

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

**MINUTES – September 14, 2005**

**Present:**

Javier Romero	President
Lilly Calvache	Vice-President
Ron Vazquez	Chief Financial Officer
Michael Moore	Retiree Member
Ronald F. Deaton	General Manager

**Absent:**

Eugene Canzano	Board Member
Gerard McCallum II	Commissioner

**Others Present:**

Sangeeta Bhatia	Acting Retirement Plan Manager
Irene Gudino	Recording Secretary
Alan Manning	Assistant City Attorney
Michael Wilkinson	Deputy City Attorney
Sarah Bernstein	Pension Consultant Alliance (PCA)

The meeting started at 9:40 a.m.

Ms. Bhatia announced the Board members present.

**1) Discussion and Possible Approval of Insurance Requirements  
— Insurance information presented at July 20, 2005, Regular Board Meeting**

Mr. Avery Neaman (DWP Risk Management) approached the Board table.

President Romero recognized Mr. Neaman. He then requested Mr. Neaman and Ms. Bernstein provide the Board with their final perspective on the insurance requirements for the new policy. Mr. Neaman noted that at the July 20 Board meeting the Board requested research be performed on what the loss history was in the particular area of retirement plans that have experienced losses caused by negligence, contractual breach, or fraud by retirement investment fund managers. He stated the second area in which research was requested was whether the issue of subrogation was of significance to those types of losses. Mr. Neaman defined subrogation as whereby an insurance company pays a claim on behalf of the investment manager and then comes back against the retirement plan to recover those monies, alleging that the retirement plan partially caused the loss.

Mr. Neaman reported that subsequent to the meeting of the 20<sup>th</sup> he wrote an email to Attorneys Mary Jo Curwen and Mike Wilkinson requesting their assistance in the legal research. He stated Attorney Curwen responded it was her belief that this type of legal research would not be fruitful. President Romero inquired of Attorney Manning why

Attorney Curwen expressed this opinion without performing any research. Attorney Manning responded the request for information was not so much a legal analysis of the issues involved, but a request for information regarding the history of what kind of claims may have been brought and what kind of liability may have been found. He explained this is the type of information that could be attained from other plans, but not the type of information that is typically available in court records to anyone doing research. President Romero expressed this was a very significant issue before the Board that will protect the Plan. He stated it was his understanding that the Board's inquiry was if there was any case law the Board should be aware of in order to set out limits and standards. President Romero added it was also his understanding that a simple search on LexisNexis could find some cases, and each case's circumstance could be researched. He stated he did not feel this was an unreasonable request and did not understand Counsel's response that the search would not be fruitful. He further stated the Board provides some salaries to Counsel and sends them to conferences, and he expects a reasonable effort from the email request. President Romero noted Attorney Wilkinson did do his homework and sent an email to other attorneys, but he would like something a little more diligent as to specific case law that has come out of LexisNexis. Attorney Wilkinson responded, when doing research, one has to look in the right place for the information, and it is his and his colleague's view that a case law research would not find that information. He explained that the Nexis part of LexisNexis is the news reports and the Lexis is the case law reports. Attorney Wilkinson indicated it did not seem that either of those reports would answer any of the Board's questions. He stated this was why he opted to send an email out to lawyers who are members of the National Association of Public Pension Attorneys (NAPPA). He stated he also thinks this was the reason Attorney Curwen answered a little more narrowly to the case law research.

Mr. Neaman pointed out that what is of great concern is whether or not the Board's requirement for Waivers of Subrogation is appropriate or effective in providing protection. He added this has also been an issue of some contention with the investment managers. Mr. Manning commented that legal research would focus on the actual legal issues in terms of what is legal and what is not, rather than on the experience of loss that others have had. He indicated one would really not find that kind of information except through an appellate court.

Mr. Neaman inquired if Lexis has a review portion of its feature where one can view non-legal aspects. Mr. Manning responded that every case that is filed does not get into the Lexis system. He added a filed complaint and various pleadings do not get into the system, only a reported case. Attorney Wilkinson explained that the issue of subrogation is that the insurance company is legally entitled to recover against someone via subrogation, and this is just basic insurance law. He added this was something Mr. Neaman could advise the Board on. Attorney Wilkinson reported that Mr. Neaman did some research on the public news databases and he himself did some research through his colleagues in NAPPA, but a further case law research would not answer that question.

President Romero clarified that what the Board is looking for is a case law that went through a judge's decision or judgment, what the circumstances were, if there was an issue of subrogation, and if the manager was sued and the pension plan countersued.

He stated, in this case, he feels it would be a legal issue and not risk management. Mr. Moore suggested the insurance companies would have the best focus on this issue because they are the ones making the payouts and figuring the rates based upon the likelihood of certain things happenings. President Romero commented the insurance companies would probably want to keep this type of information confidential.

