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

MINUTES

JANUARY 11, 2012

Board Members Present:
Javier Romero, President
Cindy Coffin, Vice President
Mario Ignacio, Chief Accounting Employee
Ronald O. Nichols, General Manager
Barry Poole, Regular Member
Robert Rozanski, Retiree Member

Board Members Absent:
DWP Commissioner - Vacant

Staff Present:
Sangeeta Bhatia, Retirement Plan Manager
Monette Carranceja, Assistant Retirement Plan Manager
Mary Higgins, Assistant Retirement Plan Manager
Jeremy Wolfson, Chief Investment Officer
Julie Escudero, Utility Executive Secretary

Others Present:
Marie McTeague, Deputy City Attorney

President Romero called the meeting to order at 9:10 a.m.

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

Public Comments
Brian White, an employee in the Water Quality Division, addressed the Board on behalf of a group of his co-workers who have reviewed the most recent annual report and wanted to know the proper mechanism to pose questions and request additional information. Mr. Romero indicated the Retirement Office Staff is available to answer questions.

1. Request for Approval of Minutes for October 19, 2011, Special Meeting

Mr. Rozanski moved that the Board approve Item 1; seconded by Ms. Coffin.

Ayes: Coffin, Ignacio, Nichols, Poole, Romero, and Rozanski
Nays: None

THE MOTION CARRIED.

2. Investment Reports for November 2011
   a) Summary of Investment Returns as of November 30, 2011
   b) Market Value of Investments by Fund and Month as of November 30, 2011
   c) Market Value of the Retirement, Death, and Disability Funds and Retiree Health Care Fund as of November 30, 2011
   d) Summary of Contract Expirations

3. Report on Status of Insurance as of December 13, 2011

Mr. Rozanski moved that the Board approve Items 2 and 3; seconded by Mr. Nichols.

Ayes: Coffin, Ignacio, Nichols, Poole, Romero, and Rozanski
Nays: None

THE MOTION CARRIED.

4. Presentations by The Segal Company – Annual Actuarial Valuations

The Board acknowledged Paul Angelo from The Segal Company, the Plan's actuarial firm. Mr. Angelo explained he was in attendance to review the annual actuarial valuations for the Plan's Disability Fund and Death Benefit Fund, as well as the annual Governmental Accounting Standards Board (GASB) Statement. He explained how the valuation procedures for these reports differ from the approach used for the pension valuation.

a) Disability Fund as of July 1, 2011

Mr. Angelo explained the valuation for the Disability Fund includes the Temporary Disability Benefits and the Permanent Total Disability Benefits and is used to determine the contribution rates for the benefits covered by the Disability Fund. He reported in Fiscal Year 2010/2011 members contributed $466,000, and the Department contributed $12.2 million. He noted Segal was recommending the Department contribution rate for the Temporary Disability Benefit Fund be increased from $1.29 per $100 of compensation to $1.43 per $100 of compensation, and he noted Segal recommended no Department contributions for the Permanent Total Disability Fund due to the $27 million reserve balance in that benefit.

Discussion ensued regarding funding approaches for the disability benefits, and the Board asked that topic be added as a future agenda item for further discussion.

b) Death Benefit Fund as of July 1, 2011

Mr. Angelo explained this report is used to determine the contribution rates for the three benefits covered by the Death Benefit Fund (i.e., Family Death Benefit, Supplemental Family Death Benefit, and the Insured Lives portion of the Death Benefit Fund). He reported Segal's recommendations as follows:

- Continue to suspend the Department's contribution rate for the Family Death Benefit due to the $1.9 million current balance for this benefit,
- Maintain the Supplemental Family Death Benefit's current contribution rate of $2.25 biweekly for active members and $4.90 monthly for retirees and disabled members,
- Decrease the Department's contributions to the Insured Lives Benefit for active members from $0.29 per $100 of covered payroll to $0.25 of covered payroll, and $1.00 biweekly for member contributions, and
- Decrease the Department's contributions to the Insured Lives Benefit for retired and disabled members from $1.48 per $100 of retirement payroll to $1.44 per $100 of retirement payroll.

