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

MINUTES – JULY 10, 2003

Present:

Javier Romero	President
Dan Mirisola	Vice-President
Lilly Calvache	Board Member
Michael Moore	Board Member

Absent:

Anne E. Cho	Commissioner
David H. Wiggs	General Manager
Ron Vasquez	Board Member

Others Present:

Sangeeta Bhatia	Assistant Retirement Plan Manager
Ellen Shimamoto	Assistant Retirement Plan Manager
Silvia Tesseneer	Recording Secretary
Mike Wilkinson	Deputy City Attorney
Allan Emkin	Pension Consulting Alliance (PCA)
Neil Rue	Pension Consulting Alliance (PCA)

President Romero called the meeting to order at 10:12 a.m. after the Pledge of Allegiance.

[Pledge of Allegiance]

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

PUBLIC COMMENTS

There were no public comments.

President Romero thanked Ms. Bertrand for her contributions to the Retirement Board. He then welcomed Mr. Michael Moore as the new retiree Board member.

1. **Consideration and discussion of the Plan's asset class "International Investments" for purposes of:**

   a) **Identifying the investment manager style (or styles) to be selected within the portfolios "Developed Markets" segment.**

Ms. Bhatia introduced item 1 as the consideration and discussion of the Plan's asset class "International Investments". She explained, in October of 2002, the Board approved 15% of the Plan portfolio be invested in International Investments while 90% of such 15% be allocated in developed markets, and 10% in emerging markets. She added the Board had not yet adopted specific investment guidelines or manager styles. Ms. Bhatia explained Resolution 04-01 outlines the three investment mangers styles within the developed markets segment, identified and recommended by the Plan's Consultant PCA (Pension Consultant Alliance). She noted the primary recommendation from PCA was to select one international manager (developed markets) under each of these styles (growth, value, core). Ms. Bhatia indicated the proposed resolution 04-01 incorporates PCA's recommendations. She explained there would be monitoring of investment managers through benchmarks recommended by PCA until more generally accepted benchmarks were developed within the consulting industry.

President Romero inquired if any discussion on Resolution 04-01 was necessary.

Mr. Moore commented on PCA's references to "growth with a reasonable bias" and "growth at a reasonable price". He inquired if these meant the same. Mr. Rue responded in the affirmative. Mr. Moore recognized the Board is directing the Plan's Consultant to develop prudent performance evaluation standards for the develop market segments of the Plan's International portfolio, etc. He then inquired as to whether this would require more original research on the part of the consultant, monitoring its development and applying it where appropriate. Mr. Emkin responded this was the normal course of events and no work would be created in order to implement this program.

President Romero inquired how would the performance be evaluated if one manager's style is, for instance, growth and the other is value. Mr. Emkin responded there are unique benchmarks available for each style and PCA would provide those to the Board. Mr. Mirisola inquired if in considering style and performance the Board was developing its own benchmarks. PCA representatives responded in the negative and elaborated on the various styles and benchmarks available. They clarified PCA's preference for published benchmarks as opposed to unpublished benchmarks.

After more discussion Mr. Moore moved approval of Resolution 04-01. Seconded by Ms. Calvache and carried unanimously after the following vote:

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

Mr. Mirisola suggested the word "bias" be changed to "reasonable price" in the resolution to correlate more with the information and wording of PCA. President Romero indicated minor amendment would be made by staff.

b) Adopting general investment guidelines for the Plan's international portfolio and specific guidelines for the investment manager styles identified for the "Developed Market" segment under a).

President Romero inquired if discussion was necessary on Resolution 04-02.

Mr. Moore referred to the proposed investment guidelines on page 1.18 and the different categories with different sets of guidelines for each. He noted the emphasis on style issue, and mentioned there were a couple of other cuts that have been taken at domestic equity, which is a large capital versus small capital and also the emphasis placed on regional being dominant in terms of differentiating the performance. Mr. Moore inquired if it is appropriate, as the Board looks at those guidelines, to take into consideration other factors, particularly the regional, to the extent it could certainly become the dominant factor again. Mr. Emkin responded managers will be monitored on an ongoing process. He recommended it should be at the discretion of the manager who would be making an evaluation they prefer, for example, Europe versus Asia. He noted these would be the two regions measured against and those would be a finding as to whether the manager made the country weighting successful or unsuccessful. Mr. Moore inquired if the Board was confining the managers to regional weighting, based upon the averages, and would these be a risk managers could load up, theoretically, on Japanese stock versus European stock and vice versa. Mr. Emkin indicated the most significant weighting is how the manager added value over the last years. He noted the active international managers have generally done much better than the benchmark, in large part because the manger, underweighted Japan, which as everyone knows hasn't done well. Mr. Emkin explained managers focused on Europe, which did much better on a relative basis. He advised PCA clearly does not feel comfortable directing managers have, for instances, half of their money (or whatever the amount) in Japan or any other specific area. He emphasized that is up to the managers under their discretion. He noted the expectation will be the managers shall be broadly diversified and if the managers choose not to have any exposure to Japan, that would raise a flag and PCA would be pointing that out as part of the evaluation process on an ongoing basis.

