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

MINUTES

JUNE 13, 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:
Alan Manning, Assistant City Attorney
Marie McTeague, Deputy City Attorney

President Romero called the meeting to order at 9:09 a.m.

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

(OUT OF ORDER)
The Board met in closed session at 9:11 a.m. on the following item:

2. **Closed Session Pursuant To Government Code Section 54956.9(A) To Confer With Counsel Regarding Pending Litigation (One Case) And Possible Action:**

   In Re Bank Of New York Mellon Corporation False Claims Act Foreign Exchange Litigation, Ex Rel. Fx Analytics, Plaintiffs, V. The Bank Of New York Mellon Corporation, The Bank Of New York Mellon Trust Company, N.A., Et Al., Defendants (United States District Court, Northern District Of California, San Francisco Division, Case No. 3:11-Ev-05683-Wha)

The Board met back in open session at 9:28 a.m. with no action taken.

(OUT OF ORDER)
1. **Request for Approval of Minutes:**
   a) May 9, 2012, Regular Meeting
   b) May 23, 2012, Regular Meeting

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

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

   THE MOTION CARRIED.

(OUT OF ORDER)
PUBLIC COMMENTS
Ms. Escudero stated no public comments were requested at this time.

3. Discussion of the Global Inflation Linked Securities Mandate Guidelines

Mr. Wolfson reported this item was for Board consideration to modify the manager specific guidelines for Western Asset Management Company (WAMCO), the Plan's current manager for the Global Inflation Linked mandate. He stated representatives from WAMCO requested their guidelines be modified to allow the use of derivatives to help hedge the portfolio, especially during crisis situations.

The Board acknowledged Neil Rue and David Sancewich from Pension Consulting Alliance (PCA). Mr. Sancewich explained the guideline changes were prompted by WAMCO's request for more room to manage volatility and interest rate exposure within the Plan's Global Treasury Inflation-Protected Securities (TIPS) portfolio in the Real Return allocation. He indicated PCA and Plan Staff worked with WAMCO and revised the guidelines to: 1) add interest rate futures and government securities issued by countries to the list of eligible securities; 2) limit investments in original futures margins and options premiums to no more than 5% of the portfolio; and 3) add cash, cash equivalents, and liquid assets to the derivatives exposure.

Mr. Nichols asked if WAMCO would have grounds to increase their fees due to added collateral requirements, and Mr. Rue stated he believed the probability of that was low.

In response to Mr. Ignacio's question of why WAMCO chose this time to request these changes, Mr. Sancewich explained WAMCO's request was in response to a due diligence question which asked if they wanted to change anything in the guidelines or process, given the current environment.

Mr. Ignacio also asked if most investment manager policies have a 5% limit and whether that figure is considered to be conservative. Mr. Sancewich replied many managers have no guidelines or constraints on derivative uses, and 5% is very conservative from an industry standpoint. Mr. Rue clarified the 5% is the margin account maintenance level and not the exposure level.

Mr. Ignacio asked why WAMCO's reference to swaps was not mentioned in the guidelines, and he asked for clarification of the perception of hedging a hedge in reference to "other options or futures positions".

In response to the hedge of a hedge reference, Mr. Rue explained WAMCO could choose to have a derivative contract that offsets another derivative contract, and it would only be used for reducing interest rate risk exposure.

Regarding why swaps were not included in the guidelines, Mr. Sancewich said excluding swaps keeps the portfolio conservative and in line with less risky derivatives.

With respect to the 5% margin, Mr. Rozanski asked if an incremental margin would need to be posted once the original margin is posted. Mr. Rue said it would. He added it would not be included in the original 5% policy limitation; however, a minimum level of capital in those margin accounts would have to be maintained.

Mr. Rozanski moved that the Board approve Resolution No. 12-89 to amend the investment Policy for the Global Inflation Linked Securities Mandate; seconded by Mr. Nichols.

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

THE MOTION CARRIED.

(Mr. Manning left the meeting at 9:51 a.m.)

4. Discussion of Absolute Return Allocation

Ms. Bhatia stated earlier this year the Board adopted the recommendation of Pension Consulting Alliance (PCA) to restructure the Absolute Return strategy within the Real Return asset class and, as part of that recommendation, agreed for PCA to conduct a survey of the hedge fund industry and report back to the Board on the industry's best practices. She stated the results of PCA's survey were provided to the Board, and PCA representatives were in attendance to present their findings and recommendations.

