CITY OF LOS ANGELES
BOARD OF DEFERRED COMPENSATION ADMINISTRATION

ADOPTED MINUTES
SPECIAL MEETING NOVEMBER 30, 2016
700 E. TEMPLE STREET, ROOM 350

BOARD MEMBERS:

Present:
John R. Mumma, Chairperson
Michael Amerian, Vice-Chairperson
Cliff Cannon, First Provisional Chair
Raymond Ciranna, Second Provisional Chair
Wendy G. Macy, Third Provisional Chair
Thomas Moutes
Don Thomas

Not Present:
Linda P. Le
Robert Schoonover

Staff:

Personnel:	Jody Yoxsimer	Steven Montagna
	Matthew Vong	Daniel Powell
City Attorney:	Curtis Kidder	

1. CALL TO ORDER

John Mumma called the meeting to order at 9:01 a.m.

2. PUBLIC COMMENTS

None.

3. MINUTES

A motion was made by Ray Ciranna, seconded by Don Thomas, to approve the October 18, 2016 meeting minutes; the motion was adopted unanimously.

4. INVESTMENT PROVIDER PRESENTATION: VANGUARD

Edward McGettigan of Vanguard, the Plan's investment provider for the DCP Small-Cap, Mid-Cap, & Large-Cap stock funds, provided background information on Vanguard, describing it as a fund company structured such that share earners in Vanguard funds own the investments; the funds own Vanguard as the business operation; and Vanguard provides its services to the funds at cost. He indicated this translates to no conflict of interest for investors and that any profit made by Vanguard is re-invested in business or is returned to investors in the form of lower expenses on investments. He indicated Vanguard currently manages approximately $3.8 trillion in assets.

Mr. McGettigan then turned the presentation over to Walter Lenhard, Senior Investment Strategist with Vanguard. Mr. Lenhard began his presentation by stating he joined Vanguard in 1992 as the fifth employee in the equity indexing group and noted that indexing has become far more popular in the last 25 years.

Mr. Lenhard reviewed the performance of Plan's passively managed Vanguard Large-cap, Mid-cap, and Small-cap funds. He noted their high absolute performance and indicated the S&P 500 1-year and 5-year performances returned 15.43% and 16.37% respectively. He stated that the Mid-cap and Small-cap funds have also performed well. He then reviewed how the Plan's funds performed against the index and noted that the 1-year and 5-year returns for the DCP large cap stock fund were identical to the S&P 500 benchmark. Mr. Mumma inquired about what it meant for a benchmark to be spliced. Mr. Lenhard responded that the benchmark for mid-cap and small-cap funds had changed several times over the years, and the splice is the combination of the relevant benchmark for when it was used. Devon Muir of Mercer Investment Consulting, who was in attendance at the meeting, asked Mr. Lenhard to explain to the Board why Vanguard decided to change benchmarks. Mr. Lenhard responded that the decision was related to driving down expenses and noted that from 2000 to 2015, Vanguard's expense ratio decreased from 10bps to 4 bps. He stated that Vanguard prefers to stay with a benchmark unless there's a reason to make a change. He stated Vanguard had been using MSCI benchmarks because they were good benchmarks, but they were more costly by 1-2 basis points. He added that Vanguard leads the industry in cash flow over the last several years and that as funds get larger, they are able to lower expenses, but only if a fund is paying a flat fee for a benchmark, rather than basis points. He also stated that in 2004, MSCI was the "gold standard" due to its practices, but by 2014 other benchmarks like CRSP began employing the same strategies, resulting in similar returns. He indicated that as such, Vanguard decided to switch to benchmarks that charge a flat dollar amount. He stated that this allowed Vanguard to continue to lower their funds' expense ratios and return benefits to shareholders. He stated that Vanguard changed the benchmark on half of their assets under management and indicated that after making the transition, Vanguard's cash flow continued to be strong and their tracking error stayed in line. He added that in considering the change, Vanguard considered why their clients were investing with them, and they concluded that investors just wanted the benefit of indexing, rather than being beholden to any specific benchmark.

Mr. Lenhard stated that at a high level, Vanguard has been launching index funds since 1976 and their indexed assets under management are over $2 trillion. He stated that over the last few decades, indexing has grown from 3 - 4% to 34% of overall equity fund assets. He stated that in the 1990's people would debate active vs indexing, however today indexing is understood as the default best way to invest. He stated that he thinks indexing will comprise higher than 1/3 of assets under management, but will level off and plateau within the 50-70% range where index and actively managed funds will exist together in some form of symbiotic relationship.

