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

MINUTES – April 7, 2004

Present:

Javier Romero	President
Lilly Calvache	Vice-President
Dan Mirisola	Board Member
Ron Vazquez	Chief Financial Officer
Michael Moore	Retiree Member

Absent:

Frank Salas	General Manager
Gerard McCallum II	Commissioner

Others Present:

Adriana Rubalcava	Acting Retirement Plan Manager
Sangeeta Bhatia	Assistant Retirement Plan Manager
Lesley Kuo	Investment Officer
Thomas Harrington	Retiree Consultant
Irene Colon	Recording Secretary
Michael Wilkinson	Deputy City Attorney
Sarah Bernstein	Pension Consulting Alliance
Neil Rue	Pension Consulting Alliance

President Romero called the meeting to order at 9:15 am after the Pledge of Allegiance.

[Pledge of Allegiance]

Ms. Rubalcava indicated there is quorum of the Board present.

PUBLIC COMMENTS

Ms. Rubalcava stated there were no public comments.

Mr. Moore stated it was not necessary to continue to have an Investment Committee Meeting and dual agenda since the Board cannot do anything now as an Investment Committee, given that the most recent Attorney's opinion relative to a quorum of four members required to be present to take an action. Ms. Rubalcava responded in the affirmative and stated the Plan staff will prepare agendas for the Regular and Special meetings only.

1. **Interviews and possible selection of an Investment Management Firm or Firms (From those responding to the Plan's Request for**

Proposal – Core Fixed Income Managers):

a. Aeltus Investment Mgmt., Inc./ING

Messrs. Joe Pickert, Senior Vice President, and James B. Kauffmann, Senior Vice President, of Aeltus Investment Management, Inc./ING approached the table.

President Romero acknowledged the representatives from Aeltus/ING Investment Management, Inc.

Mr. Pickert introduced Mr. Kauffmann and provided a brief background of the firm's success. He indicated that the firm consists of over 200 Fixed Income Managers and the firm is at the top 1% within the most recent three-year and five-year period, which is a tremendous performance over and above their peers and the benchmark. He also noted there was a half percent difference in return over the three-year or five-year period, which may not be that much in equity, but in Core Fixed Income it is a huge difference in their performance, which shows on a consistent basis.

Mr. Kauffmann pointed out the secrets to the firm's success are: 1) the team uses leverage technology to create an information advantage; 2) the team finds bonds at a discount to their long term value because of the enormous calculation engine that the information is processed through; 3) the team applies seasoned judgment to each bond before it gets into the portfolio, and it has to look cheap and be a good fundamental credit; 4) the team makes a lot of small right decisions and does not take a lot of risks on a big decision because there is not enough yield in the bond market to bail them out of a bad decision, and 5) the team uses state of the art risk management, specifically credit and quantitative risk management, ensuring proper portfolio exposure.

Mr. Vazquez asked what is their average number of holdings in terms of securities or companies and what is their maximum exposure. Mr. Kauffmann responded the firm does not want more than 2% in a specific company, but most of the firm's exposure is about half of a percent. President Romero clarified if their number of holdings was 316. Mr. Kauffmann responded that was all holdings, but that included mortgages and some government bonds. He explained that Corporate Bonds might run about 25% of the portfolio, which are about 75 to 100 holdings.

Mr. Vazquez inquired the firm's average credit rating and threshold in terms of credit ratings for buying securities. Mr. Kauffmann replied the average credit rating for these portfolios is AA. He stated he will not buy a portfolio or a security in a corporate portfolio that is not investment grade BBB or higher.

Mr. Vazquez inquired the firm's turnover percentage. Mr. Kauffmann replied the firm's organic turnover is 250%; but if the mortgage market were taken into consideration, then the portfolio turnover would rise to about 450%.

Mr. Vazquez asked the size of the portfolio that the Board would be looking at, in terms of clients and dollar value. Mr. Kauffmann responded the portfolio size is about

$750 million, but in the composite there is a little over $3 billon. He added his team manages roughly 60 billon dollars. Mr. Vazquez inquired if these were all separate accounts. Mr. Kauffmann replied that some accounts are commingled and some are separated. He explained the firm has different platforms depending on the preference of the client.

Mr. Vazquez asked Mr. Kauffmann to demonstrate the positives and negatives of the separated accounts. Mr. Kauffmann responded, when dealing with a large amount of money, a separate account would be more sensible because it could be tailored to the Board's specific needs; however, when dealing with small amount of money, the costs are less for a commingled fund because the firm can do it in bulk. He explained that if he had small portfolios he could put together, then he can buy and sell in bulk, which saves a little bit of money with each transaction.

Mr. Vazquez asked for clarification about the firm's 14 credit analysts. Mr. Kauffmann explained there are 14 different individuals, each with a very focused attention to an industry. He stated he has an aerospace analyst, retail analyst, banking analyst – each focused on a different sector of the market.

Mr. Vazquez inquired about the firm's longest holding in their portfolio in terms of the amount of time it was held. Mr. Kauffmann replied that the firm's turnover of the corporate holdings is very low; therefore he could hold a bond for years. He went on to explain that he has credits in the portfolio that are strictly corporate holdings and he will not sell unless they become so expensive because he is not paid to own the risk, or unless he sees something that disturbs him from a fundamental credit quality standpoint. Mr. Vazquez asked the firm's average duration of the portfolio.
Mr. Kauffmann replied the average duration of the portfolio was about four years, which changes a lot because the firm could be asked to run money to a certain index, and if that index changes, the firm may change a bit. Mr. Kauffmann stated the firm is never going to be more than half a year different in duration than the benchmark, which would be a big risk. He emphasized to the Board that the firm takes a lot of small risks instead of the big risks.

Mr. Moore asked if the firm has had to change the weight of the firm's investments to minimize the risk the firm faces of rising interest rates. Mr. Kauffmann replied in the affirmative and explained that for the first time since he has been with Aeltus/ING, the duration is positioned as short as it could be relative to the benchmark. He explained he is almost never half a year shorter than the benchmark but he is right now because the firm has had a substantial risk of rising rates. Mr. Kauffmann further explained that because of the substantial risk of rising rates, the firm is going to further shorten the average maturity.

President Romero inquired if the firm uses minority vendors for any business.
Mr. Pickert explained the response given to that question in the RFP was specific for the investment of the portfolio, for which they are not using any vendors, because they are doing it all in-house and there is no outsourcing. He stated that the firm does use minority vendors in their day-to-day dealings such as purchasing items. President

Romero further asked if the firm has any involvement in the community, colleges, outreach programs, etc. Mr. Pickert replied the firm is involved on a location basis. He explained that there are three main investment money management headquarters; in Hartford, New York, and Atlanta. He added the firm has its own foundation of Aeltus/ING that provides funds to various programs, and the firm encourages the managers to be on boards.

President Romero asked if the firm's fees were negotiable. Mr. Pickert answered the firm has definitely reduced their fees substantially for the Board. He stated they are negotiable and willing to work with the Board depending on the size of the mandate and what the Board wants from the firm.

President Romero informed Aeltus/ING representatives that if they are chosen, the Board wants to make sure that someone with authority at Aeltus/ING has reviewed the RFP insurance requirements and can guarantee that the firm can comply with the insurance requirements. Mr. Pickert stated the firm's insurance experts have provided a certificate of insurance, which is actually three different pages in the presentation handout, which complies, meets, and exceeds every one of the Board's insurance requirements.

Mr. Vazquez asked where the Aeltus/ING team was located. Mr. Pickert replied that 44 members of the team are located in Atlanta, Georgia. Mr. Vazquez also asked, in terms of the management procedure, what portion of the firm's return does the firm look for in securities to buy and hold versus those that the firm is looking for anomalies in the bond market to get excess return. Mr. Kauffmann responded the firm makes about two-thirds to three-quarters of the firm's return from securities selection. He stated the firm makes about 20% from sector rotation and they make the rest from yield curve and interest rate position.

President Romero thanked Aeltus Investment Management, Inc./ING for their presentation. The representatives of Aeltus Investment Management, Inc./ING thanked the Board and left.

b. Lincoln Capital

Messrs. Robert J. Schank, CFA, and Andrew A. Johnson, Managing Director, of Lincoln Capital, approached the table.

President Romero recognized the representatives from Lincoln Capital.

Mr. Schank introduced himself and Mr. Johnson. He provided a brief background of Mr. Johnson and the firm's performance. He stated the firm has 66 client relationships overall and has over $34 billon of assets under management. He indicated that the ratio of clients to assets is among the largest in the industry. Mr. Schank stated that the firm focuses on a limited number of large sophisticated clients and also a relatively limited number of products. He added in terms of the organizational structure of Lincoln Capital, they are a subsidiary of Lehman Brothers and have a close working relationship with a lot of independents with Lehman Brothers. He gave a brief history of how Lincoln Capital became a subsidiary of Lehman Brothers. He stated the organization consists of 28 investment professionals, which have about 12 years experience on average.

Mr. Schank briefly described the structure of the firm. He stated the firm has three general products lines: High Yield, Non-Investment Grade, and Cash Management. He explained that the High Yield product line consists of a team of 9 investment professionals, which have managed portfolios since 1997 with assets of over $2.7 billon, with 16 clients. The Non-Investment Grade product line consists of a team of 13 investment professionals who have managed portfolios since 1981 with assets over $26 billon, with 62 clients. Lastly, the Cash Management product line consists of a team of 6 investment professionals that joined Lincoln Capital in 2003 with assets over $5 billon and with 3 clients. He indicated that Cash Management is an organization that came abroad about 9 months ago and is headquartered in Boston, Massachusetts and reports to the people in Chicago, Illinois; and day-to-day they are very independent from management. He briefly mentioned the firm's clientele, which included LACERS, Santa Barbara County, Merced County, as well as Sacramento County. He also briefly mentioned the firm's professional investment grade team, which is headed by Mr. Johnson, and is directly responsible and supported by a research group of 5 Senior Analysts, as well as 4 Junior Analysts, and 2 trading experts.