Mr. Nichols commented on the overfunding of the reserve levels and asked if anything inherent made the Department contributions more expensive than necessary. Mr. Angelo responded it was unclear if moving from a reserve approach to a level cost approach would increase the cost for the disability benefits and some of the death benefits, but a level cost approach for the insured lives death benefit for the non-contributing members increased the cost as demonstrated in the GASB report.

c) GASB Statement as of July 1, 2011

Mr. Angelo explained the Plan's auditors determined that the portion of the insured lives death benefit that covers retired members is subject to the GASB accounting rules, and this statement is for reporting only and not for determining department contributions. He noted that asset smoothing is not used for the Insured Lives Death Benefit for Non-Contributing Members because these are relatively short-term investments and are not subject to high volatility.

Mr. Angelo reported if the Non-Contributing Death Benefit were being funded according to GASB rules, the unfunded liability would be approximately $86 million, the annual required contribution would be 1.31% of active compensation or approximately $11 million, and the Net Pension Obligation

(NPO), which is accrued when expenses exceed cash funding, would be approximately $25 million compared to last year's $20 million NPO.

Mr. Rozanski moved that the Board:

1) approve Resolution No. 12-44 to adopt the actuarial review of the Disability Fund and recommendations of the Plan's actuary;

2) approve Resolution No. 12-45 to adopt the annual review of the Death Benefit Fund including the recommendations of the Plan's actuary; and

3) approve Resolution No. 12-46 to adopt the GASB actuarial valuation and review of the Death Benefit Fund for Non-Contributing Members as of July 1, 2011;

seconded by Mr. Nichols.

Ayes: Coffin, Ignacio, Nichols, Poole, Romero, and Rozanski
Nays: None

THE MOTION CARRIED.

5. Discussion of Proposed Excise Tax Liability as Contained in the Patient Protection and Affordable Care Act

Ms. Bhatia reported this item was brought back at the Board's request to provide a better understanding of the proposed excise tax which was brought to the Board's attention by the Plan's auditors during the review of the Annual Audit Report and Financial Statements for 2010-2011. She stated the report prepared for the Department by The Segal Company (Segal) was attached for the Board's information, and Paul Angelo from Segal was present to provide some clarification.

Mr. Angelo explained the proposed excise tax is a provision of the Pension Protection and Affordable Care Act of 2010 (PPACA) that, to Segal's understanding, imposes an excise tax of 40% on the cost of health plans above a certain threshold. He stated the 40% tax only applies to non-Medicare retirees between 55 and 64 years of age, and retirees who are 65 years of age and over will have a lower threshold because they are eligible for Medicare. He noted the proposed tax is not effective until 2018, and much uncertainty exists on how it will work.

Mr. Angelo stated the Plan's actual premiums are well below the threshold but, because the calculations are long term, any increase in premiums theoretically would not occur until 20 years from the effective date of the proposed tax. He added it is still unclear how the tax will be paid.

He added Segal was directed to calculate the excise tax and incorporate the result into this year's valuation report which resulted in a reflected liability of approximately $30 million. He noted if the calculation was included into the cost today, the Annual Required Contributions would increase by approximately 0.25% of payroll, the unfunded liability would increase by approximately $30 million, and the funded ratio would decrease by approximately 1.5%. He stated these figures were based on their pro rata and were no guarantee of the actual costs.

In response to a question by Mr. Nichols regarding when it would be prudent to start providing additional reserves to cover the additional costs, Mr. Angelo said he believed it would continue to be the Department's discretion to determine the funding level as long as it was willing to live with any spread between the cash and the expense.

All agreed that much discussion will need to take place in the future regarding the proposed tax.

6. Presentation by Glass Lewis – Annual Proxy Season Review

The Board acknowledged Robert McCormick, Chief Policy Officer at Glass Lewis & Co.

Mr. McCormick reviewed developments that occurred during the 2011 proxy season. He reported 2011 was the first year the required Say-on-Pay was implemented. He provided background on the Say-on-Pay and stated it has become a standard global tool to allow shareholders to express their input on executive compensation.