Mr. Moore inquired if it may constitute a significant increase in the element of risk, to the extent managers can load up on one region that may do poorly, because they miscalculated. Mr. Emkin responded the general guidelines require manager be diversified, minimizing the potential for huge bets to be made in a single country. He added the general concern is if the Board became too specific, that becomes an excuse for poor performance if in fact the Board mandates specific percentages in specific regions. Mr. Emkin added, as consultants their goal is to make sure when a manger is hired by the Board they are given discretion and are accountable with the key being not to minimize their discretion so much that it could impact performance, relative to other accounts. Mr. Moore questioned whether or not there should be any guidance or encouragement for the international manager's use of ADR's, versus working in the local foreign markets. He expressed his understanding there is potentially long-term savings if work is done through ADR's. Mr. Emkin reiterated it should be up to the manager's discretion and their performance will be regularly evaluated and measured. He added, if it makes more sense to buy Sony as an ADR, as opposed to Sony as a stock in Tokyo, the managers would be expected to do that, because that's the cost efficient thing to do, which will enhance performance and that would be better for the portfolio's return.

Mr. Moore questioned the consistency of currency hedging (up to a maximum or 25% of portfolio) but on the international equity manager's hedge, this ratio must not exceed 50%. He inquired if there's a reason for that inconsistency. Mr. Rue replied it should be 25% in both. Mr. Moore inquired what percentage in an international portfolio would hedging represent (in terms of cost). Mr. Emkin responded there has been very little hedging in active international portfolios. He explained it was important for the Board to understand why the benchmark is an un-hedged benchmark and if the managers use hedging, they take benchmark risk, because they are taking a risk that isn't in their benchmark. He explained, generally speaking, managers will not do that, not just international but in any asset class. He added managers don't want to have performance that is a great variance from their benchmark. Mr. Emkin stated currency is the largest traded market being traded on a daily basis. He commented, when Coke makes an investment in Japan or England, they have to send dollars to that country converted into pounds or yen and whenever their profits are repatriated to the United States they have to sell the local currency and that is happening daily. Mr. Emkin reported World Trade is basically currency; therefore, trading currency is very efficient and very inexpensive. He further added the cost is "opportunity cost" and, if in fact, the manger's bet is "the dollar is going to be stronger", therefore they would sell yen and buy dollars and if they are wrong, that's a big management cost and not a fractional cost associated with trading.

Mr. Emkin elaborated on the big European economies (such as France, Italy, Spain, Germany) and Hong Kong and Japan. He explained these are referred to as "developed" because of their developed economies. He noted these would be economies that have high degree of transparency, have good legal infrastructure and very efficient trading systems, with a lot of research on them, as opposed to the emerging markets were those conditions don't exist yet. Mr. Mirisola questioned the 30 issues and 10 markets requirement. He noted the way it is worded, it seems as though they could own 5%, for instance, in Japan and cover one of the 10 stock markets and one issue in Japan. Mr. Emkin clarified the total portfolio has to have 30 issues and 10 markets.

After more discussion Ms. Calvache moved approval of Resolution 04-02. Seconded by Mr. Moore and carried unanimously after the following vote:

Ayes: Romero, Mirisola, Calvache and Moore
Nayes: None

c) Refining the process for the selection of International Equity Investment Managers within the identified Developed Markets segment and within the various investment manager styles identified under a).

Ms. Bhatia reviewed Resolution 04-03 and explained the two manger selection options outlined by PCA. She stated Option 1 talks about interviewing all candidates applying for the developed portion of the RFP, regardless of the management style, and to bring them all together. Ms. Bhatia noted Option 2 involves dividing the candidates into management styles to be identified and interviewed in groups. She added the proposed Resolution is based on Option 2 as being the more organized way of approaching the selection.