Mr. Neaman reported the results of his one day internet research was done solely at the Los Angeles Public Library website and is summarized in the Board agenda packet. He further reported there were 10 incidents reported, ranging in losses suffered from \$500,000 to \$500 million. Mr. Neaman stated the primary cause of loss was breach of contract, along with negligence, mismanagement, and fraud. He stated the range in assets under management at the investment management firms was \$500,000 to \$6.2 billion. He then expounded on the County of San Bernardino Employee Retirement System's loss. Mr. Neaman reported they were able to recover \$15 million out of \$65 million that was lost from insurance. Mr. Deaton inquired, in that instance, how did subrogation help. Mr. Neaman responded there was no subrogation. Mr. Deaton inquired if San Bernardino did have subrogation what would have been the benefit. Mr. Neaman responded if the insurance company paid \$15 million of the loss and concluded that San Bernardino County was partially responsible, they would have sued the County alleging that they participated and would want reimbursement for part of the \$15 million they paid out. He added that the Waiver of Subrogation would prevent the insurance company from suing the Plan to recover any monies.

Mr. Deaton inquired if there had been an instance where there was a loss and the insurance company sued the retirement plan. Mr. Neaman responded that in his research he did not find such a case, most likely because he was looking through business and newspaper articles. Attorney Wilkinson commented, in order to trigger subrogation, there has to be an insurance company who pays first, therefore, there would have to be a loss before there is any involvement in subrogation. Mr. Deaton inquired if Attorney Wilkinson's findings were that the insurance companies did not have any losses. Attorney Wilkinson responded that the plans did not report they had any loss history triggered by subrogation. Mr. Deaton inquired how many responses he received. Attorney Wilkinson responded he had received five responses.

Mr. Vazquez inquired about the summary view of other plans with regards to the Waiver of Subrogation. Ms. Bernstein responded PCA reviewed a number of plans (LA Fire and Police Pensions, LACERS, and CALPERS), and none of them required a Waiver of Subrogation. She stated PCA's recommendation to the Board is not to force business limits on opportunity costs on the investment manager selection, which has happened over the last couple of years with the current policies. She stated in the survey PCA completed of various funds and their policies, most of the policies were set by staff and not adopted by the Board. Ms. Bernstein gave an example of the Kansas Board adopted policy requiring a minimum of \$1 million in insurance for any investment manager and then 1% of assets in terms of insurance over and above that. She stated her perspective is that even if the DWP Retirement Board chose a tiered approach at 2% they would still be in the range of professional liability that will not harm the Plan in terms of not allowing access to top tier money managers who do not want to pay extra money for insurance.

President Romero noted he was concerned about PCA's memo stating, "The insurance standards appear to have influenced the resulting overall portfolio such that it may be less well diversified across organizations than it would have been if the Plan's insurance requirements fell within the range of insurance requirements for managers of other public plans across the country." He stated he feels the Board had a good pool of candidates to choose from. President Romero indicated after every interview the Board asked PCA if there was any reason they should not accept the candidates, and PCA's response was that they were good companies. He expressed PCA's comment could be a little misleading in that the Plan is less diversified.

Mr. Moore stated he was very concerned that 40% of the top ten management firms were excluded because they failed to meet WPERP's insurance requirements. He stated the Board could be accused, from a fiduciary standpoint, of abrogating their responsibilities if they do not provide any insurance at all to protect the Plan. He continued saying just the opposite is true if the Board cuts down the field of potential firms that could provide good service to the Plan, leaving them subject to criticism from a fiduciary standpoint as well. Mr. Moore pointed out that all the major pension plans do not have insurance requirements anywhere near that of DWP. He expressed that, based on what he has seen so far, he does not feel the Board is being reasonable, because in his opinion something is wrong if WPERP's standards are that far away from the rest of the players. Ms. Bernstein stated she agreed with Mr. Moore and the reason for PCA's comment that was referenced by President Romero is that the Board went through a lot of discussions over the last month when they had to eliminate a manager (Northern Trust). She noted part of the reason for the removal of Northern Trust was that they did not meet the insurance requirements they agreed upon. Ms. Bernstein used the Northern Trust issue as an example of a process the Board went through wherein they ended up consolidating managers due to insurance restrictions. She stated PCA did not mean to imply that WPERP did not have good managers.

President Romero stated with that particular issue, PCA's recommendation was to have one index manager, but as a result of Board discussion and disagreement, it was decided to have two. Mr. Deaton expressed he feels the Board acted prudently and the question now is whether to continue on the current path that we had before or do we want to use the evidence we have today to change course in terms of insurance requirements.