Mr. Lenhard explained why Vanguard believes indexing works. He stated that investing in equities is a "zero sum" game and no matter what the market returns, half of managers outperform the aggregate market whereas the other half underperform the aggregate market. He argued that once expenses are removed, the average actively managed fund underperforms the indexing benchmark, while some active managers will always outperform indexing. He stated that in an average year, only 30-40% of active managers outperform the index, and indexing outperforms the other 60-70% of managers. He added that it depends on a given asset class whether it's better to index or pursue active management. He stated that it's generally better to index large-cap and utilize active management for other market asset classes.

Mr. McGettigan added that Vanguard believes in both indexing and active management. He stated that Vanguard believes in active management if it is disciplined, low cost, and contains oversight of the manager to hold them accountable.

Mr. Lenhard walked the Board through the performance of large-cap US funds versus the S&P 500 Index over 10 years. He reported that the benchmark returned 7.31% and that 35% of managers outperformed the benchmark. He then reported on Vanguard's assortment of share class structure, indicating large institutions pay as low as a two basis point expense ratio. Mr. McGettigan added that the City's Plan does use the lowest cost share classes available for the products it invests in.

Mr. Lenhard then described Vanguard's securities lending practices. He stated that the S&P 500 index has no expenses and Vanguard has an expense ratio, which is historically 20 basis points. He stated Vanguard employs a few techniques to earn back that 20 basis points so that the net return of the fund looks more like the benchmark. He indicated that Vanguard lends some of their held securities to other Wall Street institutions and gets paid for doing so. He stated that Vanguard requires the loans to be fully collateralized and that they invest that collateral conservatively in a money market instrument to earn a few basis points. He reported that Vanguard takes 100% of the net revenue and puts it back into funds, while other index providers will do revenue split and keep part of the revenue.

Tom Moutes asked how conservatively the collateral is invested. Mr. Lenhard stated that it goes into a fund with almost no risk from Vanguard's perspective. He added that securities lending had a problem 7-8 years ago, when people lost money through this practice. He stated that the loss occurred on the investment of the cash collateral because investment managers, in trying to earn higher returns took greater risk, which resulted in losses. He stated that Vanguard, in contrast, has been very conservative and has had no losses in its securities lending program. Don Thomas asked whether lending to institutions that are short selling exposes the equity to risk. Mr. Lenhard responded that from Vanguard's perspective, they don't view that as a negative return risk due to the collateralization.

Mr. McGettigan added that in the industry there are volume and value lenders. He stated that a volume lender will lend any security they can even if they're earning a very small margin, while value lending means lending fewer "special" securities where there is a higher premium. He reported that Vanguard takes the value approach, which makes it more conservative. Mr. Muir asked what percentage of the portfolio is typically on loan. Mr. Lenhard indicated 0-5% of the portfolio.

Mr. Lenhard provided a review of the S&P 500 fund. He stated Vanguard takes two approaches to portfolio management, one being a complete replication approach where they own every single security in the same weighting as a given index and the other being an optimization approach which is used for larger indices. He stated that for the S&P 500, they use a replication approach and that returns for Vanguard Institutional index Fund are within a basis point of the S&P 500 index.

Ray Ciranna asked whether Vanguard has any equal weighted products. Mr. Lenhard responded that most growth comes from market cap weighted indexing, which Vanguard strongly believes in. He stated that indexing has taken one third of assets away from active managers, so the market responded with new products. He added that Vanguard believes in market cap weighted indexing because of low-cost broad diversification risk control as well as low turnover, low transaction costs, and low capital gains realizations. He added that while one can weight the S&P 500 other ways, there is a 50/50 chance it will outperform or underperform over the short term. He noted that over the long term, however, as soon as the market opens up, it gets out of line and is no longer equally rated, the fund must be rebalanced which in turn results in additional turnover, transaction costs and advisory fees. He stated that because of this, he did not think alternative weighting methods are superior to market cap weighted indexing. Mr. Ciranna inquired whether Vanguard has any studies or data to support this. Mr. Lenhard responded that firms offering these products tilt them towards factors that have worked over the last 10–15 years, i.e. value and midcap weighting when those factors had outperformed during some time periods. He stated that he's concerned they're going to be sold like actively managed funds have been sold, claiming that they have outperformed the index. He argued that this can potentially cause confusion among investors chasing returns. Mr. McGettigan added that with an equal weighted index, you are underweighting largest companies and overweighting smallest companies. He argued that taking a smaller company bet over larger company bet is an active decision to vary away from a market cap index. He stated Vanguard believes that the market cap is the true index, and anything different is taking a bet on some or multiple factors.