He reported on reverse mergers at Chinese companies, where some Chinese companies will buy a United States or Canadian company and credit it back to list it in North America and thereby bypass required disclosure controls.

He also spoke about diversity in companies' Boards of Directors, and on shareholder access where shareholders ask companies for the opportunity to nominate someone to a company's board without going through the expense of a "proxy contest".

He provided an update on new regulations concerning proxy advisors, fiduciary definition, and mandatory auditor rotation. He also reported that Glass Lewis has refined the Plan's policy regarding shareholder proposals on divestment enhancement to streamline the process and reduce the number of case-by-case evaluations.

7. Presentation by Pension Consulting Alliance, Inc. – Third Quarter Hedge Fund Performance

The Board acknowledged David Sancewich from Pension Consulting Alliance (PCA). Mr. Sancewich reported that Aetos was currently the sole manager in this portfolio. He stated they underperformed for the month down 2.1% net of fees, and they underperformed for the quarter but have recovered somewhat. He stated they have outperformed their peers since inception by 2.9% on an annualized basis, and PCA has no alarms or concerns with the way they are managing this portfolio. He noted PCA recently visited Aetos' Menlo Park office and will provide a report at the next meeting.

Mr. Sancewich reported several changes in the hedge fund industry have taken place recently and approximately 60% of all single strategy and fund-of-fund managers have underperformed into the end of 2011, which he attributed to a bias toward equity markets and the Securities and Exchange Commission regulations.

8. Discussion of Performance of T. Rowe Price Associates, Inc., - Large Cap Growth Manager

Mr. Wolfson provided the background for this item which recommended T. Rowe Price be placed on short-term watch for continued underperformance. He indicated T. Rowe Price was aware this item was on the agenda and no representatives from the firm were in attendance.

Mr. Nichols moved that the Board approve Resolution No. 12-47 to place T. Rowe Price on watch for nine months; seconded by Mr. Ignacio.

Ayes: Coffin, Ignacio, Nichols, Poole, Romero, and Rozanski
Nays: None

THE MOTION CARRIED.

10. (ARTICLE OF INTEREST) ***Internal BNY Mellon Documents Show Panic*** **- <u>The Wall Street Journal</u> (OUT OF ORDER)**

No discussion.

11. Retirement Plan Manager's Comments (OUT OF ORDER)

Ms. Bhatia reviewed some of the Retirement Office highlights of 2011.

She acknowledged the contributions of the entire Retirement Office staff and thanked the Retirement Board for its support.

With respect to Administration, Ms. Bhatia reported on the turnover in the composition of the Retirement Board, particularly the Retiree representative; and the ex-officio members (Chief Accounting Employee, General Manager, and DWP Commissioner). Staff attempted to keep up with the changes and provide a smooth transition for the new Board Members. She noted the effectiveness of the Board meetings was a result of the preparation of Board materials and the timely distribution of Board packages.

She noted Staff tried to keep up with the discipline of preparing and distributing meeting minutes within approximately six weeks of every Board meeting, and she acknowledged Reggie Brewer for the technical support he provides for the Board meetings.

She reported the Retirement Board agendas and packages are now posted on the Retirement Office website. She noted this can sometimes be a disadvantage when members of the media access the material and reference the Retirement Office or Retirement Board without having received any official comments by Retirement Office staff.

With respect to benefits, Ms. Bhatia reported the Plan is responsible for the payment of approximately $380 million annually in retirement benefits to approximately 10,000 retirees and beneficiaries; approximately $8 million in death benefits for active and retired employees which varies each year; and approximately $13 million each year in disability benefits.

She reported the Reciprocity program and the associated costs became a concern in 2010, and extensive work took place in 2011into producing reports and actuarial work pertaining to the program. She noted the issue continues to be handled by the Department's Labor Relations Office.

Ms. Bhatia reported Staff implemented the new additional annuity payout options in February 2011 and successfully implemented the change in the interest crediting rate from 8% to 7.75%. She noted this involved a considerable amount of Staff work to ensure that member records properly reflected the changes and that charges were properly made on service purchase contracts.

