DEFINED CONTRIBUTION PLANS TRUSTEE
SPECIAL MEETING MINUTES
Monday, December 18, 2017

The Defined Contribution Plans Trustee Board of the City of San Diego held its special meeting in the Committee Room. Location: 202 C Street, 12th Floor, San Diego, California. The meeting was called to order at 1:05 p.m. by Estella Montoya.

Trustees Present: Julio Canizal, Robert Davis, Gail Granewich, Mark Hovey, Abraham Hunt

Staff present: Tom Brady, Estella Montoya, Quennelle Allen

Presenters:

Wells Fargo IRT	Denise Jensen (telecommuted)
Milliman	Jeff Nipp Bill Cottle
BlackRock	Sean Lewis Brendan Bowe
Vanguard	Scott Donaldson Michael Desmarais Tom Atchison
Capital Group	Michael Bowman John Smet
J.P Morgan Investments Management Inc.	Lynn Avitabile Patrick Carter

1. ACTION ITEMS

A. Roll Call (5-0) Estella Montoya

B. Select a Pro-tem for today's meeting Estella Montoya

MOTION TO NOMINATE MARK HOVEY AS CHAIRPERSON: Julio Canizal
SECOND: Gail Granewich
Approved: (4-0) Mark Hovey abstained

C. Dispense with the reading and approval of the minutes of November 29, 2017

MOTION TO ACCEPT THE MINUTES OF NOVEMBER 29, 2017: Gail Granewich
SECOND: Robert Davis
Approved: (5-0)

D. Introduction of Fund Managers

Mr. Cottle stated that he did a thorough review of Target Date Fund Managers and narrowed the list to twelve eligible Fund Managers. He informed the board that everyone (except CalPERS) responded to their questionnaire. Mr. Cottle confirmed they reviewed the results of the questionnaire at the last meeting on November 29, 2017. Mr. Cottle stated that the four most qualified candidates are here to present. Two passively managed firms and two actively managed target date funds. Mr. Cottle advised they will present in this order: BlackRock, Vanguard, Capital Group, and J.P. Morgan. Mr. Cottle stated there was information on the differences between the four managers on page 3 of the informational deck. He explained the top of the page compared the passive managers (BlackRock and Vanguard) and the bottom of the page compared the active managers (Capital Group and J.P. Morgan). Mr. Cottle discussed the information on page 4 and explained the length of time the target date fund firms manage funds through retirement. Capital Group manages assets thirty years through retirement. Mr. Cottle noted that J.P. Morgan has an opened commingled real estate fund that the other asset managers do not have. Mr. Cottle stated that they have included the time periods that the asset mix changes or remains constant as the participant moves further into retirement. Mr. Cottle advised that following pages of the packet includes information on the net of fees, returns, risks, and sharpe ratio. Mr. Cottle reviewed the four asset managers and he found that the active fund managers are stronger than the passive fund managers. Mr. Nipp advised the board that they will ensure the presenters stayed on time. Ms. Granewich inquired if the presenters had 30 minutes and additional time for questions. Mr. Nipp stated that the presenters had 30 minutes to present and to answer questions. Mr. Hovey advised to begin the presentations. Mr. Nipp informed the board that Ms. Jensen with Wells Fargo IRT was telecommuting via phone conference.

- BlackRock

Mr. Cottle introduced Mr. Bowe and Mr. Lewis with BlackRock. Mr. Bowe informed the board they were going to make the presentation as efficient as possible given the time limitations. Mr. Bowe stated that he would compare BlackRock with the other passively managed fund that will be presenting after them. Mr. Bowe advised that they can summarize the differences in three main points. The first point, diversification, they believe diversified target date funds are crucial in driving successful outcomes for participants specifically during down markets and recession periods. Mr. Bowe identified that they believe diversification is more than adding asset classes to the portfolio and BlackRock focuses on keeping in line with the overall philosophy and investment objective to the fund. The second point is taking the right type of risk at the right time along the glide path. Mr. Bowe clarified that the BlackRock target date fund focuses on taking bigger equity risk for the younger participants because they can afford that risk. The third point, is their view of the to verses through narrative which is the idea of balancing longevity risk versus market risk at the tail end of the glide path.