Mr. Lenhard reviewed the characteristics of the the Plan's Mid-cap portfolio and reported that it was in line with the benchmark. He stated that the Plan's Small-cap fund is benchmarked against the CRSP US Small Cap Index. He reported that the overall characteristics of the portfolio mirrored its benchmark.

Mr. Thomas inquired about Vanguard's stance on target date funds. Mr. McGettigan responded that Vanguard offers target retirement / target date funds that work as a suite of 12 funds in five year increments. He stated that in a target date fund, an investor can choose a year of anticipated retirement and invest money into an asset allocation that automatically becomes more conservative over time. He indicated Vanguard uses an index approach to target date funds and stated there are five underlying index funds within the target structure. He stated that they could offer this in an active structure, but decided that indexing was more appropriate for the type of investors in target date funds. Mr. Thomas asked if there's something to be gained or lost from investing in the underlying funds as opposed to holding the target date fund itself. Mr. McGettigan responded that the reason target date funds are successful is because participants pick an allocation and never change it throughout their career, which from a financial investment theory perspective results in severe overweights or underweights from where one should have been from an equity fixed income perspective. He added that target date funds are largely designed to counter the inertia and procrastination that behavioral finance has observed in participant behavior.

John Mumma asked if Vanguard offers risk-based profile funds. Mr. McGettigan responded that Vanguard offers both target date as well as four different risk-based portfolios. Mr. Mumma asked from a philosophical perspective whether it's acceptable for an investment provider to outperform an index when the goal is to mirror it. Mr. Lenhard responded that it's preferable to have an index that outperforms by a few basis points over the long term as opposed to one that tracks it perfectly. He added that Vanguard leverages several strategies to earn back the expense ratio to perform more in line with the benchmark. He listed securities lending and class action lawsuit proceeds as two examples, which can lead to positive excess returns. Mr. McGettigan added that the three equity funds the Plan holds are full replications. and that the total bond market fund that the Plan holds is a sample/optimized fund. He stated that the benchmark has approximately 9000 securities while the fund has 7,000 or 8,000. He stated part of the reason for that is that in terms of bonds, the benchmark includes smaller issues that the Plan cannot invest in, and sometimes when they come to market, are very expensive and not prudent to invest in. He stated Vanguard will sample and try to get characteristics as close as possible to the benchmark, which can cause tracking error, but usually is a wash in the long term.

Mr. Thomas noted that in comparison to Charles Schwab's offerings, Vanguard's index funds have a higher expense ratio and asked why that was the case. Mr. McGettigan responded that Vanguard has seen increased competition and that some competitors are trying to get into the business by undercutting Vanguard. He speculated they may be operating the funds as loss-leaders and didn't know how long that could be sustained. He stated that Vanguard's expense ratio is determined organically because it's solely based on operating costs. Lastly, he added that the expense ratio has decreased over the years and will continue to do so. Mr. Lenhard added ten to fifteen years ago, equity exposure cost as much as 1% or 1.5%, but there is a "cost lowering war" which he described as good for plan sponsor, but a challenge for Vanguard.

5. BOARD REPORT 16-33: THIRD PARTY ADMINISTRATOR TRANSITION UPDATE

Steven Montagna presented the monthly update and progress report regarding the Third-Party Administrator (TPA) transition, which is expected to conclude during the third quarter of 2017. He stated that several in-person as well as weekly conference call meetings have occurred between City Plan and Voya staff to work through implementation details.

Mr. Montagna stated that it was determined early in the process that it is important to create and codify a mission for the transition. He stated it is important to make clear that the change the Plan is undergoing is not only a change in TPA provider, but more importantly, an opportunity for the Plan to move forward and improve what it is doing and how it doing it.