Mr. Johnson explained how the enhanced index works, which is the product they are presenting to the Board. He indicated that the firm's objective is to add 15 to 25 basis points to a broad benchmark and, at the same time, to minimize the probability of underperforming. He explained the two ways the firm adds value to the product are: 1) issue selection, which is choosing Bond A over Bond B because of the characteristics that make Bond A better, from which the firm gets 10 to 15 basis points or 5-70% of the value added over time; and 2) the spread related factor, which means making asset allocation decisions, such as whether the portfolio is going to be over-weighted in corporate bonds versus treasuries, from which the firm will probably get 5 to 10 basis points a year or 30-50% of the value added. Mr. Johnson stated, that in terms of risk control, which is a big factor in the firm's process, the team diversifies the corporate portfolio, such that risk should be a non-event to the portfolio. He continued to state that the team's typical size as a percentage holding in a corporate bond is 2%, so that is very small. Mr. Johnson emphasized that the team does not take large risk with respect to single issued corporate bonds; also however, in terms of the shape of the yield curve and level of rates, the firm takes low risks, so the firm is yield curve and duration matched at all times in this product.

Mr. Johnson briefly summarized the enhanced bond indexing returns of the firm since inception, which is about 15 years. He stated within one year, the team has added 35 basis points, in 3 years 22 basis points, and in 5 years 20 basis points, which is in the middle of what the team is expecting to earn in this product.

Mr. Johnson stated the firm believes that a consistently applied investment process is critical to producing consistent performance. He explained the first step in the process is Portfolio Strategy and Risk Budgeting, where the team determines what the sector allocation or sector weights are going to be, what the strategy theme is going to be within those sectors, and what level of risk the team is going to be taking. So it is in this first step where the team explicitly decides how much risk to accePt in the portfolio. Mr. Vazquez asked Mr. Johnson what he meant by "themes". Mr. Johnson gave an example of a theme as: in the corporate sector, the team views that financial companies will do better than industrials, so the team would express this theme, or idea, by over-weighting financials relative to the benchmarks. He continued to explain step two in the process, stating that "Sector Research and Valuation" is very critical to the first step; here, the team determines its expectations within the firm for returns within each sector. He added that this process is an ongoing process, and the sector teams look at their evaluations at least once a week. Mr. Johnson explained that the third process is "Issue Selection" where the team spends a lot of time in every sector trying to own the cheapest bonds, i.e., the best bonds a portfolio could possibly own. Mr. Vazquez inquired about the type of analysis the team uses. Mr. Johnson gave an example from the mortgage sector: the team spends a fair amount of time looking at specific mortgage pools to decide what their prepayments are going to be. He elaborated on this further by stating if someone has a premium mortgage – one that trades above 100 or above par, it is bad for them to get prepayments back because they get par back for something worth like 104 –105. The team spends a lot of time mining pools to decide which ones are going to prepay slower. Mr. Johnson explained the final step, which is "Portfolio Construction and Risk Management", where the team decides what the sectors weights are going to be, what the issues are going to be, and the team has to manage the risk in the portfolio. He informed the Board that he receives a report for every portfolio every day in terms of what its risk exposures are, which are looked at by a team separate from the portfolio managers, as well as the portfolio managers.

Mr. Johnson also explained the asset allocation and risk budgeting process. He stated there are two things involved in this process: Client Risk Tolerance and Investment Guidelines, which require the team to ask how much tracking error the client is willing to allow the team to have (example, 20 basis points, 25 basis points), as well as their guidelines, which when combined with the team's forecast for all the sector returns, determines where the portfolio should be in terms of sector weights, corporates, mortgages, treasuries, agencies, etc.

Mr. Johnson explained the investment process, especially with respect to the corporate market. He stated that the team's current view of the corporate market is that the fundamentals are good and profitability and cash flow is improving. He continued to state, that longer term, the team believes that corporate spreads will be determined by how well the economy does – the team is constructive on the economy, which is good for corporate bonds; so in fact, they have a modest overweight in bonds in wirelines, autos, wireless and the media/cable sectors. Mr. Vazquez asked Mr. Johnson what he meant by "modest overweight" and what percentage of the portfolio is invested in corporates. Mr. Johnson responded he was talking in terms of risk exposure and dollar duration. He explained that this was the result of multiplying the percentage weight times the duration of the portfolio. Mr. Johnson stated that at this point, the team has an overweight in corporates of 0.15 years of dollar duration.

Mr. Johnson spoke about Lincoln Capital's Risk Exposure Framework, which is internally maintained and process generated, whereby the team calculates risk for every bond in the portfolio and every rate of return in the index. He stated the team looks at 67 different factors, and at the end of the day, they can very precisely control all the risk in the portfolio.

Mr. Johnson summarized why this is a good product. He indicated it is an ideal core bond investment program that has low administrative oversight, with no surprises, a highly liquid portfolio, and low fees. Secondly, they have had a consistent and disciplined investment process. He emphasized that they have an experienced and highly qualified investment team. Mr. Johnson expressed another point why the product is good is due to the consistent performance. He explained that the returns are equal to or greater than the benchmark for 47 of 62 quarterly periods (76%) and 56 of 59 annual (rolling four-quarter) periods (95%). He added the firm could customize the risk/return profile to fit a client's needs.

Mr. Schank informed the Board of the firm's fee schedule, which would be about 4 ½ basis points per year. He stated that, the parent company has reviewed the insurance requirements and they are 100% on board in regards to the items required by the Board. Mr. Schank stated that Lincoln Capital has had a program since 1992 that deals with brokerage firms owned by minorites, women, etc. He added that it is not easy in bond land when best execution is paramount on every trade that is made. He emphasized that Lincoln Capital is trying very hard to support these types of firms as much as they possibly can, but when best execution is on the table, there may be other investments in the portfolio easier to do than bonds. He stated, however, that it does not mean they will not try as hard as they can to satisfy the Board's requests.

President Romero asked Mr. Schank if Lincoln Capital utilized women and minority owned businesses as vendors and if they were involved in the community. Mr. Schank indicated the firm's staff consisted of different nationalities and gave the example of Andrew A. Johnson, Managing Director of Lincoln Capital, who is African American. He mentioned that Lehman Brother's plays an extensive role in the community and that some members of the Chicago location are involved in numerous types of community organizations.

President Romero inquired if Lincoln Capital's fees were negotiable. Mr. Schank responded in the affirmative. President Romero then asked if Lincoln Capital was indeed located in Chicago, and Mr. Schank confirmed they are located in Chicago.

Mr. Vazquez asked what guidelines does Lincoln Capital follow in terms of how far they can be from the index, in terms of duration to the benchmark. Mr. Schank answered that, in terms of duration, Lincoln Capital has to be within 0.1 years. Mr. Rue explained that, in contrast to the other managers, Lincoln Capital manages risk the tightest to the benchmark on both the duration and the yield curve. Mr. Vazquez asked what role treasureries played in the portfolio. Mr. Schank responded that when the team wants to be over weighted, in corporates and asset backs, the team typically sells treasuries to achieve that overweight. Mr. Vazquez inquired what the percentage of holdings were in corporate and asset backs. Mr. Schank explained corporates are roughly 27% and asset backs are 8-10%. Mr. Vazquez then asked if they have guidelines on the percentages. Mr. Schank responded that they do not have strict guidelines on percentages because they see it in terms of dollar durations and they do have guidelines in terms of dollar duration. He stated they have guidelines in terms of how much they can own of any issued bonds, which are very strict. Mr. Vazquez asked for clarification on the percentage per corporate issue. Mr. Schank informed Mr. Vazquez it was 0.2% on average. Mr. Vazquez asked what the overall average was for the portfolio in terms of bond rating. Mr. Schank explained the Lehman Brothers and the portfolio are rated AAA.

Mr. Moore asked for the firm's average turnover. Mr. Schank answered, stating they tend to turnover a portfolio a little over 100% once a year. Mr. Moore inquired if the firm considered bidding on another product, and if not, what were the arguments in favor of taking this approach, as to say a slightly more aggressive approach where the team is not as technical. Mr. Schank explained there was another product the team would have considered but it has a track record of only 3 ½ years long with 50-75 basis points of value added. He further explained that the reason why they did not offer the product was because it does not have the five year track record, which the team thought was paramount. He stated the team's active product, which is much more active and uses more duration, did not fit with what the Board was looking for. Mr. Rue added, in fairness to Lincoln Capital, that was based on the advice of the consultant who thought it would be a good product to look at in the spectrum of the products the Board was looking at, in terms of being very tight to the benchmark, and complimentary to the other products as well. Mr. Schank indicated that the more active product he was discussing is the Structured Core. He stated that the team has four accounts – ($1.6 billion) in this higher-octane product but it does not have a five-year track record. Mr. Moore questioned if the firm has changed, or were significant changes made to take into account the risk of interest rates rising. Mr. Schank explained that the product by its construct takes no duration risk. He added there is little the team can do because they cannot be shorter than the benchmark; however, in the Structured Core, they can afford to be shorter.

President Romero thanked Lincoln Capital for their presentation. The representatives of Lincoln Capital thanked the Board and left.

Evergreen Investments and Principal Global Investors were originally scheduled to be interviewed next, but both investment firms declined the interview; therefore, Wells Capital Management and Smith Breeden were interviewed next.

President Romero called for a brief recess at 10:20 a.m.

[Recess]

The Board meeting interviews reconvened at 10:22 a.m.

c. Wells Capital Management

Mr. Thomas A. Harrison, IV, CFA, Senior Managing Director, Mr. Kirk D. Hartman, Chief Investment Officer, Ms. Marie A. Chandoha, Senior Portfolio Manager & Managing

Director, and Ms. Sandra M. Willen, CFA, Managing Director of Wells Capital Management approached the table.

President Romero recognized the representatives from Wells Capital Management.

Mr. Harrison introduced himself and the Wells Capital Management team. He introduced himself as the Senior Managing Director for the Los Angeles location for Wells Capital Management. Mr. Harrison introduced Mr. Hartman as the Chief Investment Officer of Wells Capital Management and indicated Mr. Hartman's responsibilities include managing the 12 investment teams that manage the products within Wells Capital, which include all resources that Ms. Chandoha and her team have at their disposal. He introduced Ms. Willen next and indicated she also works in the Los Angeles location of Wells Capital. Mr. Harrison added she is a 25-year veteran in the investment management business and has a lot of experience in the public fund area and she is focused on the client service or client relationship side of the business. He informed the Board that if the Board chose Wells Capital Management, Ms. Willen will be the lead client relationship person. Mr. Harrison stated he will introduce Ms. Chandoha later in the presentation.