Mr. Lewis discussed section 2, slide 9, BlackRock views target date funds as a risk management exercise. He explained that as the participant move through their working careers and into retirement, the participant is trading off various risks across the various stages of their lives such as; market risk, inflation risk, and sequencing risk. The different stages of the participants life is included in designing the glide path which is needed for BlackRock to be able to deliver strong retirement outcomes for the participants. Mr. Lewis explained that the interpretation of a strong retirement outcome is the ability for a participant to spend stability throughout retirement. Mr. Lewis explained that the strategy to get the strong outcomes relies on three main points: diversification, to versus through narrative, and intelligent investment strategies that are cognizant of behavioral biases to make sure people get the benefits of a professionally managed strategy throughout the participant's life. Mr. Lewis provided a brief overview of slide 10. He explained that BlackRock partnered with the University of Michigan and gathered information from their panel study of income dynamics. Mr. Lewis advised that the panel study of income dynamics was a real study with live data that started in 1968. The panel would reach out to 10,000 families every year and asked how their income evolved or changed. The study showed that earning income was relatively low when the participant enters to work force approximately 40 years period to retirement. The study found that individuals reach peak earnings at ages 50 to 55. As the individual approaches retirement the year earnings begin to fade. After the retirement date, the individual will no longer have an ability to earn income. The studies that are being incorporated in the glide paths are consistent with the various economies that they have launched glide paths (Mexico, Canada, US, and Taiwan). Mr. Lewis stated that pension participants have an understanding that their pensions are going to give them sustainability as they move through retirement. However, a 401(k) cannot be treated like a defined benefit but by having participants in the right glide path they can provide the sustainability of a pension.

Mr. Lewis discussed the glide path and is proposing that in the first 15 years of the participant's career they are encouraged to go for growth to maximize returns. As the participant moves into building wealth and protecting savings around age 50 to 55 the earning potential begins to fade. The day the participant retires their assets are in the lowest risk that is maintained through the retirement years. As the participant moves through retirement, any change to allocations to risk will increase withdrawal volatility and there is less certainty around how much money the participant can consume in that portfolio at any given year. Mr. Lewis claimed that having a static allocation to risk is the most efficient way to draw down assets in retirement in the absence of going to an annuity. Mr. Lewis advised that currently BlackRock glide paths do not offer annuities.

Mr. Hovey inquired why there would be a higher withdrawal volatility for participants in retirement years that change allocations. Mr. Lewis explained that it would be due to sequencing risks. If the participant retires in 2007, and in 2008 there is a draw back in the market. The participant does not have the ability to bolster their portfolio with contributions. The participant will sell out of risky assets and buy into new assets as the market is recovering. The participant has now reduced capital without the ability to recover.

Mr. Lewis explained the graphs on slide 12. BlackRock glide path has the younger participant have a 99% risk portfolio versus a 90% risk portfolio. Mr. Lewis advised that within 15 years the participants have additional returns and balances that are 8.6% higher than if they were in a 90% risk portfolio. Mr. Nipp stated that he had a question on the Michigan study. He asked if there was a difference in public and private employees and if the graphs change. Mr. Lewis stated that they have the data but have not compared it and they would be able to provide it at a later date. Mr. Lewis explained that the graphs would change based on education level. Mr. Lewis continued to slide 15, and explained the different diversified options that are available through LifePath Retirement. Mr. Lewis noted that Global Developed Real Estate Funds are at 15% for younger participants and turned off for older participants because it has equity like volatility.

Mr. Lewis concluded his presentation by expressing how important it is for diversification and taking the right type of risk at the right time along the glide path, and lastly the narrative of to verses through which is the idea of balancing longevity risk versus market risk at the end glide path. Mr. Lewis explained that they would also assist in educating the participants of the target date funds. Mr. Nipp inquired if the trust funds were commingled and Mr. Lewis confirmed they were.

- Vanguard

Mr. Atchison introduced Mr. Donaldson and Mr. Desmarais to the board. They thanked the board for inviting them to present their product. Mr. Atchison provided a brief summary of the Vanguard's target date fund successes. He explained that by 2020, they will have $3 trillion in industry assets. Mr. Donaldson discussed that Vanguard's philosophy and focus is to create enduring investment portfolios, help investors reach their goals through a holistic approach, deliver a defendable solution that is globally diversified, transparent, and at a low cost. Mr. Donaldson believes their philosophy is unique because it is clear and simplified compared to other competitors in the industry.