Mr. Rue inquired as to the Board's understanding under Option 2. President Romero clarified the interviews would be done by groups of managers with similar style characteristics. He added interviews could be done in one day, perhaps interviewing 4 managers with value style, then select one from that group and then proceed to growth and so forth.

Mr. Mirisola questioned the grouping of styles and PCA's scoring process. Mr. Rue responded there is some notion of style consistency in scoring, though they look at their investment performance and take that into account. Mr. Mirisola inquired if some of these companies could score higher as a growth than as a core. Mr. Neil responded they do not score them relative to their peers within the style, they are scored overall, but style consistency is an issue. He added there are other factors driving investment performance outside of the domestic market, such as country weighting and currency influence. He added while style is important, it's not the driver and it is ok in international markets. Mr. Emkin explained what is a value measure in France, may not be a value measure in Japan. He noted markets may treat accounting conventions completely differently and the whole use of style is a good tool but it's not nearly as clear-cut or well defined as it is domestically. He clarified it's important to use style as a consideration, which is relatively new and, until recently, people did not use style in the selection process, they generally hired generic managers. Mr. Rue further added, when filling certain interview slots care and discussion should take place.

President Romero questioned how to determine if a GARP (Growth at a reasonable price) manager will go into core of if they will go into growth. He added he prefers to stick to Value, Core and Growth and interview that way, but there are GARP managers and it is necessary to know which of these three to put them in. Mr. Rue recommended putting GARP with core.

Mr. Mirisola inquired if it was the intent of the consultant to generate another correlation matrix after the managers are selected for interview. Mr. Emkin responded in the affirmative.

Mr. Moore then inquired if many of these international managers were capable of managing portfolios of varying styles. Mr. Emkin responded only the biggest shops offer multiple styles, but most organizations have one label.

President Romero asked for clarification regarding the weighting and recommendation of the managers PCA likes. Mr. Emkin stated the recommendation would be to look at the group of managers who could do the job, with consideration of the correlation between them and going with the manager who will give them better diversification. President Romero questioned if a manager whom the Board considers under GARP and involved in the interview process states they prefer to be considered growth, how would PCA handle that. Mr. Emkin stated some of this is arbitrary and PCA, as a consultant, will draw a line and will make the decision.

Mr. Moore wanted clarification on the consultants' recommendation of going with Option 1 as opposed to Option 2. He noted Option 2 included a potential 2 to 4 months delay if chosen. He added he understood what was being recommended for a vote was not the consultant's first recommendation. Mr. Emkin explained the concern was if managers were bunched by style interviews would probably take place on more than one day and the Board did not want the process to take months to accomplish. He clarified it was primarily a timing issue and not a substance issue. Mr. Moore inquired as to the key factors of PCA rankings. Mr. Rue outlined the RFP process and explained the investment manager's strategy, and client base were factors in PCA's rankings. He indicated they weigh those issues and score the RFP's subjectively. Mr. Emkin stressed the same questions and the same process is used for all the managers. Mr. Moore inquired if the Board could have access to PCA's evaluations. Mr. Rue replied once the finals have been determined, the copies of the original RFP are submitted with the Board packet along with PCA's formal booklet of their recommendations and findings.

After more discussion Mr. Mirisola moved approval of Resolution 04-03. Seconded by Ms. Calvache and carried unanimously after the following vote:

Ayes: Romero, Mirisola, Moore and Calvache
Nayes: None

Ms. Bhatia indicated similar issues must be addressed by the Board when PCA makes their recommendation relating to the emerging markets segment of the international portfolio.

Mr. Mirisola inquired about the timeline expected for the subsequent events. Mr. Rue recommended putting the cash to work in small cap (domestic equity) rather than in international emerging markets, as 90% of international equity allocation is developed markets, representing 15% of the portfolio. He suggested the Board may want to think about going back to the selection of domestic small cap managers before proceeding with the international emerging market segment.

2. Authority to Purchase Commercial Paper from the List of approved Issuers.

Ms. Bhatia outlined Item 2 provides the authority for staff to purchase commercial paper from a list of approved issuers, and this is the basis for cash investments. She noted this authority was for the period of July 1 through September 30, 2003

Mr. Moore questioned the maximum investment in any one issuer, and if there were separate policy issues. Ms. Bhatia answered in the affirmative and elaborated the policy is separate and establishes a 15% maximum with any one issuer.

Mr. Moore moved approval of Resolution 04-04. Seconded by Ms. Calvache and carried unanimously after the following vote:

Ayes: Romero, Mirisola, Calvache and Moore
Nayes: None

3. Reconsideration of Portfolio transition strategy for the Plan's re-allocation of Assets to a Passive Index – Russell 1000 and in-kind transfer to an Active Large Growth-Equity.