She reported Staff kept up with complex tax provisions and implemented changes in the tax treatment of several Plan benefits as required by changes in federal and state legislation and tax counsel.

She noted the annual member statements were produced using the new computer system module that has been in place for a couple of years. She noted the timeliness of providing the statements has improved each year, and this year's statements were mailed in August.

Ms. Bhatia reported the Retirement Office attempted to reorganize the personnel resources in the Benefits Group, within the constraints of MOU provisions, to provide better oversight and compatibility with the new computer system.

She reported operational costs were reduced by using standardized paper and envelopes instead of the custom paper previously used.

Ms. Bhatia reported 32 retirement seminars were held in 2011, including six seminars in the outlying areas, with approximately 50 to 70 attendees per seminar; approximately 1,600 employees were trained this past year.

She stated Retirement Office management continued to improve communication with Retirement Office employees and increased the frequency of the "all-office" meetings.

Ms. Bhatia reported the Retirement Board and Staff are responsible for the oversight of investments for both the Retirement Fund and the Retiree Health Fund, and as of June 30, 2011, the value of the portfolio was over $8 billion.

She noted the Board hired six new investment managers/mandates and funded five new investment managers. Staff completed contracts for seven new investment managers which included contract extensions, and all required extensive Staff work and coordination as well as legal reviews.

She reported Staff renegotiated several contracts and saved approximately $250,000 annually on the extension of the Wells Cap High Yield contract, approximately $50,000 annually on the Pension Consulting Alliance contract, and approximately $24,000 annually on the contract with Courtland Partners.

She reported Staff also successfully negotiated fees with The Boston Company Emerging Markets contract for a saving of approximately $90,000 annually.

She noted the Commission Recapture program earned $284,000 in 2011, and the Securities Lending program earned approximately $2.6 million.

She reported several Investment Policy revisions were successfully managed, one of which was the 5% allocation to Covered Calls.

Ms. Bhatia also reported on some of the challenges and setbacks that occurred in 2011. She noted Staff fell behind on various projects, in particular the implementation of the new computer system. She attributed this to the lack of sufficient resources (vacancies, employees out on long term disability, as well as reasonable accommodation). She reported when Staff was able to fill a vacancy it took from three to four months to fill the position.

She reported that Staff has been unable to implement the payroll module of the new computer system and is negotiating with the vendor to assign resources to repair some of the defects Staff has uncovered. She reported existing Retirement Staff continues to juggle operations and testing, and data clean-up continues to be a significant issue and also poses risks with respect to the accuracy of benefits at times.

She stated the document imaging contract and the scanning of back files has still not begun, but Staff has established the workflow for the forward scanning. Staff was able to scan approximately 36,000 documents which included the 9,000 annual member statements.

Mr. Romero thanked Ms. Bhatia and Staff for all that had been accomplished and for the savings they provided for the Plan.

12. Future Agenda Items

Mr. Nichols asked for sometime in the first half of this 2011 to have a follow-up discussion with Paul Angelo on some the issues he addressed during his valuation report with respect to simplifying or modifying the methods for establishing reserves in the funds, the possibility of reallocation among them, etc.

Mr. Romero asked for a running update on financing contracts in other countries. He also asked for report on the salary parity of the Department's Chief Investment Officer (CIO) with the CIO positions in the City.

9. Proposed 2012 Manager Presentation Schedule (OUT OF ORDER)

Mr. Rozanski moved that the Board approve the 2012 Manager Presentation Schedule; seconded by Mr. Nichols.

Ayes: Coffin, Ignacio, Nichols, Poole, Romero, and Rozanski
Nays: None

THE MOTION CARRIED.

With no further business, the meeting adjourned at 11:19 a.m.

Javier Romero 2/22/12
Javier Romero, Board President — Date

Sangeeta Bhatia 2.22.12
Sangeeta Bhatia, Retirement Plan Manager — Date

Julie Escudero 2.22.12
Julie Escudero, Utility Executive Secretary — Date