Mr. Harrison communicated six points that Wells Capital can deliver to the Board in reference to the product as well as an overview of the company. He stated that Wells Capital Management's parent company, Wells Fargo, has a local commitment to Los Angeles, which is the largest corporate giver to the LA community by a factor of 40%, giving over $10 million to Community Development, Education and Human Services charities and organizations. Mr. Harrison noted that Wells Capital has a local commitment to the Board and indicated the investment management team can deliver all the services beyond managing fixed income including a broad array of services to meet the Board's need in working with the Board's consultants. He also informed the Board that Wells Fargo ranked 17 of the top companies in the country in the area of diversity by Diversity, Inc., although Wells Fargo's goal is to be in the top 10. He stated that as far as inclusion is concerned, the team continues to expand the business efforts with minority and women owned brokerage companies. Mr. Harrison conveyed that the Wells Capital Management team maintains its strong business integrity and avoids the controversies of market timing, which helps maintain their AAA rating. He communicated to the Board, as noted in their proposal of February 28th, 2003, the insurance language detailed in the RFP is acceptable language to Wells Capital. He added he submitted a letter from the President of Wells Capital confirming that the firm adheres to the language of the insurance requirements verbatim. He concluded, stating Wells Capital has the best performing Core Fixed Income Strategy, utilizing a sound investment process that is managed by smart people. He briefly introduced Ms. Chandoha as lead of the Core Fixed Income team, along with her partner Mr. Bill Stevens, and stated they are located in Walnut Creek, California in the Bay area. Mr. Harrison added she was formerly with Goldman Sachs and she has spent 10 years with First Boston, in charge of 100 Fixed Income credit analysts around the world.

Ms. Chandoha conveyed the firm's investment philosophy. She stated that being in the bond business for a long time has shaped her and her partner's convictions about the best way to generate consistent performance in the bond market through a bottom –up process. She added the team focuses on identifying pockets of value and backing that up with excellent execution. Ms. Chandoha indicated the team feels it is much easier to gain a competitive edge identifying mispricings in the market. She also stated they are able to generate consistent performance through a team with deep experience in the bond markets. Ms. Chandoha emphasized the team's credibility by mentioning the team members have all distinguished themselves at other firms before joining Wells Capital Management. She stated the experienced team is also supplemented by a rigorous investment process and tight risk controls. She added the team also generates their consistent performance by making a lot of small bets – they are focused on hitting singles and doubles and not trying to rely on a few key positions to generate the team's performance. Ms. Chandoha noted the team is focused on investment grade liquid bonds. She added if the Board were to look at the portfolio over time, they would not see any esoteric or illiquid bonds in the portfolio.

Ms. Chandoha referred to a chart, on page 7, showing the teams performance on an annual basis since inception. She indicated the firm has outperformed their benchmark in each year, since 1990, which continued in 2004 so far through the first quarter where they outperformed their benchmark by 24 basis points. She stated that the investment team's performance indicates the investment style of the team. Ms. Chandoha revealed the firm's outperformance or underperformance versus the benchmark, on a quarterly basis, through a graph on page 8. She pointed out the team has only underperformed the benchmark in three quarters since inception. Ms. Chandoha pointed out that the bars below the line show the limited downside risks, which she attributes to the firm's risk management and risk tools. She indicated the team's style is not dependent on a certain kind of market; rather, the team can find dislocations across different types of market places, so that helps generate the consistency of the team's performance.

Ms. Chandoha introduced the firm's investment and client service team. She introduced Mr. Bill Stevens as the architect of the investment process who has been with the team for 12 years. She continued stating he started his career on Wall Street where he traded or managed mortgage-trading desks at three Wall Street firms. She stated he earned his MBA at Harvard. She indicated they hand picked the senior members of the team, and they look for deep experience in the bond markets. Ms. Chandoha indicated that every senior member of the team has at least 15 years of experience in bonds. She introduced other members of the team who are highly involved on a daily decision making basis and mentioned their credentials. She pointed out that this team is dedicated to the active core product that the Board is considering.

Ms. Willen emphasized that Ms. Chandoha has indicated that generating excess return for the clients is a key component of the firm's investment philosophy. The firm takes pride in how they service their clients and they are privileged to work with public agencies, as well as joint trustee and corporate pension plans. She added that for the Core Fixed Income clients, the average size client is about $225 million. She emphasized, if they were given the opportunity to be selected as one of the Board's Fixed Income managers, she will be responsible for the relationship and have the primary day-to-day contact with the Board. She also emphasized, as Mr. Harrison mentioned, that knowing their clients is important to them, which does not end when clients are no longer prospects – it is very much a part of the long-term relationship. She stated Mr. Harrison and herself will continue working together to service the Board's communication needs.

Ms. Chandoha explained the team's investment program through the bottom up process, which is performed within rigorous constraints. She indicated the bottom up process consists of three factors. The first factor is a well-defined securities universe, where the team searches for relative value. The well-defined securities universe is tied to the benchmark, and the team looks to the benchmark for those securities. She added they focus on subsectors of the market where the team feels they can find the best risk/reward. Ms. Chandoha stated the second factor that frames their investment process is the team's risk management tools, which help make sure the team is not making any excessive or uninvited bets in the portfolio. She mentioned the third factor of the bottom up process is when the team takes very limited interest rate exposures, although most clients allow them to take bets of ±10% of the benchmark in interest rate risk. She stated, however, that the team generally keeps that to ±2% and most times they are not taking that kind of bet.

Ms. Chandoha described the types of securities Wells Capital Management invests in. She stated the team focuses on high-grade liquid bonds, mortgages, treasuries, asset backed securities/CMBS, agencies, U.S. credit and CMOs. Ms. Chandoha explained that in some sectors of the market, where there are a lot of issuers of specific risks, for example corporate bonds, the team has a more diversified portfolio. She stated that a lot of the team's investment guidelines allow them to invest up to 5% in any one corporate name, but their average position size in corporates is a little less than half a percent, and a large position for them is 1.5%. Ms. Chandoha stated that, on average, the team holds between 60-80 corporate positions.

Ms. Chandoha touched upon the investment process and types of instruments the team buys. She stated the risk tools are really what makes their process replicable and what helps preserve the performance they worked so hard to get. She indicated that the risk tools have been part of their process since 1994 and it is something they use on a day-to-day basis. Ms. Chandoha explained that every time they make a trade, it updates intra-day and reflects back what their risk exposures are. She stated that at the highest level, the risk tools allow them to slice and dice their portfolios across 11 risk dimensions. Ms. Chandoha elaborated that on a more micro-level, their risk tools allow them to delve into each sector of the market, for example corporate bonds, how they are positioned in each industry versus the benchmark, and within each industry what names they are in and how they are positioned. She pointed out that, although they are bottom up, they pay a lot of attention to the benchmark and what kinds of risk exposures they are taking to the benchmark and make sure they are not taking too large a risk versus the benchmark that could compromise their performance.

Ms. Chandoha stated all of the portfolios are managed on a "team approach"; hence, all of their portfolios are managed identically. She explained that their risk systems ensure that all of their client's portfolios are managed in the same fashion. Ms. Chandoha reiterated that they are a close-knit team and they have a lot of daily discussion with the team about the markets and relative value. She stated the team has regular meetings, quarterly and weekly, where the team reviews the markets and the portfolios, and in these meetings they set target levels as to how they want to be positioned. Ms. Chandoha gave an example of the decision process. She stated, that for example in corporate bonds, if they want to be positioned and have a slight overweight versus the benchmark of about 3%, they may set a range around ±2%, and the sector specialists then have the autonomy to go and look for relative value and find dislocations in the market as long as they stay within the target or target ranges that they have set in the risk tools; these targets appear in their risk system. She emphasized that Mr. Stevens and she are ultimately responsible for all the decisions that happen in the portfolio.

Ms. Chandoha concluded stating the firm's culture is one of excellence and outperformance. Every day the team comes in looking to outperform the benchmark. If selected, the Board will know they will be working hard to generate that performance with a handpicked team using their comprehensive risk controls, picking one bond at a time.

Mr. Vazquez inquired about the one client Wells Capital Management lost.
Ms. Chandoha explained it was an insurance client who took their money management in-house.

President Romero asked if Wells Capital Management's fees were negotiable.
Mr. Harrison answered in the affirmative.

President Romero also asked if the management team was located in Los Angeles, to which Mr. Harrison answered yes and explained the management of the product is in Walnut Creek in the Bay area, and they have a major office which deals with the servicing side in Los Angeles.

Mr. Moore raised a question having to do with what they felt they would have to do given the fact that the market has historically low interest rates. Ms. Chandoha explained that the team's goal is to outperform the benchmark and the bigger issue is the contraction of credit spreads in the market. She stated that last year the team saw very wide credit spreads, particularly in corporate bonds, and corporates performed very well and now yields for all products are very, very tight; so it is hard to find relative value but it really goes to show the team's strength of finding the dislocations in the market and adding value by looking for those dislocations and monetizing them.

Mr. Moore asked what the percentage turnover was in the portfolio. Ms. Chandoha answered their turnover is between 2 ½ and 3 ½ times, which is in the realm of an active core manager.

Mr. Moore inquired what risks are presented, given the fact that it is a very different weighting than the index itself. Ms. Chandoha explained that, when looking at a portfolio on the dollar basis, with so many dollars in mortgages, it seems like the portfolio is overweighted versus the benchmark, but when the team manages the risk of the portfolio, the team is looking at how risky those instruments are versus the mortgage index, and the team buys very conservative mortgages, so the team is not going to have the same risk profile as the mortgage component of the benchmark. Mr. Harrison further explained there is another example where there is an option of a 2-year treasury or a 30-year treasury, which are both treasuries, but the 30-year treasury is going to be a little more risky. Ms. Chandoha continued to explain they focus on very conservative bonds, so they can buy more of them but they do not carry as much risk as the higher risk instruments.

Mr. Vazquez asked where does the duration of the portfolio stand now versus the index. Ms. Chandoha stated it is 0.4 years short versus the benchmark, which is very tiny. Mr. Vazquez also asked, in terms of total returns, what percentage does the team get from yield of core holdings versus mispricings in the market. Ms. Chandoha responded they have been computing a daily attribution in the last four years, and about 85% of the outperformance comes from security selection, about 10% comes from sector contributions, and the rest from duration or yield curve positioning – which is the average over that period of time. Mr. Harrison stated this affirms the bottom up value approach to security selection.

President Romero thanked Wells Capital Management for their presentation. The representatives of Wells Capital Management thanked the Board and left.

d. Smith Breeden

Messrs. Eugene Flood, Jr. Ph. D., President and CEO, Charles C. Field, Senior Associate of Client Servicing and Marketing, and Jay A. Gladieux, Product Portfolio Manager from Smith Breeden Associates, Inc. approached the table.

President Romero recognized the representatives from Smith Breeden Associates, Inc.