Mr. Moore noted, with regards to the two-tiered approach, one tier had to do with the amount of capital under management and the other tier appeared to be primarily a function of the volatility of particular funds that were being invested in. He then expressed he did not understand the second tier because without insuring against loss or volatility one is insuring against errors and omissions and crime. Mr. Moore stated it seems to him that the volatility does not provide any measure of either of those. Mr. Neaman responded if one accepts the fact that the amount of money the investment manager has under management, and the fact there are ranges of variances in risks of mandate, then these are two good bases for moving toward the tiered approach. Mr. Moore clarified that he understood the dollars under management, but it was the additional cut relating to the volatility that he does not think gives a feel for how much insurance is needed for errors and omissions or crime. He added volatility is not a measure of the likelihood of those two things happening. Mr. Neaman responded he

thinks it would be an indication in part, because the volatility of an investment relates directly or indirectly to errors and omission that could be made by the investment manager in managing those assets. He explained this is something that is completely passive and linked to an index, has a very low risk of loss, and a relatively low probability of loss. Mr. Moore reiterated his opinion that volatility should not play that much of a role, and the Board should be more focused on what the likelihood is of errors and omissions.

Mr. Vazquez stated it was his understanding that the Board would receive a recommendation today on moving from the current status to a different threshold, and also address the issue of Waiver of Subrogation. He requested Mr. Neaman come back with a range of insurance coverage that will not preclude the pool of managers the Board can select from. Mr. Vazquez stated, with regards to the Waiver of Subrogation, the one insurance company that did offer that to their client is no longer offering it. Consequently, the Board requiring the firms to provide a bank letter of credit or something else in lieu of having the waiver makes it less economical for the managers to do business with WPERP. Mr. Neaman responded that 15 of the 16 managers that are managing the Plan do have Waivers of Subrogation. Mr. Vazquez responded that one of the manager's insurance expired and the insurance company would not re-offer it.

Mr. Deaton commented there has not been any evidence that the waiver will actually protect the Plan. Mr. Neaman agreed with Mr. Deaton. Mr. Deaton expressed if there is evidence that the waiver will protect the Plan against something, he will be more than willing to enforce it. But until he can see that the waiver does anything besides reduce the ability to get better performance with no protection on the down side, he has a difficult time supporting it. Mr. Deaton left the Board meeting at 10:23 a.m.

Mr. Neaman indicated that a definitive conclusion has not been reached as a result of this discussion. Mr. Moore commented that perhaps the reason the Board still does not have a recommendation is because PCA and the City Attorney's Office are saying the standards set are too high. He suggested the Board state exactly what they want and then it can be refined. Mr. Moore pointed out there was also the issue of other outfits out there that are already on board that are having problems in the market right now. Ms. Bernstein responded on the managers managing public securities that you have already hired, if the manager's performance is below par, you need to replace them in the near term or if a manager comes back and cannot meet your requirements you are then faced with figuring out whether to get rid of them because they cannot meet the insurance requirements. She pointed out this was one issue that would need to be addressed when dealing with private equity and alternative investments in a few months. Mr. Vazquez informed the other Board members that Intech approached him and stated compliance with the Waiver of Subrogation was going to cause their costs to go up significantly. He suggested the Board either change the requirements or replace Intech. President Romero suggested discussing the issues separately, and if the issue of subrogation is the immediate one, then the Board can address that and then the tiered approach. He stated, as of now, nothing needs to be decided unless there is a loss of a manager or until the selection of the real estate and alternative investment managers.

Mr. Neaman pointed out that the Waiver of Subrogation is a contract requirement in existing contracts and legal opinion has to determine whether that contract can be modified midterm. Mr. Vazquez stated it was his understanding that when the contracts were initially signed with the fund managers, the Waiver of Subrogation was not included. Ms. Bhatia clarified that the Waiver of Subrogation was in the RFP itself and was included in the addendum to the contract. In response to Mr. Vazquez's question as to whether the waiver was in the initial contract, Ms. Bhatia clarified the initial Intech contract did not include a Waiver of Subrogation, but the contract was incomplete and was missing the required attachment, which did include the Waiver of Subrogation. Mr. Vazquez requested the contracts be amended. Mr. Moore inquired of the City Attorney if the contracts would have to be amended, and commented the firms might be more comfortable with the contract amendment since they are the ones that our obliged to adhere to it. Mr. Moore suggested a letter be sent to the managers stating the WPERP is no longer holding the firms accountable to the Waiver of Subrogation. Attorney Manning responded he agreed with Mr. Moore's approach.

President Romero inquired if there was going to be any more research regarding the Waiver of Subrogation. Attorney Wilkinson responded if there were a need for additional research, the City Attorney's Office would be happy to comply. However, neither he nor Mr. Neaman found any existence of subrogation being used in the context the Board requested. President Romero stated he wanted it on record that the Board is doing its due diligence and that the City Attorney's Office and Risk Management has direction of the Board that there is nothing alarming regarding the Waiver of Subrogation and necessitating Board consideration. Mr. Moore commented the City Attorney and Mr. Neaman could pursue this issue further and bring additional information back to the Board. Attorney Wilkinson stated he thinks that he, Mr. Neaman, and Ms. Bernstein have collectively researched different avenues and he personally did not know any other place to look for further information. Mr. Neaman concurred with Attorney Wilkinson.