He stated the report includes the mission of the transition which ties to the mission of the Plan. He provided the Board with five key objectives of the TPA transition, which include the ability to use new technology and tools to help participants create and maintain retirement income security, and being able to better leverage personalized local counseling. He stated other key objectives include streamlining administrative services; raising the bar on communication and engagement efforts which includes utilizing the dedicated full time Voya communications employee who will be locally based; and using the transition to move the Plan toward a framework of measuring success and creating accountability for making change and progress happen through better data and results measurement.

Mr. Montagna noted this endeavor will not be undertaken as a single point in time change but a process of ongoing improvements. He stated that City and Voya staff have outlined several areas of potential Plan enhancements/improvements that will be shared with participants. He stated participants will be assured that there will not be any increase in fees, and that transactional fees identified during the RFP as higher than existing fees were negotiated down and there will no longer be a fee for rollover account maintenance. He stated the Plan is working to incorporate its Retirement Income Projection Calculator within Voya's web platform, and the goal was to have auto-enrollment functionality in place by the time the transition is made, which will include a percent of pay deferral option. Mr. Mumma inquired as to whether the Controller's Office confirmed this was possible. Mr. Montagna indicated prior indications from City and DWP payroll staff indicated this was possible. He stated Voya is able to administer direct deposit of loans to participant accounts, accelerate loan repayments, and use ACH for purchase of service payments.

Mr. Montagna reported that a primary discussion point during implementation meetings was the City's ability to improve upon the data the City provides to the TPA via the payroll feeds. He stated that City payroll currently provides minimal data, but staff was researching providing a full demographic file including those who are currently in the Plan and those who are not. He reported that some state and local agencies already do this. He stated that providing additional demographic information would allow for targeted communications or employment status updates which would be helpful in processing of distributions. He added that another option may be adding more fields to bi-weekly contribution files. He stated City staff would like to discuss these possibilities with payroll systems staff. He stated that, as a baseline, the Plan is looking for the ability to increase the data fields accompanying the contribution file. Mr. Montagna stated that communication from the Board to the Controller's office on this matter would be helpful. Wendy Macy asked what happens if one payroll system says 'yes' and one says 'no' to providing a demographic information. Mr. Montagna responded that both we need to say 'yes' to implement improvements.

Mr. Montagna continued his presentation by discussing participant communications. He stated that staff was working with Voya to create an announcement and introduction of the TPA change in the early part of 2017, well in advance of the transition. He reported staff would return at the January 2017 meeting with a draft of the communication piece. He also stated that staff would bring information regarding efforts to create a stakeholder infrastructure including labor partners, the retirement systems, and others who could help to reinforce Plan communication initiatives.

Ms. Macy noted the Plan has had public meetings and information about the transition was already public. She inquired as to whether a message should go out prior to January. She also inquired as to whether participants have already contacted staff regarding the transition. Mr. Montagna replied that there haven't been any inquiries, but recommended that before the Plan publishes information it be fully vetted by the Board.

Mr. Montagna concluded his presentation by providing an update on the pending report from Board to City Council requesting TPA contract extensions. He clarified that procedurally the matter was referred first to the Mayor, which would then make the appropriate referral for CAO review or to Council. Mr. Ciranna noted that the matter won't be before the council until after the contract expires and inquired as to the Plan's liability in this case. Mr. Montagna stated that contract includes language for services to continue past its expiration date. Curt Kidder commented that there is some risk if Council does not approve the extension in that the contractor's services would not be compensated. However, he noted that it is not unusual for a contractor to provide services out of contract and then to be compensated once the contract is approved.

A motion was then made by Mr. Moutes, seconded by Mr. Ciranna, to receive and file the update regarding the Third Party Administrator transition; the motion passed unanimously. A second motion was made by Mr. Ciranna, seconded by Mr. Moutes, to approve and authorize the Board Chairperson to sign a communication from the Board to the City Controller and Department of Water and Power requesting their cooperation and assistance in implementing the necessary payroll programming changes related to the transition; the motion was unanimously adopted.

6. BOARD REPORT 16-34: DCP FY 16-17 GOALS, STRATEGIES & METRICS

Daniel Powell updated the Board on progress made toward FY16-17 participant goals, strategies and metrics, provided an update regarding the results of the 2016 National Retirement Security Week campaign, and presented staff's request for approval for $2,500 in funding for the random gift card drawing conducted for the campaign.