Ms. Bhatia reported on Item 3. She stated BNY/GTM (Bank of New York/Global Transition Management) was approved as the transition manager earlier this year with the understanding there would be no cost to the plan. She explained during contractual discussions it was discovered BNY was expecting to be compensated by third parties for items such as "order flow". She added, in order to avoid conflicts of interest, terminology was needed in the contract, stating BNY would act in the best interest of the plan and as a fiduciary. Ms. Bhatia indicated BNY is willing to abide by such requirement, provided an insertion as to their compensation by direct commission charge to the plan.

Mr. Moore expressed concerns regarding the compensation through "order flow". Ms. Bhatia explained it's a way of positioning securities in connection with execution of trade and this is a way brokers get compensated. Mr. Moore expressed he was troubled by how they would seek compensation from third parties and felt it would put BNY in a conflict of interest.

Mr. Emkin explained a broker, unless acting as a fiduciary, does present a conflict of interest. Using Schwab as an example, he suggested Schwab could own a position in a stock and could be a market maker in that stock and could be on the other side of the trade, so this is why when asking them to be a fiduciary, they have to avoid those sorts of conflicts. Mr. Emkin further added, in a normal brokerage relationship there is full disclosure. He noted the manager could be on the other side of the trade, therefore, they are not acting as a fiduciary and this is when contract negotiations include a standard of loyalty because of the liability exposure. Mr. Moore inquired if this should be a standard requirement of everyone in all Plan engagements.

Mr. Michael Wilkinson, of the City Attorney's office, commented in the affirmative and stated, unless overruled at some other part, all the contracts (from the City Attorney's office perspective) have fiduciary protection and anything less than that presents additional risk for the plan.

President Romero summarized for Mr. Moore, initially, BNY was going to do it for free, because they wanted the Board's business, as prospective client, and they wanted that relationship. He added once Plan staff said to them they need to act as fiduciary, BNY replied they can no longer act in a free capacity, and would have to charge the plan a commission of 1.5 cent per share. President Romero stated this commission was considered too high and therefore not acceptable, so staff and Duamel managed to bring BNY down to 1 cent per share and this is were the Board is at right now. He explained the Board has the ability to evaluate the transition at the end, and see how well BNY did and the consultant will address the issue as to what is Plan B, in the event BNY does not perform. Mr. Moore questioned if it presents problems in terms of not being competitively bid. President Romero explained PCA had recommended the Board consider Merrill Lynch, Northern Trust and Bank of New York (as the Plan custodian) and wanted to move into position because of the potential of market impact going into RFP. He commented the decision the Board made was cost minimal, compared to the potential market impact, which could happen going forward if waiting too long. He added, going forward, with the rest on strategy, it was PCA's recommendation to do an evaluation to see how BNY would do with a passive strategy, whether the balance of the transition would be given to them or to a short list of the major transition brokers that could be determined later.

Mr. Rue explained the transition service was competitively bid, but it was with existing vendor relationships that were established. He also noted they believe BNY is capable, and transition management is a new type of business niche within the investment industry (5 years old). Mr. Rue stated BNY has a credible expertise in that space and have presented some of that information in front of the Board. He mentioned they did a limited competitive bid, instead of a long RFP process, to come up with a vendor. Mr. Rue explained they let BNY run with it because they are a capable firm, and to see how they do. He suggested, if they do well, they could continue to execute the transition of business that gets generated as the Board moves forward. He indicated, if something comes up, (through a Post Trade Analysis) that's a negative signal the Board needs to consider some external vendors with no existing relationship.

Mr. Moore inquired as to the specificity of this item, if it basically is authorizing a commission charge that will be negotiated by staff. President Romero answered affirmatively.

Ms. Calvache moved approval of Resolution 04-04. Seconded by Mr. Mirisola and carried unanimously after the following vote:

Ayes: Romero, Mirisola, Calvache and Moore
Nayes: None

4. Consideration of Plan changes applicable to the following bargaining units, under the "most Favored Nations" provisions, as a result of recent Memoranda of Understanding (MOU) approved by the Board of Commissioners (no further Plan amendment needed).