Mr. Flood shared a brief history of Smith Breeden Associates, Inc. with the Board. He spoke about the founder and Chairman of the firm, Mr. Doug Breeden. Mr. Flood stated that overall the firm has 30 billion in assets under management. Mr. Flood communicated that the firm is privately owned by the employees, so there is no conflict where there is no broker dealer or a big retail arm. He continued stating that the firm is very focused on institutional investment management. Mr. Vazquez asked, aside from the 13 billion in asset management, where is the rest. Mr. Flood replied that the rest was in their advisory business where they advise banks, so there are 17 billion of assets under management that they advise for banks. He indicated the diversified group of clients and fund investors include corporations, foundations and endowments, public funds, Taft-Hartley funds, government sponsored enterprises, and non-U.S. institutions, which consists of a short list of firms that have been with Smith Breeden Associates, Inc. since 1982. Mr. Flood explained that the reason for the short list is due to a comprehensive selection of clients where there is a really good fit. He emphasized the firm has not lost a client due to performance in the history of the firm, and clients stay with the firm for a long time because they try to deliver on what the firm promises. Mr. Vazquez asked what number of mandates or portfolios does the firm have under management and which one is Smith Breeden Associates, Inc. presenting to the Board. Mr. Flood replied the firm has about 25 or 30 separate mandates and the Core mandate is what is being presented to the Board. Mr. Flood described the firm's investment team as having a long-term commitment to research, and they have a number of people on the investment team who come from academic backgrounds, some of whom have both joint appointments with universities and with the firm. He pointed out the firm has organizational stability which rivals anybody in the financial service industry. He introduced the investment team that would be working with the Board as follows: himself, Mr. Field, Mr. Daniel C. Dektar, Chief Investment Officer, Mr. Timothy D. Rowe, Senior Portfolio Manager, Mr. Gladieux, and Ms. Marianthe S. Mewkill, Chief Operating Officer.

Mr. Gladieux described how the firm's core investment grade strategy seeks to add 50 to 100 basis points of annualized excess return with an information ratio of 0.75 or better, which means the team targets a very consistent return over time. He mentioned the investment grade core strategy invests in investment grade securities and is benchmarked to the Lehman Brothers Aggregate Bond Index. Mr. Gladieux shared that the team's performance results generated positive gross excess returns in every calendar year since inception on October 1, 1994. He stated that the team's three-year annualized gross excess return of 77 basis points, with an information ratio of 1.61%, is much better than what the team targeted. Mr. Gladieux said that the team focuses primarily on security selection in sector allocation decisions. He explained that the team tends to not take significant duration and interest rate, yield curve or volatility bets, which are more risky, less predictable sources of return.

Mr. Gladieux stated the team's investment process blends fundamental and quantitative research with experience and judgment to create results. He stated that, in research, the firm's investment team has developed quite a reputation for fundamental economic work. Mr. Gladieux said that they are also very well known for their quantitative analysis. He emphasized that key members of the firm's research staff are quite well known in academic communities. Mr. Gladieux stated that the research, particularly in regards to understanding portfolio risk, corporate risk, valuation in mortgages, and option adjusted spread analysis, and a very innovative approach to performance attribution, is quite different than virtually all managers on the street and it is the core of what leads the team to this control of risk and very consistent performance results with no surprises.

Mr. Gladieux explained another aspect of this research approach is that the team constantly challenges their assumptions. He stated, the team has models that look at risk, help build efficient portfolios and size positions, but the team's performance attribution is independent of all of the models used in building portfolios – it is an independent check. Mr. Gladieux stated they go through a very disciplined attribution process every month and use that to drive the continued refinement and evolution of the team's analytics.

Mr. Field shared reasons why Smith Breeden would be a good fit for the Board. He stated Smith Breeden has had positive excess returns in every calendar year since it's inception on October 1, 1994; the firm has a long history and a deep commitment to research; the team that has developed a record will be the team working for the Board; and most of the team has worked together for over a decade.

President Romero inquired about the diversity program of Smith Breeden and asked if there was diversity within the firm's workforce and subcontractors. Mr. Flood responded there are no subcontractors but brokers are chosen based on best execution, which the firm defines broadly so that it includes not only trading execution but also research and dealing with problems like fails, etc. President Romero asked if there is any involvement with community colleges. Mr. Flood responded the firm is quite active in that area. He stated that he personally sits on four different boards and he thinks this is important for personal reasons – building minority presence in investment management is something that he has been actively working on for the last 18 years. He continued saying he sits on the board at the business school at MIT, at the board of the economics department at MIT, on the board of visitors with the University of North Carolina, Chapel Hill, and the board of the Fuqua School of Business. Mr. Flood stated that in addition to his involvement in boards, the firm is constantly working at building minorities into the pipeline and the firm also helps to sponsor each year the LEAD program, which is for minority high school students who are interested in business and this is done through Duke University.

President Romero asked if Smith Breeden has carefully looked over the insurance requirements, and can assure the Board that they will comply with all the insurance requirements. Mr. Flood replied yes they would comply with all the insurance requirements. He continued that they are prepared to meet those requirements, inclusive of the waiver of subrogation. President Romero asked if the fees were negotiable with which Mr. Flood answered in the affirmative. He stated that he would like to point out that the fee schedule presented before the Board, is the normal fee schedule for up to $20 million of errors and omissions insurance. He proposed that to meet the $50 million requirement what they would do is change the break point in this fee schedule from the $500 million, as the first break point, to $800 million, to help to defray some of the costs. President Romero clarified if this team would be located in Chapel Hill, North Carolina. Mr. Flood responded yes it is, and the firm has two offices in Chapel Hill, North Carolina and one in Boulder, Colorado, which serves as the west coast office. The headquarters is Chapel Hill, North Carolina.

Mr. Vazquez inquired if they had any guidelines in terms of the duration of the portfolio versus the index. Mr. Gladieux stated that typically the team runs the duration of the portfolio very close to the benchmark but, in terms of guidelines, the team could vary it as much as a quarter of a year, but they do not seek to generate excess returns through their duration positioning. He continued stating they find more predictable results leveraging their analytics in the relative values securities selection decisions. Mr. Field added, they mentioned having a lot of academic background with a number of Ph.D.s and MBAs, but the one thing the team is smart about is that they know they are not smart enough to forecast interest rates, and they do not think anybody can do that so they keep a very tightly controlled duration.

Mr. Vazquez asked how many securities were held. Mr. Gladieux quoted roughly around 200 in a portfolio, depending on what time and the type of sector you are in. Mr. Vazquez asked for clarification as to where they stand now versus the index. Mr. Gladieux stated they are fairly conservatively positioned – that does not mean they are

overweighted in treasuries rather than underweighted in treasuries, but they have AAA asset backed securities and AAA commercial mortgage securities, and they are overweighted in the AAA residential mortgage securities. Mr. Vazquez asked the representatives to briefly describe the macro factors and how they identify them. Mr. Gladieux explained that macro factors are when interest rates go up and down, the yield curve changes shape, and changes in volatility, which has to do with in the team's quantitative analytics. He stated that a great deal of the team's focus is in very precisely measuring those exposures in the portfolio, understanding their dynamics, and the interplay of the dynamics between duration, interest rate slopes, volatility, changes in interest rates, the swap market, changes in prepayment assumptions, and understanding the interplay so the team can properly position the portfolio to avoid unexpected results from those market factors which can impact a portfolio.
Mr. Vazquez asked if by these, he meant he was looking for pricing aberrations of a particular bond. Mr. Gladieux responded that, in securities selection, the team constantly looks for undervalued bonds and that is where their focus is. He said they are very good at valuations in the mortgage sectors and relative values between coupons and mortgages and between different types of mortgages. He stated the team is exceptionally good at understanding credit risk exposure and credit evaluations, which kept them out of the problems of the credit meltdowns over the last number of years, and that is one of the reasons why the team has performed so well relative to the their peers and has such a strong record.

Mr. Moore asked what the average turnover of the portfolio was. Mr. Gladieux responded it ranges from 60-125%, and averages a little over 100% but the team tends to play very active and very liquid sectors, which is their particular strength. Mr. Moore inquired if they are focusing on government backed mortgages as an important component, as well as analytics. Mr. Gladieux responded in the affirmative. He stated if the Board was to look at the firm's tradition and what they are known for, people are very well aware of their cutting edge research in mortgage analytics. Mr. Gladieux stated that in fact, Mr. Breeden, the founder of Smith Breeden Associates, Inc., was really the active vanguard of developing options, adjusted spread analysis, and understanding mortgages, and he did that research and developed that approach in the mid-1980s – way before anyone else in the market. Mr. Moore asked what in the last year did the team do in recognition of the historically low interest rates, and what difference did that make. Mr. Flood answered that the macro team, which he runs, had called the slow down of the economy early on. He stated the team has closely observed this falling interest rate environment that the nation has experienced over these last several years. He explained that one of the consequences of these low rates, is that prepayments on mortgages are at record highs, and so, as owners of mortgage back securities, it can typically hurt when interest rates go down, because typically capital is given back just at the wrong times, when interest rates are going down.
Mr. Flood continued that the key to how they managed portfolios over this last year and a half was to find mortgage back securities that were relatively insensitive to falling interest rates. He said the focus of the research was to find those securities that did not prepay quickly when rates went down, which fell into several classes which they bought for their clients and made very good profits. Mr. Moore asked what typically are those types of securities. Mr. Flood gave an example of a low loan balance security and stated it was a mortgage back security that has very low sensitivity. Mr. Gladieux added

the firm's research is proprietary, so as a result it gives the team an independent view of value, and they can identify the value before other players in the market.

President Romero thanked the representatives of Smith Breeden Associates, Inc. for their presentation.

The representatives of Smith Breeden Associates, Inc. thanked the Board and left.

President Romero called for a brief recess at 11:24 a.m.

[Recess]

The Board meeting interviews reconvened at 11:34 a.m.

President Romero asked the Board members to share their comments and preferences of which firm to choose for the Core Fixed Income Portfolio Manager. Mr. Moore stated he would pick Aeltus/ING and Wells Capital. He noted they have the highest return on both a 3-year and a 5-year basis. He also particularly likes the fact that Wells has as much local involvement as it does, but the two seem to be outstanding firms. Mr. Moore explained that Lincoln Capital is doing what it is supposed to do, but it seems the Board can get more if the Board were to go with the other two. He added that Lincoln Capital is just a different type of player because they are bidding essentially just on an index fund.
Mr. Moore explained that while Smith Breeden has pretty good numbers all on its own, it has got a slightly higher risk.