The Board acknowledged David Sancewich and Neil Rue from PCA. Mr. Sancewich explained this item did not involve issues with Aetos (the Plan's current hedge fund manager), rather it is a recommendation to change the Plan's current commingled account to one with two managers in separately managed accounts. He stated PCA recommends the Board establish guidelines for both mandates that would mitigate equity risk and also work with the three other components in the Real Return allocation. He stated PCA also recommends the Board conduct a formal search and allow Aetos to formally respond to a Request for Proposal (RFP).

Mr. Rue confirmed that the Board Members already approved a two-manager structure, and now needed to determine the types of managers to use, how the managers should complement each other, and the amount of funds to allocate to each. He noted the current allocation to Aetos is $35 million and, under the two manager structure, the smallest allocation to any one of the managers would be approximately $45 million. He stated if after the RFP process the Board chose to retain Aetos, PCA would recommend the Board renegotiate Aetos' fees from a performance based fee structure to a flat fee structure.

Mr. Sancewich highlighted PCA's survey results and their paper on structuring hedge fund portfolios. He stated they currently classified Aetos as a convergent manager, and statistics indicate a better way to construct the portfolio to avoid tail risk. He stated this would ideally be with two managers with consistently lower volatility of returns on an annualized basis.

Messrs. Sancewich and Rue explained the search process and explained the first step would be to establish a separately managed account, then establish guidelines to include in an RFP (one for convergent strategies and one for divergent strategies).

Ms. Coffin asked that if Aetos was capable and willing to move in the direction PCA recommended, could they then just redirect instead of going through the RFP process. Messrs. Sancewich and Rue explained the proposed structure and performance target are very different from the current mandate, and it is important for the Board Members, Staff, and PCA to understand and agree on how this is going to work. They added competition is necessary to secure the lowest possible fee structure.

In response to Ms. Coffin's question regarding how the separately managed funds would be advertised in the RFP, Mr. Rue said that although the RFP has not yet been designed, the two sets of guidelines (convergent and divergent) would be included as two separate exhibits, and the respondents would indicate their style.

The Board directed PCA to develop an RFP for two separately managed hedge fund managers and present it to the Board for discussion and approval.

5. Discussion of Contract with Fred Alger Management, Inc., Domestic Large-Cap Growth

Mr. Wolfson provided the background for this recommendation to extend the contract with Fred Alger Management, Inc. (Fred Alger), for an additional three years. He reported that although the Board placed Fred Alger on watch in May 2012 for failing to meet the short-term performance criteria, the firm has added value since inception, and has performed in the second quartile compared to their peers in all periods except for the one-year period. He stated this extension request was more for procedural purposes since Fred Alger's contract is set to expire on July 31, 2012, and the firm was recently placed on watch status for up to nine months.

In response to Mr. Rozanski's comments about the level of risk which Fred Alger takes, Mr. Sancewich said the large cap growth active mandate administered by Fred Alger is not managed against the benchmark and is reviewed regularly. Mr. Rue added Fred Alger is higher than the average growth manager, but they are not in the extreme, and their contract contains the standard 30 day termination clause should the Board wish to end the agreement. Mr. Sancewich added PCA and Staff will continue to monitor Fred Alger's performance and will report back to the Board at the end of the watch period.

Mr. Poole asked if PCA considered the performance of other similar managers prior to recommending extending the contract instead of conducting a Request for Proposal (RFP). Mr. Wolfson explained extending the contract for now will provide for the full nine-month watch period approved by the Board before the contract's scheduled expiration at the end of July.

Mr. Poole said he would like PCA/Staff to survey the performance of comparable managers six months prior to the end of a contract to see which managers performed in the upper quartile during various periods and to determine whether or not to issue an RFP. Mr. Rozanski echoed Mr. Poole's request for more information to better make an informed decision for future extension requests.

Mr. Rozanski moved that the Board approve Resolution No. 12-90 to extend the contract with Fred Alger Management, Inc., for three years; seconded by Ms. Coffin.

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

THE MOTION CARRIED.

(The Board recessed at 10:38 a.m. and reconvened at 10:44 a.m.)

6. Discussion of Preliminary Strategic Investment Agenda by Pension Consulting Alliance, Inc.

Neil Rue from Pension Consulting Alliance (PCA) outlined the series of tasks PCA will complete over the upcoming twelve months to enhance the Real Return class.

Mr. Rozanski asked why the Timber Manager search required so much time, to which Mr. Wolfson stated timber is opportunistic and structured like private equity so managers often raise capital at inconsistent times.