Ms. Bhatia outlined Item 4 representing benefits approved by the Board of Commissioners through the MOU process. She explained in March 2003 there was a Plan amendment, authorizing an extension of the retirement benefits provided to Local 18, and to other bargaining units as they completed their MOU negotiations. Ms. Bhatia explained the first Resolutions ("most favored nation" provisions) presented today cover the Security Unit, since the Board of Commissioners approved their MOU earlier, awarding them the same benefits originally awarded to Local 18. She explained the Board had adopted Plan language permitting the extension of Local 18 retirement benefits to other bargaining units as they settle their MOU, without further Plan amendments.

Ms. Bhatia reported the second resolution presented today concerns approval of benefits for the Load Dispatchers Uni, since the Board of Commissioners also approved their MOU earlier. She added upon approval of the two resolutions (04-06 and 04-07) staff will be able to implement the retroactive changes to the affected retirees and at the present moment, there is one Load Dispatcher retiree subject to pension recalculation as a result of the new MOU.

Ms. Calvache inquired if by adopting these two resolutions, would SCIU Local 347 Security and Load Dispatchers have the same benefits as Local 18. Ms. Bhatia responded affirmatively.

Mr. Moore moved approval of Resolution 04-06 and 04-07. Seconded by Ms. Calvache and carried unanimously after the following vote:

Ayes: Romero, Mirisola, Calvache and Moore
Nayes: None

5. **Staff update on the contract status of the following investment managers selected:**
    a) **Northern Trust Investments, Inc. – Russell 1000.**
    b) **Merrill Lynch Investment Managers – Russell 1000.**
    c) **Fred Alger Management, Inc. – Large Domestic Growth.**
    d) **Intech Mathematical Investment Strategies – Large Domestic Growth.**
    e) **MFS Investment Management – Large Value Domestic Equity.**
    f) **Merrill Lynch Investment Managers – Large Value Domestic Equity.**
    g) **Global Transition Management/Bank of New York Brokerage-portfolio turnover services**

Ms. Bhatia introduced Item 5 as an update report on the status of the various contracts and the anticipated effective dates. President Romero inquired about Northern Trust Investment. Ms. Bhatia replied it was approved by the Board, but coordination needed to be done between the transition managers and the Plan's custodian bank and this should be in effect August 1, 2003.

Mr. Mirisola questioned what the problem is in terms of delays, and why signatures have not been obtained by all parties and if it would definitely be done by the effective date of August 1, 2003. Mr. Emkin stated he has never seen anything as complicated as the Plan's process in order to get contracts signed. Mr. Mirisola expressed his disappointment in the matter and how it has been handled, particularly the delays evidenced.
Mr. Wlkinson informed the members the contract with Northern has met with the approval of the City Attorney's Office.

Ms. Bhatia commented the City has many requirements in establishing a contract with a vendor and not all requirements are accomplished by those vendors, and this explains the delay. Mr. Mirisola pointed out he feels the Plan has lost maybe a couple hundred million dollars since the contract has been approved, because the money has not been invested while people sit and wait for signatures. President Romero explained, perhaps it was necessary to have a transition manager first, so even if the contracts were signed there still is no transition manager.

Ms. Bhatia elaborated on the transition contract drafts being sent back and forth, due to fiduciary issues. Mr. Mirisola questioned if the contract was completely done in the last couple of weeks, why hasn't Northern Trust gotten their contract for signature. Ms. Bhatia explained it has to go through transition manager. She added staff could have gotten the contracts signed without moving any money.

President Romero suggested moving on to Item B.

Ms. Bhatia reported the contract for Merrill Lynch was close to finalization. She stated Merrill Lynch requested their own agreement be attached to the Plan's contract and staff had to read through every line, to make sure there were no contradictions between the two documents.

Ms. Bhatia outlined item C & D. She stated Fred Alger and INTEC were the large domestic growth and those were also expected to be completed. She added both contracts have been worked on, issues resolved, and staff expect the contract to be effective August 1, 2003. She then commented item E & F are the large value domestic equity and the draft contract has already been sent out, but the final contract has not been completed. She commented BNY (transition), was just recently approved.

President Romero inquired if the contracts, starting with Fred Alger, down the list through BNY, are also scheduled to go into effect August 1, 2003. Ms. Bhatia replied affirmatively.

Mr. Moore questioned the termination provision of these contracts. Mr. Emkin replied there are 30 days provisions, but the Board can remove the assets at their discretion with no notice and would only be obligated to pay the fee for the 30 days period.

The Board meeting was adjourned at 11:25 a.m.

JAVIER ROMERO
President

DUAMEL VELLON
Secretary

SILVIA TESSENEER
Recording Secretary