Mr. Mirisola stated his preference was the same as Mr. Moore's choices; however his reasons were different. He explained that Lincoln Capital's fee would not even pay for the difference in the outperformance of the index. Although they were all very good, Mr. Mirisola stated, he thought, according to PCA's documentation, that Smith Breeden and Aeltus/ING are making their money the same way. He continued stating that Aeltus and Wells are making their money through different methods. He pointed out he would like to hire investment managers who are diversified and outperformed the index, which they have both equally done.

Ms. Calvache stated the order of the firms she preferred, starting with Aeltus/ING, Wells Capital, Smith Breeden, and Lincoln Capital. She likes the fact that Wells is local and Aeltus/ING has pretty high returns.

Mr. Vazquez stated he liked Wells Capital and Aeltus/ING. He was particularly intrigued by Aeltus/ING's methodology for selecting securities.

President Romero stated the Board members have good rationale for their choices – the requirements are there, the diversity is there; however, he had one problem with Aeltus/ING in that they did not have a good minority diversity program. He stated he was content with going with the decisions of the other Board members if that is what they are comfortable with.

Mr. Mirisola mentioned the Board Resolution requested voting on an alternate manager, to which he would choose Smith Breeden. Mr. Rue informed the Board that Smith Breeden was hedging on the insurance requirements because they are a boutique firm. Mr. Moore moved selection of Aeltus/ING and Wells Capital Management, Inc. and Smith Breeden as an alternate for Core Fixed Income Managers. Seconded by Mr. Mirisola and carried unanimously after the following vote:

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

2. **Consideration and possible selection of alternative investment manager for International Developed Market.**

Ms. Rubalcava introduced Item 2, stating it had already been discussed at last month's meeting. She explained the resolution was being brought forward for approval along with an email handed out this morning which discusses Delaware still having a $10 million gap in their insurance. She stated staff was requesting that the Board select an alternate manager for the International Developed Market in case the situation is not resolved, or to appoint the Boston Company or Lazard Freres.

President Romero inquired how the Board felt about the issue. Mr. Moore inquired how important the insurance coverage was with respect to this matter. Mr. Vazquez responded he believed DWP's insurance requirements versus what is standard in the industry are way too rigorous. He expressed that if the Board does not address this matter now, it will become more of a problem in the future when the Board looks to change managers and a lot of the firms do not carry that level of insurance.
Mr. Vazquez added the insurance is too expensive to purchase in the marketplace and makes it economical for them to make it up through higher portfolio management fees. He stated, as a result, it may seriously limit the number of very good firms the Board can consider and restrict the Board's ability to get the best performers in the market. Mr. Vazquez noted that Earnest Partners would have to significantly increase the management fee to at least cover a portion of the additional cost. He suggested the Retirement Board revisit the insurance requirements for errors and omissions. He stated he knows what the risk management group has recommended, but he feels it is too excessive and he would like to see the insurance requirement trimmed back to a $20 million level.

President Romero inquired if this was the amount of the City's insurance requirements. Mr. Vazquez responded the City was all over the place in numbers and some managers do not have any insurance requirements at all. Ms. Bernstein (PCA) concurred with Mr. Vazquez, adding that Los Angeles City's Employee Retirement System looks at what the standards are for each manager it selects and then decides the insurance requirements based upon the mandate and the size of the company.

President Romero inquired what PCA's position was on this issue. Ms. Bernstein stated that for a long time PCA has agreed with Mr. Vazquez's position, and a year ago they submitted some information to the Board regarding the insurance standards for managers indicating that LADWP was far more stringent than other large ($1 billion plus) public pension funds. She noted PCA has had to weed out managers who were ranked number one because they did not meet DWP's insurance requirements.

Ms. Calvache asked Mr. Vazquez why the Plan had such high insurance standards and has it always been this way. Mr. Vazquez requested Mr. Avery Neaman (Risk Management) to approach the table to discuss the issue.

Mr. Avery Neaman approached the table.

President Romero recognized Mr. Neaman.

Mr. Vazquez noted the Board has found that many firms could not meet the $50 million errors and omissions limits that were adopted. He indicated a lot of top performers and large money managers for public funds nationwide do not cover those types of limits and they have expressed it is cost prohibitive for them to do so and manage the Department's funds at a reasonable management fee. He stated the question is when looking at the universe of public funds and what the standards are for insurance, why are DWP's requirements much more excessive than other funds. He added he was not sure what the experience has been in this industry in terms of losses that might be covered by this type of insurance and asked if Mr. Neaman had any ideas about this. Mr. Neaman responded, a couple of years ago, there was a loss where a money manager on the East coast had to pay out $500 million after litigation. He clarified risk management did not set the $50 million insurance requirement arbitrarily, but by a study in which PCA was involved, and he stated he views this as a reasonable requirement in light of the size of the mandates and the recent claims history. He indicated he believed that the errors and omissions coverage was far more important than the crime coverage, for which the City set a limit of $50 million.

Mr. Vazquez inquired, from Mr. Neaman's standpoint as a risk manager, if the Retirement Board were to adopt a standard in the $20 million range, would this be prudent in that it is higher than most funds while giving the Board a larger universe of firms to consider in attaining the desired managers. Mr. Neaman suggested the Board consider a tiered approach because Mr. Vazquez's statement of the larger firms not carrying those limits is not true. Mr. Vazquez proposed the Board consider a tiered approach and also consider the risk inherent in each investment mandate. He then inquired of Mr. Rue, if one had a large index fund, would the inherent risk in this be less. Mr. Rue responded he believed this would be the case because it is an index fund and there is no active management involved. He added an index fund's only job is to replicate a widely held benchmark and if the portfolio drops by 10% or 15% in one year it has noting to do with the manager, but with the market. Mr. Vazquez reiterated going with a tiered approach but factoring in the risk inherent in the way the firms manage the portfolios might make it a lot better for the Board, the Retirement Plan and the retirees as a whole, by engaging the best managers possible for the management of DWP's funds. He inquired if Mr. Neaman could develop a tiered insurance standard for the Board, with input from PCA as to the risks of one type of investment versus another. Mr. Vazquez expressed he felt bad that their current requirements were imposed on the firms that they have so far engaged. Mr. Moore noted some firms were ruled out because it was clear they could not meet the requirements. Mr. Mirisola commented this is why the Board should not implement anything to change the requirements now, but should finish the process as is. He expressed the Board had not yet had a firm that was that much better as a potential manager but could not meet the insurance requirements. Mr. Vazquez indicated he was very concerned with Earnest Partners because they were by far, in his own estimation, head and shoulders above anyone else and had written a letter stating they cannot meet the requirements unless they significantly increase their management fees. Mr. Mirisola agreed that this issue should be revisited in the future, but not in the middle of the process. He stated he felt the requirements for insurance were discussed thoroughly at many meetings, and with PCA's recommendation, the Board directed the consultants to go forward with the RFP. Mr. Mirisola expressed that to change it now would be unfair to everyone who was already interviewed. He added this would be going against the Mayor and the City Ethics Commission's specific request of staying consistent.

Attorney Wilkinson interjected and informed the Board that having a discussion leading into any sort of change in the insurance requirements would be beyond what is on the Board agenda. Ms. Rubalcava commented there were two items on the agenda regarding the insurance requirements. Attorney Wilkinson expressed it was President Romero's call, but if it gets to a point of changing the amount of the insurance requirements it would have to be an item for another meeting. Mr. Rue inquired, with respect to agenda items two and six, wherein a discussion on changing the insurance requirements is an option, is Attorney Wilkinson suggesting this cannot occur today. Attorney Wilkinson responded that if the Board was going to change the insurance requirements as a whole, it could not be discussed.

Mr. Moore inquired if errors and omissions was the most prominent of the stumbling blocks, or was it just one of several issues. Mr. Vazquez listed the waiver of subrogation as another. Ms. Rubalcava commented that the waiver of subrogation is now in a standard contract used by DWP Retirement. She stated staff had to go back to the investment managers and request them to sign a new item that was not in the original contract. President Romero commented that the waiver of subrogation was an issue with initial responses to the RFP as to the amount of participants. Mr. Mirisola indicated he explicitly remembers Mr. Vazquez asking Mr. Emkin (PCA) if $50 million was too high and Mr. Emkin responded this was reasonable, and any good company would be able to comply. Mr. Rue responded there were other stringent standards involved besides insurance requirements. Mr. Moore commented since the Board recognizes there is some unfairness involved in the process, it should be corrected now and not just on an individual basis as Attorney Wilkinson suggested. Attorney Wilkinson clarified he was just concerned with the requirements of the Brown Act and what changes the Board could make today according to what was listed in the agenda. He added, this did not mean the Board could not change the insurance requirements in the future if listed as an agenda item. The discussion continued among the Board members regarding the insurance requirements.

Mr. Vazquez suggested this item be placed on a future agenda for discussion. He also requested Mr. Neaman develop some alternatives the Board could look at and consider with regards to the size and risk of the mandate. Mr. Moore inquired what Mr. Vazquez suggested the Board do with regards to Delaware and Earnest Partners. Mr. Vazquez suggested deferring Board action on the item. Mr. Mirisola expressed holding off the funding in order to wait for insurances to come through was not prudent and would cost the Plan money. More discussion ensued.

Mr. Moore inquired if the Board wanted to keep Delaware or Earnest Partners, would the fees need to be negotiated. Ms. Rubalcava stated Delaware wanted to lower the insurance requirements without lowering the fees. Ms. Bhatia clarified Delaware was requesting consent to provide $40 million in professional liability instead of $50 million and they did not mention fees at all. Mr. Neaman stated in his recent discussion with Delaware, the firm expressed they would be willing to consider filling the gap of $10 million provided they were given the time to underwrite it. Ms. Bhatia inquired how much time were they requesting. Mr. Neaman responded 30 to 60 days. Ms. Bhatia pointed out that the contract requires the investment managers submit their paperwork within 30 days. Mr. Mirisola suggested a compromise of having Delaware sign a contract to fund them with the $40 million, with the contingency of an additional $10 million within 90 days.

President Romero acknowledged that all the Board members' positions and concerns were reasonable. He inquired exactly what were Delaware Investment's and Earnest Partner's issues. Mr. Neaman responded Delaware's issue was $10 million of coverage gap and Earnest Partners issue was their alleged inability to get enough errors and omissions coverage. Ms. Calvache inquired how much insurance did Earnest Partners currently have. Mr. Neaman responded $10 million, but they could acquire another $20 million. President Romero suggested addressing each firm separately without discussing the waiver of subrogation. He stated, in terms of Earnest Partners, the Board could justify lowering the requirements based on the size of the firm and their performance over a 5-year period. He asked the question, with regards to Delaware, could the Board justify lowering the insurance requirements to $10 million for the sake of funding.