Mr. Powell began by reporting that with 550 year-to-date (YTD) gross new enrollments the Plan was on pace to meet its goal of 1,485 annual enrollments. He stated that YTD participant annualized average contributions were $7,987, a 13.5% increase from the prior year, outperforming the goal of 2%. However, he noted that contributions fluctuate greatly from pay period to pay period. He also reported that staff is developing a contribution calculator so participants can calculate their contribution as a percent of pay, rather than simply a dollar figure.

Mr. Powell reported that the Plan adopted a goal of reducing the total amount of closed accounts by 3%, a reduction from 867 to 841 closures. He stated that during the first quarter of the fiscal year, the Plan saw 190 account closures, putting the Plan on track to meet this goal. He also reported the Plan is not on pace to reach the goal of reducing the total number of gross dollars rolled out of the plan by 5%, a reduction from $91.5 million to $86.6 million. He stated that during the first quarter of FY 16-17, $31.3 million rolled out. He reported that to address this, staff is developing new communications resources and strategies but added that incoming rollovers during the same period totaled $59.2 million, double the outgoing rollovers. He stated the increase in incoming rollovers was likely attributable to sworn participants rolling in DROP funds.

Mr. Powell reported that 2016's National Retirement Security Week campaign revolved around an interactive "Financial Wellness" exercise, which asked Plan participants to complete a brief series of quiz questions to become eligible for a random gift card drawing. He stated the objective of the campaign was to raise awareness of the City's Plan by helping participants place retirement planning within a larger financial wellness context. He reported that this year's campaign reached a new record with survey responses totaling 2,962, over twice the total from the year prior.

Mr. Powell concluded his report by stating that staff typically includes a request for gift card funding for National Retirement Security Week prior to the implementation of the campaign, but did not do so this year. He stated that staff is therefore requesting that the Board approve $2,500 to fund gift card incentives.

Mr. Mumma, in encouraging enrollment, inquired whether the Plan could reach out to people who completed the National Retirement Security Week survey but are not Plan participants. Mr. Powell responded that the staff would look into that suggestion.

A motion was made by Cliff Cannon, seconded by Mr. Thomas to receive and file the report regarding the Deferred Compensation Plan goals, strategies and metrics; the motion was unanimously adopted. A second motion was made by Mr. Cannon, seconded by Mr. Thomas, to approve the expenditure of $2,500 for gift cards for the 2016 National Retirement Security Week survey drawing; the motion was unanimously adopted.

7. BOARD REPORT 16-35: PLAN PROJECTS & ACTIVITIES REPORT

Matthew Vong updated the Board on the status of current and/or pending Plan projects and activities for October 2016. He reiterated the conclusion and success of 2016's National Retirement Security Week campaign. He reported that the Plan Governance and Administrative Issues as well as the Plan Investments committees would convene on December 7, 2016 and December 14, 2016, respectively. He reported that the Union Bank trade agreement issues have been resolved, but the Plan was waiting on exemptions to general contracting requirements to be finalized.

Mr. Vong concluded his report by stating that management assistant, Angela Yin, had resigned her position effective week of November 14, 2016. He stated staff would be looking to refill her position as soon as possible.

Mr. Moutes noted that the Board Reports indicated that Plan staff would be providing monthly metrics update reports. He suggested that this report be provided on a quarterly basis.

Mr. Ciranna inquired about the execution timeline for the Union Bank contract. Mr. Montagna responded that there is uncertainty due to the question of exemptions. He reported that Personnel Department internal staff stated that the exemptions were acceptable, but it was not clear who has the authority to grant the exemptions. He stated that this issue arose for previous bank contracts and exemptions were granted in those cases. He reported that staff would work with Mr. Kidder on this matter, and once it is resolved, execution of the contract should occur quickly since there will be fewer requirements to work with.

A motion was made by Mr. Thomas, seconded by Mr. Cannon, to receive and file staff's update on Plan projects and activities during October 2016; the motion was unanimously adopted.

8. REQUESTS FOR FUTURE AGENDA ITEMS

Mr. Mumma asked that investment provider presentations be sent out further in advance in the future. He also asked that Plan staff and consultants require higher quality reports with more depth. Mr. Moutes added that he would like to see attribution analysis for active investment managers.

9. FUTURE MEETING DATES – December 20, 2016

10. ADJOURNMENT

A motion was made by Mr. Moutes, seconded by Mr. Cannon, to adjourn the meeting; the motion was unanimously adopted. The meeting adjourned at 10:25 a.m.

Minutes prepared by staff member Daniel Powell.