(OUT OF ORDER)

8. Presentation by Pension Consulting Alliance, Inc. – 2012 First Quarter Real Return Performance

David Sancewich from PCA reported this is the first performance report for the Real Return Asset Class and includes the performance for the Global Inflation Linked Securities (GILS) portfolio as well as the Absolute Return portfolio. He noted the Real Return performance reports will eventually include Timber and Commodities.

He reported the portfolio outperformed the benchmark by ten basis points net of fees in the first quarter of 2012. He indicated the three year performance (which, in addition to hedge funds, includes GILS as of 2010) outperformed the benchmark by 6.3%, and underperformed the benchmark 0.8% for the five-year period.

He reported the five-year performance of the current portfolio with Aetos, including the historical portfolio with Pacific Alternative Asset Management Company (PAAMCO), trailed the benchmark largely due to the 2008 market crisis, but Aetos and the portfolio have performed well versus the universe and outperformed over all time periods, particularly the three-year period at 3% and the five-year period at 2.7%.

He reported as of March 31, 2012, the Real Return allocation was 89% global inflation bonds and 11% hedge funds. He noted the portfolio has outperformed the benchmark since February 2007 when the hedge fund component was funded.

He reviewed the five-year annualized return and the various portfolios in the Real Return allocation (WAMCO's Inflation Linked Bonds, the aggregate Hedge Funds, and Aetos).

(OUT OF ORDER)

7. Annual Presentations by Emerging Markets Equity Managers

a) The Boston Company

The Board acknowledged Andrea Clark, Senior Analyst from The Boston Company (TBC). Ms. Clark stated that since the Board had decided to contract with another emerging markets value firm, her presentation would be brief. She reviewed the management changes that took place during the past year. She reported the performance for the first quarter of 2012 experienced a major rally in emerging markets with significant fund flow activity. She reviewed the market activity, country attribution, sector attribution, and performance attribution.

She ended her presentation with a description of the steps TBC is taking to help mitigate some of their exposure to the high level of uncertainty in the market while also generating investment ideas for their portfolio.

b) T. Rowe Price

The Board acknowledged John Plowright from T. Rowe Price. Mr. Plowright called attention to the supplemental information he provided as an amendment to the presentation material. He also acknowledged this was the last presentation to be made by T. Rowe Price as one of the Plan's Emerging Markets managers.

He updated the Board on the minimal changes to the investment team, and he provided an update on the emerging markets environment and market valuations.

He reported the first quarter performance was very positive, but the second quarter was less favorable. He stated the performance for the year exceeded the index by approximately 1%. He noted the portfolio added 60 basis points in April, 90 basis points in May, 60 basis points month-to-date for June, and he added the portfolio is approximately 2% above the index since inception.

He reported on the attribution and pointed out that most of the outperformance came from North Asia. He ended with a review of the portfolio's characteristics and weightings.

(OUT OF ORDER)

9. Investment Reports for April 2012

- **a.i) Summary of Investment Returns as of April 30, 2012 (new format)**
- **a.ii) Summary of Investment Returns as of April 30, 2012 (old format)**
- **b) Market Value of Investments by Fund and Month as of April 30, 2012**
- **c) Market Value of the Retirement, Death, and Disability Funds and Retiree Health Care Fund as of April 30, 2012**
- **d) Summary of Contract Expirations**

No discussion transpired as these items were provided for reference only.

10. Retirement Plan Manager's Comments

Ms. Bhatia reported the new Integrated Pension System has been implemented; however, Staff is still working with the vendor on a number of outstanding items which ideally should be incorporated into the new system. She noted the Retirement Office received a very good price on the system project initially, but the length of time it took to implement the system and the challenges Staff has experienced with the data cleanup may require additional funding for maintenance and for some of the outstanding items that should have been part of the development. She noted Staff is using the request for retirement estimates as an opportunity to perform some of the data cleanup.

She segued into a report on the considerable backlog of retirement estimates and stated the backlog is primarily a result of staff shortages. She stated management had to focus most of the resources on implementing the new system so the estimates had to be reprioritized. She indicated currently two Management Analyst positions, two Principal Clerk Utility positions, and one Senior Clerk Typist position are vacant. She stated approximately 100 employees who plan to retire within a year have requested estimates, and basically only two staff members are available to calculate the estimates so overtime is occasionally utilized. She discussed some of the challenges related to providing these estimates, and she added that Staff is working on catching up.

11. Future Agenda Items

None requested at this time.

With no further business, the meeting adjourned at 11:23 a.m.

Javier Romero Board President	7/11/12 Date	Sangeeta Bhatia Retirement Plan Manager	7.11.12 Date
Julie Escudero Utility Executive Secretary	7.11.12 Date		