Ms. Rubalcava expressed, based on the Board's decision on items two and six, staff would have new and additional challenges as they try to close with the other investment managers.

Mr. Mirisola reiterated his suggestion of entering into the contract with Delaware with the agreement that within 90 days they would get another $10 million. Mr. Moore suggested Delaware should also be required to pay the transition costs should Delaware not produce the $10 million for insurance and this should be included in the language of the signed contract before they are funded.

Mr. Vazquez noted there were managers who have been funded since October of last year who have yet to meet the insurance requirements. He then inquired what number of firms did DWP have funded that have not met all the insurance requirements. Mr. Mirisola commented, if the insurance was not in the contract, he did not believe there was anything that could be done about it. Ms. Bhatia clarified the insurance requirements were a part of the RFP. Mike Wilkinson inquired if the contracts for the companies had already been signed. Ms. Rubalcava responded that contracts had been signed, but the insurance papers had not been delivered. Ms. Calvache inquired how many companies had been funded and had not met all of the insurance requirements. Mr. Vazquez responded Merrill Lynch and Northern Trust. Ms. Rubalcava commented there was an additional three firms who were selected, have not been funded, and have not turned in all of their insurance paperwork.

Mr. Moore inquired what leverage the Board had from a legal standpoint as to breach of contract, short of removing the funding. Attorney Wilkinson responded he would have to look into this. Mr. Neaman noted that the contract language states the firms are to comply with insurance requirements within 30 days of award of contract. Ms. Rubalcava informed the Board that there were four large cap managers who have not completed their insurance paperwork either, but they were funded in February. Mr. Mirisola noted those firms did sign the contract agreement to provide the insurance; therefore it is staff's job to work on enforcing it.

Robert Harkins from the Boston Company approached the podium.

President Romero recognized Mr. Harkins.

Mr. Harkins reported the Boston Company had been a vendor to the Retirement Board since the early 80's. He indicated when his firm updated their insurance in October to meet DWP's requirements, they spent $40,000 a quarter to meet some of the specifics but did not change their fee structure. He informed the Board that the Boston Company currently meets all the requirements and look at it as a down payment on the future of their relationship with DWP. Mr. Harkins returned to the audience.

Mr. Neaman pointed out that Fred Alger spent money on complying with the insurance requirements, and it was not estimated when submitting their fees. He added Merrill Lynch was going to comply with the additional $25 million of insurance. Mr. Neaman stated he feels the protection the Board is asking for is 100% reasonable for all firms managing money for the DWP Retirement System. He asked the Board to consider the fact that reducing insurance requirements set in the RFP is affecting their fiduciary responsibility. He pointed out if there were a loss from Earnest Partners in the $10 million to $40 million range the Department would have to absorb that loss. Mr. Rue responded that in a mandate (small value, small growth) like Earnest Partners, where the average volatility is 20% a year you cannot go back and sue Earnest partners for declining assets. He stated it would be a negligence issue. Mr. Mirisola commented the smaller the company the more risk there is. He stated with the larger companies one could request lower insurance because one could go after the assets of the huge corporations and collect the money.

Mr. Rue stated he agreed with Mr. Neaman's suggestion of a tiered approach, possibly by mandate size.

Joseph Silver of Merrill Lynch approached the podium.

President Romero recognized Mr. Silver.

Mr. Silver clarified, for the record that Merrill Lynch had provided all of the forms and there is only one outstanding form in which the language has been agreed upon and will be submitted to Mr. Neaman. He stated, as far as the coverage is concerned, the excess $25 million coverage is still being provided through a letter of guarantee from Merrill Lynch. Mr. Silver returned to the audience.

Mr. Moore suggested voting on Mr. Mirisola's previous motion of hiring Delaware Investments, but specifying they must have the full $50 million of insurance in 90 days. He added there should also be language in the contract that explicitly states they are responsible for any transition costs should they not comply with this provision.

Mr. Vazquez moved adoption of resolution 04-97 with the amendment. Seconded by Mr. Moore and carried unanimously after the following vote:

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

3. **Status of transition from Merrill Lynch to Boston Company, discussion and possible action with respect to various options for implementing the transition.**

Ms. Rubalcava noted at the last meeting the Board decided to terminate Merrill Lynch and the Boston Company offered to take over the account. She stated Mr. Harkins and she had been in discussion and Boston Company has submitted a letter requesting receipt of the same basis points as Merrill Lynch had received in managing the portfolio. Ms. Rubalcava reported, in addition, the Boston Company would like the opportunity to review letters that have been sent to them regarding their portfolio by the previous Retirement Plan Manager and have it summarized in their contract. She added the firm expressed a desire to review the contract they signed approximately a year ago and make some changes. Ms. Rubalcava indicated the memo included in the Board agenda packet offered two options: 1) continue to work with the Boston Company and renegotiate their contract, or 2) keep the funds at Merrill Lynch and move forward with choosing a new manager.

President Romero inquired if the Boston Company had anything to add.

Robert Harkins approached the table.

President Romero recognized Mr. Harkins.

Mr. Moore requested a better explanation of why the Boston Company would want to renegotiate the contract. Mr. Harkins passed out an outline summary of where the Boston Company stood. He expressed his firm was ready to take on the Merrill Lynch Large Cap portfolio. He indicated their internal counsel has asked them to have the Retirement Board execute the letter that was sent to staff on March 26. He stated the letter summarizes under one cover their current contract (No. 130) which DWP signed in the middle of 2002, and letters updating it dated August 5, 2003; October 17, 2003; October 23, 2003; and November 28, 2003. Mr. Harkins stated Boston's counsel was concerned if something were to happen to him, how would the person replacing him know what is expected with DWP's mandate. He reported when their contract was executed back in 2002, it was to take the Board from a situation of making individual buy/sell recommendations of the securities, to ones where the manager would have the responsibility of full discretion investment management. He stated the Board since then has requested several changes in the handling of the portfolio and their counsel would like to restate the agreement so there is one document that is clear in its instructions. Mr. Harkins indicated their counsel put together a letter stating the portfolio would be run based on the two most recent letters from the prior Retirement Plan Manager, which instructs Boston Company to optimize the portfolio to the S & P 500. He added, along with this, DWP would stop paying them the $105,000 a year for managing the Highmark portfolio separately.

Mr. Harkins stated, with regards to the fees for taking on the Merrill Lynch portfolio, if it was going to be run separately and if the securities are being run through their fundamental research process, it is only fair they get the same treatment as Merrill Lynch. Mr. Harkins indicated if the letter could be executed, the Boston Company would be ready to go with the portfolio tomorrow. He added their contract expires on June 30th, but he has already gotten senior management on board to agree to extend it.

Mr. Moore inquired about Mr. Harkin's statement of Boston focusing on adhering to an S & P 500 type guideline. Mr. Harkins clarified they have been doing this for the Department's remnant portfolio since August of 2000. Mr. Moore inquired if this would be the standard as well for the Large Cap Value portfolio as opposed to the Russell 1000 value. Mr. Harkins responded they could optimize the portfolio to the Russell 1000 or to the S & P 500. Mr. Moore requested PCA's recommendation with regards to a change in the guideline from a Russell 1000 to an S & P 500. Mr. Rue responded PCA's preference would be to have the portfolio managed against the Russell 1000 value.

President Romero inquired what PCA's opinion of Ms. Rubalcava's second option was. Ms. Rubalcava expressed her concern that the Board was under the impression this was going to be an easy transfer and she wanted the Board to set a policy on how they want the Retirement staff to handle these situations. Ms. Bhatia explained when the transition first started, Boston Company was going to be looking after the portfolio as is, which is called the remnant portfolio. She noted, on page 3.3 of the letter, the Boston Company is asking for changes in the guidelines that were provided for that remnant portfolio and not the Merrill Lynch portfolio that the Board is considering moving to Boston. She explained it was not just as simple as moving the fund from Merrill Lynch and making a decision on whether it is going to be a separate account or merged into the remnant portfolio. She stated it would also involve revisiting all the guidelines and providing new ones. President Romero stated his suggestion was just to have Boston Company babysit the portfolio, but now they want to negotiate fees.

Mr. Harkins indicated the way Ms. Bhatia characterizes it is not true. He stated the Boston Company received a letter from the previous Retirement Plan Manager dated October 23, 2003, stating "the remnant portfolio should represent one portfolio with the S & P quality characteristics as designed by the Boston Company". He clarified his firm is not asking for anything new, but just wants to make it clear they are running the portfolio the way they were last instructed, which is way different than the contract they signed with the Department. Mr. Harkins stated the difference in his and Ms. Bhatia's understanding of the contract brings to point why it is so important there are clear instructions under one letter. He emphasized his firm has almost $1.6 billion of DWP's Plan assets and is taking full fiduciary responsibility. Ms. Bhatia agreed there should be clarification as to what is expected of the Boston Company. She commented in going back to the time the Board changed from the advisory relationship to full discretion management, Boston Company was asked as to which benchmark they would be following. She added at that time the S & P 500 was mentioned.

Mr. Moore inquired when Mr. Harkins talks about the remnant portfolio and the guidelines of the S & P 500 in the letter, is Boston still doing this with minimal trading when necessary. Mr. Harkins responded in the affirmative. Mr. Moore inquired if the Merrill Lynch portion would be dealt with in the same manner, but adhering more to a Russell 1000 value. Mr. Harkins responded in the affirmative. Mr. Moore asked if Boston Company was taking exception to any of the more detailed criteria or guidelines that were approved by the Board for that portfolio. Mr. Harkins responded in the negative. Mr. Rue clarified that Boston Company would be a caretaker manager with one existing mammoth portfolio, but other portfolios may come in to play with different guidelines. Mr. Mirisola commented he knows where Boston Company is coming from with regards to the fees because they will have to pay people to watch the stocks, however they will not be actively trading as Merrill Lynch would have. He added they would be paid a lot of money for just babysitting the portfolio.

Attorney Wilkinson referred to the October 23rd letter and expressed his concerns on the Board rushing and throwing out all of the investment guidelines and stapling the letter from Mr. Vellon to the contract without the input of PCA and a decision from the Board.

