

The Board meeting was adjourned at 12:08 PM.

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JAVIER ROMERO
President

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DUAMEL VELLON
Secretary

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SILVIA TESSENEER
Recording Secretary