Mr. Vazquez moved the requirements for Waiver of Subrogation be removed from future contracts and renewals of existing contracts. Seconded by Mr. Moore and carried unanimously after the following vote:

Ayes: Vazquez, Romero, Calvache, and Moore

Nays: None

President Romero inquired if the second issue of how the Board is going to proceed with implementing the removal of the Waiver of Subrogation could be discussed under the current item. Attorney Wilkinson stated it would be okay to discuss the insurance limits under this item. President Romero pointed out that every money manager's insurance expires at a different time. He inquired if the managers should be told that effective their expiration date they would no longer be required to submit this Waiver of Subrogation. Attorney Wilkinson stated it was his understanding that the problem is with the renewal of the contracts. President Romero responded there was an issue of fairness because the Waiver of Subrogation is going to cost the managers more money. He inquired how can the Board tell one manager they have to pay and then another that they do not because they came in after the fact. Attorney Wilkinson clarified the new insurance requirements would affect renewals and contracts in going forward. Mr.

Moore commented that when Mr. Neaman is reviewing adherence to the insurance requirement he will no longer have to check for the waiver.

Attorney Wilkinson inquired if there were any negotiations being conducted or RFPs currently being issued. Ms. Bhatia responded that an RFP for an external auditor was just advertised and a Waiver of Subrogation will not be pursued. She then suggested addressing the removal of the Waiver of Subrogation on existing contracts by letting the manager's insurance policies lapse on the Waiver of Subrogation and informing managers to not pursue its renewal. Mr. Vazquez suggested a letter be sent out to each firm letting them know that when their current insurance expires, a Waiver of Subrogation will no longer be required. Attorney Wilkinson recommended re-advertising the RFP for external auditor to avoid legal problems.

Ms. Calvache inquired if the Board was going to direct Mr. Neaman to make the decision regarding the insurance limits or was the Board going to give any guidance. President Romero stated Mr. Neaman should return with a recommendation and the Board will make the final decision. Mr. Neaman stated the focus is now on the limits of liability for professional liability and crime. Mr. Moore expressed, in terms of giving guidance, he would have great difficulty in supporting anything higher than \$20 million. President Romero inquired if the limit of liability has been a significant issue. Mr. Neaman responded that only one of the managers (Earnest Partners) has had less than \$50 million in limits of liability and a Board exception was made for them. He stated the only issues have been the Waiver of Subrogation and the Department's Proof of Insurance Form, which is really City policy and procedure. Mr. Neaman left the Board meeting.

Mr. Vazquez noted there is currently a firm (Fidelity) on watch and the Board is waiting to see what develops before acting. Ms. Bernstein stated that the Board is not taking any action at this time and a higher level of monitoring and notification of the manager is in place. Mr. Moore inquired if there was consideration of putting another manager on watch as well. Ms. Bernstein responded in the affirmative. She stated INVESCO was hired last June and has had some performance issues. However, PCA has decided to wait until after the third quarter and may bring a monitoring issue to the Board at that time. She added that INVESCO is scheduled to report to the Board at the October 19, 2005 meeting. Mr. Vazquez explained the reason for his inquiry is because this might prompt the need for engaging a new manager and the Board will be faced with the insurance issue.

## **2) Proxy Voting Policies Roundtable**

The following presenters provided the Board with information on various proxy voting policies:

Ted White, Deputy Director, Council of Institutional Investors

Tom Lopez, Chief Investment Officer, Los Angeles Fire and Police Pension System

Dan Gallagher, Chief Investment Officer, Los Angeles City Employees' Retirement

System

Kevin Cameron, President, Glass Lewis and Co.

**A tape of the presentation can be provided to Board members upon request.**

Mr. Moore inquired of Ms. Bhatia if currently the Board is working with the old proxy guidelines and if the fund managers are voting the proxies based on those guidelines. Ms. Bhatia responded in the affirmative. Mr. Moore inquired if President Romero has visited this subject previously. President Romero responded that Ms. Bhatia and Mr. Abarro reviewed and voted on the proxies. Ms. Bhatia clarified the proxy was voted in-house until 2002. Mr. More inquired if the guidelines changed in the last five years. Ms. Bhatia responded in the negative. President Romero suggested the guidelines be reviewed.

The meeting ended at 12:17 p.m.

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JAVIER ROMERO  
President

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SANGEETA BHATIA  
Secretary

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IRENE GUDINO  
Recording Secretary