Mr. Mirisola suggested taking Merrill Lynch's contract and putting Boston Company's name on it with an additional paragraph stating the portfolio is to be held for a short period of time. He inquired if Boston Company would agree to manage that portion of the portfolio under the same terms and conditions Merrill Lynch did, and if so, this could be executed right away since they already met the insurance requirements. He added staff and the City Attorney could work out clarifying the other part of the contract. Mr. Harkins expressed this was a good idea. Ms. Rubalcava interjected that there were two issues of Boston babysitting the Merrill Lynch account and the summarizing of the contract. She informed the Board this would not transpire in a week's time because both staff and the City Attorney's office would have to research it. Mr. Mirisola stated the terms on the remnant portfolio could be clarified, but the Board's main concern was getting the Merrill Lynch money managed, which is currently in limbo. He then suggested an interim stamp on the contract within a week's time. Mr. Harkins responded this could not be done in a week. He stated there were two options from Boston's standpoint. One would be the Board reviewing the letter, coming to an agreement, and then 45 days before the June 30 contract execution, complete an amended and restated contract. He added this would extend the Department up to December. He suggested another option of working on the amended and restated contract right now, which would be encompassing of both things.

Joseph Silver (Merrill Lynch) approached the podium.

President Romero recognized Mr. Silver.

Mr. Silver expressed that Merrill Lynch accepts their termination from the Large Cap Value and will do whatever the Board wishes to affect a clean effective transition to the new manager. He informed the Board that while the portfolio is in limbo the Department is paying active management fees, and there is a team of investment professionals who are currently overseeing the portfolio. Mr. Silver proposed the Board had the option of keeping the portfolio where it is until they hired a new manager or they could opt to park the money by putting it into an index with them or with Northern Trust. He explained this way the Board will at least get the market return and not subject themselves to active management. He stated the third option would be to go with the Boston Company. Mr. Vazquez inquired what the current status of Merrill's management was. Mr. Silver responded Merrill had been directed not to put the account on hold, so technically they have the right to make any sells or purchases. Mr. Mirisola expressed the Board did not agree to that. President Romero clarified there were fiduciary issues raised as to what would happen if the Board instructed Merrill not to trade and it was decided to continue with active management and talk to the Boston Company to see what the feasibility was for them to take over the portfolio.

Mr. Vazquez moved that the Board leave the money with Merrill Lynch to actively manage the portfolio per the contract until a new manager is hired. Seconded by Mr. Mirisola and carried unanimously after the following vote:

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

Neill Rue expressed he was comfortable with the Board's decision given the uncertainty of the Boston Company.

Mr. Harkins inquired if the Board wanted to take the opportunity to instruct the Boston Company to extend the contract for the overall remnant portfolio. President Romero responded this could be worked out with staff, but the Board would have to decide on any material changes. Ms. Rubalcava indicated staff would come back to the Board for option two on page 3.2 of the agenda packet.

4. Consideration of PCA report to the Board on status of MFS investment account; possible action to terminate MFS and replace with alternative managers from item 5 below.

Messrs. Jack O'Connor, Managing Director of North America Institutional Sales, and Ed Baldini, Associate Portfolio Manager and Vice President approached the podium.

President Romero acknowledged the representatives from MFS Investment Managers.

Mr. O'Connor apologized on behalf of MFS and stated that MFS recognizes its responsibility and understands the difficult situation they put the Board through. He stated he wanted to update the Board on some of the events at MFS, and also introduced Mr. Baldini. He informed the Board that MFS is under new leadership under Mr. Bob Pozen and that MFS is done with the regulatory issues, which they are very excited about.

Mr. O'Connor stated that Portfolio Managers Ms. Lisa Nurme and Mr. Steven Gorham lead the Large Cap Value team. He informed the Board that, together, Ms. Nurme and Mr. Gorham have spent more than 15 years each working in the industry, and started out as analysts at MFS. He continued to state that over the past two and half years, they have managed and supported the portfolio in a team style. Mr. O'Connor informed the Board that Ms. Nurme recently made the decision to retire after 17 years at MFS, which is unrelated to any of the SEC issues. He stated that she is going to retire at the end of the school year to spend more time with her family, so it is a personal decision. Mr. O'Connor stated that the firm is confident in the abilities of both Mr. Gorham and Mr. Baldini to continue to manage the portfolio as the Board hired them for. He stated Mr. Gorham and Mr. Baldini also continue to have the support of the other four portfolio managers who manage other assets, as well as 52 research analysts at MFS at their disposal. Mr. O'Connor assured the Board that the firm is moving forward and taking a leadership role in the industry. He emphasized that Mr. Pozen contributes greatly to the tremendous amount of energy in the firm, which shows that the firm has the best leadership and governing procedures in place as a result of the situation with the SEC. Mr. O'Connor stated that from the firm's perspective, the team continues to have a great experience in terms of their clients, prospects, and new clients, and they have been able to maintain their focus on business, and their clients have committed and understand that the firm has taken significant efforts to improve. He explained that the best evidence of that is shown in the firm's performance at the end of the quarter where the team has more in assets under management than they did at the end of last year. He stated that, finally from a Large Cap Value standpoint, the very reason the firm manages assets with a team approach is if there is a change of one person, like someone at MFS decides that they want to retire after 17 years, the firm feels it can maintain the integrity of the investment process by keeping a team approach of having two other people who are experienced investors in the portfolio. Mr. O'Connor reiterated his point that if the Board were to choose MFS, and he understands that the issues have been challenging, they would be excited. He emphasized that other clients have demonstrated that they have confidence in the firm and he hopes that the Board will also.

Mr. Baldini expressed his three main points before the Board as follows: 1) the impact of the environment over the last nine months on the investment team, 2) the investment team itself, and 3) the firm's investment approach in the current environment. He began stating that, in terms of the impact of all the events in the last six months, he apologized for the difficulties that the firm imposed upon the Board and other clients, and stated this is the second time he has been before the Board talking about investments. Mr. Baldini expressed to the Board that it has been equally frustrating for the firm to be in the press without an opportunity to respond on the outstanding issues but he emphasized these were not investment related issues. He reiterated that no one in the firm's investment group has been involved with these issues, and the issues are related specifically to the development of the wording on the prospectuses. He stated that as Mr. O'Connor mentioned, there have been significant changes on the part of the business to address those cases.

Mr. Baldini continued to address his points by stating that he has spent a considerable time with the new CEO and he has also spent time with Mr. Pozen in the last couple of months, and there are two basic messages that they gave to the firm, internally, and that is 1) "It's done, we're through, we're moving forward and focusing on our business"; and 2) the moral boost by Mr. Pozen joining the firm as a leader in the development of the mutual fund business has been significant. He explained that the firm and team have been at the table shaping the business, rather than being outside the business and being on the defensive, and it feels great internally.

Again, Mr. Baldini emphasized that Ms. Nurme's retirement is just that - a retirement. He stated that the firm is very proud to have people retire from MFS and that many of these retirees are employees who have spent their whole career at MFS and have become professional investors over time. He informed the Board of the team leaders', stating Mr. Gorham, who has been Ms. Nurme's co-manager over the last two years and an analyst since 1992 with the firm, has grown up investing within the organization. He stated that the firm does not hire portfolio managers from outside and the firm has no intention of changing its investment style.

He reminded the Board, when MFS last came before the Board, they discussed the firm's basic investment research, how they focused on cheap companies, high quality businesses with a track record and a commitment to return cash to shareholders, and as a result the firm has low risk and favorable returns over time. Mr. Baldini expressed the firm is very comfortable with the portfolio today and the firm thinks the environment today is very favorable to their investment approach. He thanked the Board and returned to the audience.

Mr. Vazquez inquired if there was anything different from PCA's memo of March 26, 2004. Mr. Rue answered that there were no changes. Mr. Moore asked PCA to characterize what has changed and state how they see this as being different or similar to what the Board did with Merrill Lynch, where the whole team left. Mr. Rue explained it was different from Merrill Lynch's situation and it is not as significant as to what happened with Merrill Lynch. He further explained that he does not have all the facts, but regarding Ms. Nurme's retirement, it could be couched as a retirement, which is fine because it is a personal decision to leave, but it has changed the team. Mr. Rue stated it is in addition to a lot of other activities happening at MFS involving half of the leadership of that team. Mr. Rue stated that, in the Large Growth team in late 2003, MFS lost two portfolio managers and they shuffled their professionals around. He continued that Mr. Calabro was labeled as a Senior Vice President, one of the key people on the Large Value team, and he is no longer a Large Value manager and instead he is on a Total Value assignment as well as helping the Large Growth team because of the issues there. Mr. Rue summarized that there is a lot of movement of people, or at least there has been up to this point, and it is happening fairly rapidly. He pointed out this says something about what is going on at MFS, and it is quite in contrast to what the Board has experienced with other firms, where none of the teams have changed, and it is the Board's right to decide whether or not to keep or terminate MFS. He reminded the Board that, in their investment policy, it says that if the Board puts someone on probation because of organizational and/or personnel reasons, then they can let them go for the same reasons. Mr. Rue stated that from his perspective there has been enough management change here to consider other firms.

Mr. Vazquez asked if PCA has other clients that also retain MFS as a manager. Mr. Rue answered no. Mr. Vazquez clarified that the Board is the only client of PCA that has MFS as a manager. Mr. Rue replied in the affirmative.

Mr. Mirisola suggested that the Board continue to keep MFS on the watch list, since they do not have another investment manager to maintain the portfolio. He said the Board may decide to replace Merrill Lynch in six months or a year from now when the Board finally gets around to finishing the insurance requirements and everything else on hiring the managers, or the Board will decide to keep MFS. He explained this will give the Board six months to a year to watch MFS, and the Board may change its mind on hiring a replacement. Mr. Moore stated he was coming to the same decision as Mr. Mirisola in that he is not sure if he wants to retain MFS long-term, but he does not want to rule them out, at least until he has greater comfort that the Board could make such a change of managers smoothly and be confident that the Board is getting a good replacement firm in the process. President Romero concurred with Mr. Moore's comments. Mr. Rue stated it would be helpful to make a motion to that affect just to get the MFS question off the table. Mr. Mirisola made a motion to keep MFS on the watch list, and then on a future agenda item, the Board may choose a replacement for MFS. Ms. Rubalcava informed the Board that this decision did not require a Board resolution, just a motion, and the Board can decide to put Item #4 on a future agenda, and keep MFS on the watch list, without choosing a replacement for MFS.

5. **Consideration of PCA report to the Board recommending Large Cap Value Managers to replace MFS and Merrill Lynch; possible Board action to select managers.**

President Romero requested item 5 to be tabled for the next Board meeting to give the Board members ample time to review the companies and see who would replace Merrill Lynch and potentially MFS. Mr. Mirisola suggested having the Board come up with a replacement at least for Merrill Lynch because he was concerned that since the Board's money manager is terminated, there is no one responsible for managing the Board's money. Ms. Rubalcava reminded President Romero that the Board decided last month to terminate Merrill Lynch's contract, so the Board needs to choose at least one company. She suggested choosing one company to replace Merrill Lynch and choosing an alternate because of all the turmoil the Board has had with the insurance.

Mr. Rue informed the Board that they have five managers to choose from. He stated that PCA received a letter from Barrow Hanley, Mewhinney, & Strauss, Inc. indicating they would like the Board to consider lower limits on certain insurance requirements, particularly on the $50 million errors and omissions. Mr. Rue stated he sent an updated RFI to all the other candidates who have not been retained and received varying responses. He indicated that Wellington decided not to respond, primarily for insurance requirements, and Barrow Hanley would like to remain in the game but would like the Board to modify the insurance requirements, which leaves four other companies for the Board to choose from, Bear Stearns, Capital Guardian, SSgA, and T. Rowe Price. He referred to the matrix on page 5.4 of the agenda packet, and he indicated that, in terms of insurance requirements, the three cleanest firms are: Capital Guardian, SSgA, and T. Rowe Price. Mr. Rue explained he has not had significant detailed discussions with Capital Guardian, but he did with SsgA and T. Rowe Price, and they have had their legal people review the RFP, and they want to discuss some minor errors and omissions language with the Board. He reiterated that the Board has three firms that already meet the minimum requirements, but Bear Stearns has said they will also meet the Board's requirements.

Mr. Vazquez asked Mr. Rue why the transition fees are so much more for Capital Guardian versus the other two firms. Mr. Rue replied the transition fees do vary, and that Barrow Hanley and Capital Guardian have the highest estimated transition costs because their portfolios are smaller – they have more mid-sized companies that are less liquid.

Mr. Rue directed the Board's attention to a five-year risk chart. He stated that all the firms being considered have maintained their relative position. He indicated that the firms included on the chart were Bear Stearns, Capital Guardian, Barrow Hanley, T. Rowe Price, and SSgA. He emphasized that these firms have maintained their same positions on the risk chart, so in a sense they have not changed their risk adjusted results.

Mr. Moore recommended engaging T. Rowe Price. President Romero also stated he liked T. Rowe Price. Ms. Calvache concurred that she preferred T. Rowe Price. Mr. Mirisola wanted clarification if T. Rowe Price had insurance issues. Mr. Rue confirmed they did not have insurance issues but minor concerns with the E&O language. Mr. Moore again motioned for T. Rowe Price to be chosen as a replacement for Merrill Lynch. Seconded by Ms. Calvache and carried unanimously after the following vote:

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

Mr. Mirisola moved to choose an alternate firm and suggested Capital Guardian as the alternate. Mr. Moore seconded the motion to choose Capital Guardian as the alternate firm but later recalled his second. President Romero stated he did not feel comfortable with making a decision on an alternate until he has the ability to study the firms. He suggested the Board members, including himself, review the firms and revisit the issue at the next Board meeting. All Board members agreed.

Mr. Mirisola asked if T. Rowe Price was going to go smoothly with the RFP requirements.

Mr. Ken Brooks, Managing Director of T. Rowe Price approached the podium.

President Romero acknowledged Mr. Brooks.

Mr. Brooks informed the Board that he has gone through plenty of internal discussions relative to the RFP issues, and he can vouch that T. Rowe Price's attorneys are very tough, but he assured the Board that the firm is okay with the RFP requirements.

Ms. Rubalcava clarified with President Romero that the Board has decided that MFS will stay on the watch list. President Romero confirmed that MFS will stay on the watch list and there will be no need to add them to the next Board meeting's agenda.

6. Earnest Partners to report to the Board from staff on recent correspondence regarding insurance; possible action to modify insurance requirement.

Mr. Moore stated he was already persuaded by some of the points that Mr. Mirisola has made previously and informed the Board that what was last discussed about this agenda item was the issue of fees, because Earnest Partners had a lot more room in increasing fees so there is certainly more that could be done there to move up for the expense of the insurance requirements. He asked Mr. Rue how much more insurance is Earnest Partners saying they can go for and was it the final $10 million that was really reaching the "outrageous" level as they characterized it as being. Mr. Rue suggested that the Board respond back to Earnest Partners to discuss a lower insurance requirement without talking about changing fees. Mr. Vazquez inquired what was the original fee structure. Mr. Rue estimated that Earnest Partners was about 60 basis points while the others were between 80 and 100. Mr. Moore stated he remembers it was a pretty big spread. Mr. Vazquez then clarified that Earnest Partners is looking to go to 100 basis points if the Board forces the $50 million. Discussion ensued about the options offered by Earnest Partners to the Board.

Mr. Mirisola stated that Earnest Partners was a good firm that the Board preferred and hired. He explained that Earnest Partners and the Board agreed on the fees when the Board hired them, obviously lower fees is good, but protecting the assets in the investment portfolio, particularly given a small company with a higher risk, is more appropriate. He continued to state that the Board should consider whether or not they want to pay a little bit more fees for a better return and stick with a higher insurance requirement, or have the Board decide they do not want to pay extra fees and the Board let them lower the insurance, which is going to increase the Plan's risk. President Romero asked Mr. Rue if the Board's position was really at risk. Mr. Rue replied that PCA's position, as stated in the memo, is that Earnest Partner's current insurance coverage is adequate. Mr. Rue explained to the Board that Earnest Partners is saying back off the $50 million requirement, go to $15-20 million, and there would be no increase in fees. He suggested dropping to $15-20 million. President Romero stated he can accept a lower insurance requirement, given the fact that the performance was very good. Mr. Mirisola stated he thinks under the circumstances where the mandate was set for $80 million, insuring more than half that amount is an extreme. Mr. Avery Neaman said he agreed with Mr. Mirisola's earlier comment that the smaller firms have more risk because they do not have the backing - if they fold, there is nothing there, whereas the larger firms have the money and they just need to be sued for it. Mr. Mirisola stated that it comes down to whether or not the Department's goals to hire minority and women-owned businesses are so substantial that it is willing to take on the risk, so if the Department does not mind indemnifying the Plan for the risk to meet their other objectives, he does not see why the Board should not go ahead and do that. President Romero stated he does not see a problem in bringing down insurance for this particular company. Ms. Calvache asked President Romero if he meant bringing it down to $15-20 million. President Romero confirmed $15-20 million because the performance is very good and the consultant sees no problem with reducing the insurance requirement. Mr. Vazquez made a motion that the Board change the insurance requirements for this particular situation, based on an outreach to engage a minority business and based on superior performance. Mr. Mirisola stated he would not be able to vote yes on that motion. More discussion ensued about the minimum insurance requirement, based on the options Earnest Partners offered the Board. Mr. Vazquez restated his motion to choose option 3 from Earnest Partners as it is written, which would require $15 – 20 million in E & O coverage instead of $50 million. Seconded by Mr. Moore and carried unanimously after the following vote:

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

2. Consideration and possible selection of alternative investment manager for International Developed Market.

The Board returned to item 2 in order to decide on an alternate manager for the International Value Managers who have not fulfilled their insurance requirements.

Ms. Rubalcava explained that while there is an agreement on Delaware, the Plan staff still has two other investment managers with insurance issues and if the Board could choose one in case those two managers cannot fulfill the insurance requirements, the Plan can move forward with an alternate company.

Mr. Mirisola made a motion to choose Boston Company as an alternate. Seconded by Mr. Moore and carried unanimously after the following vote:

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

Mr. Moore inquired if PCA knew where Lazard stood in terms of insurance. Ms. Bernstein stated that Lazard does not currently meet the Board's insurance requirements, because they currently carry $10 million of professional liability insurance although they are looking into obtaining additional coverage – they have not said no, but they also have not said yes. She continued, Boston, on the other hand, has gone to great lengths to meet all the Board's minimum requirements.

Mr. Moore stated he could not find the charts he was looking for that showed the standard deviations and the rates of return over time. Ms. Bernstein replied that PCA got as much information as time restraints would permit, so what the Board has is some of the annual performance through January and February 2004, and the annual performance comparison for Boston Company and Lazard compared to the benchmark.

President Romero acknowledged a representative from Lazard and asked him if he could clarify the insurance issue. The representative from Lazard stated that Lazard got the notice from the Board about a week and a half ago, and they are in the process of trying to obtain insurance according to the Board requirements. President Romero thanked the representative from Lazard and the representative from Lazard returned to his seat in the audience.

Ms. Rubalcava clarified to the Board that Item 2 on the agenda calls for a replacement for any of the International Value Managers that do not fulfill the insurance requirements. Some discussion ensued regarding the agenda wording for Item #2. President Romero clarified that a decision was made only to choose Boston Company as the alternate manager for Delaware and asked the Board members to move to the next item.

7. Discussion and possible action to extend BNY contract to provide custodian services.

Ms. Rubalcava informed the Board that Item #7 is information to let them know that Bank of New York, and the Plan staff have come to an agreement for a six-month extension and BNY has decided and agreed to take responsibility for the sub-custodians but not for the depositories. Mr. Moore inquired what should the Board be aware of in terms of what liability the Board will assume because of that limitation and is it reasonable for the Board. Ms. Bhatia stated in negotiating with Bank of New York, the Plan staff had asked that they include certain language that makes them take responsibility for depositories. She continued that unfortunately BNY is not willing to do that unless the depository is an affiliate of the Bank. Ms. Bhatia informed the Board that in most of the international markets, the depositories are not affiliates of BNY, such as in certain countries like the U.K. and some other parts of Europe. She stated this was the current issue with the Bank of New York.

Mr. Rue stated that Plan staff forwarded the language to PCA, and he checked the language with a couple of the major custodial contacts that are not the Bank of New York, and he asked them about this language to see whether or not it was standard language that they were asking for. He suggested having the City Attorney's Office have a look at the contract before final approval, but it looks like the language that they are asking for, in relation to what a foreign depository is, is appropriate. He further stated that PCA recommends that they define what a foreign depository is and what a sub-custodian is in the contract. He concluded PCA was comfortable with the language change.

Mr. Wilkinson stated that BNY initially did not want to take responsibility for the sub-custodian. He informed that Board that the custodian did take the responsibility and changed the language at the City Attorney's request.

No action was taken on item 7 and the meeting was adjourned at 2:05 pm.

JAVIER ROMERO President	ADRIANA RUBALCAVA Secretary

MOHAN WEERASINGHE
Recording Secretary