Mr. Donaldson discussed the information on page 10. He revealed that Vanguard has access to investor behavior research because they are the record keeper to an estimated 2,000 plan sponsors that total to about 3 million participants. He explained that by being the record keeper to a large number of participants they are able to look at trends, underlying data on transactions, saving, and spending behavior. The investor behavior research drives their glide path construction. They found that funds leave the plans within 4 to 5 years after retirement and the funds are being rolled into another tax deferred vehicle such as an IRA. He went on to explain that every year the government runs studies on IRA spending which found that individuals will keep tax deferment going for as long as possible. Mr. Donaldson stated that this behavioral research was imperative in creating Vanguard's glide path. He advised that the goal is to have a glide path that over time provides asset allocation and a diversified product to help the participant get substantial retirement income. For younger participants that are between the ages of 20 to 25 (45 years prior to retirement) they have a 90% equity allocation and that stays constant for several years until the participants reaches age 45. He explained that the participants start de-risking the human capital when they begin to get closer to retirement age but they still remain at a 50% equity allocation at age 65. Mr. Donaldson confirmed that the equity allocation is considered high at age 65. He explained that the behavioral research they found on participant spending showed that participants would not access these funds until age 72. He explained that this allows the participant to be exposed to the equity risk premium for a longer period of time, until they are confident they will no longer have any income stream. When the participant reaches age 72 equity allocation drops to 30% where it stays constant from 72 onward and that is the most conservative point. They believe the probability of success for the participant to have funds available beyond age 95 is relatively high.

Mr. Donaldson explained that the glide path uses US stocks at 60% and international stocks at 40% and that ratio stays constant across the entire glide path. He recalled that the fixed income side of the glide path has international nominal bonds and US nominal bonds. He explained that there is a third fixed income that is added for inflation protected securities and are short term in nature. He confirmed that all non-US bonds are hedged back to the US dollar.

Mr. Hovey informed Mr. Donaldson that many of the public safety workers are retiring at age 50 to 55 and general members are retiring at age 55 to 60. He inquired if this would impact the glide path. Mr. Donaldson explained that the initial retirement age would definitely impact the glide path. The design is to have the participant pick a fund that would best match the date they are going to retire. Mr. Donaldson confirmed the naming convention could be confusing but the glide path itself would still be accurate if the correct retirement dates are selected. Mr. Canizal inquired why it takes a participant an estimated 7 years after retirement to take funds out of the tax deferred account. Mr. Donaldson explained that the participants begin to take funds out of the account at age 72 because of government regulations.

- Capital Group

Mr. Bowman thanked the board for the opportunity to present their product and introduced Mr. Smet. Mr. Hovey informed Mr. Bowman he had 30 minutes for the presentation and that includes time for questions. Mr. Bowman explained that the objective of their target date fund series is to build wealth and preserve wealth. The goal of their target date funds is to get the participants not just to retirement but through retirement. Mr. Bowman provided a brief overview of the Capital Group organization. Capital Group is the investment management company that manages the American Funds Target Date Series. They are based out of Los Angeles and have $1.5 trillion in assets under management. Capital Group investment portfolio are not driven by a big publicly traded company because it is privately held. Mr. Bowman reported that Capital Group is the lowest cost active manager at this time because they strongly believe low fees make a difference in building wealth. Mr. Bowman directed the board to page 6 of their packet.

Mr. Bowman explained that typically passively managed accounts outperform actively managed accounts. However, that is not the case with the American –their funds have outperformed their indexes in 56% of rolling one year periods and in 96% of rolling 30-year periods. Mr. Smet explained the information on page 7, the downside capture ratios relative to S&P 500. The 5 year rolling downside capture is at 87% which is considered above average. Mr. Smet proceeded to discuss the information on page 13, the structure and philosophy of the glide path. Capital Group has been managing target date funds since 2007, they have almost $80 billion in assets and are growing rapidly. Their glide path is managed 30 years through the participants retirement date and 72% of the underlying funds have a track record of 25 years or longer.

Mr. Smet discussed the Capital Group philosophy of building wealth and preserving wealth. He explained that they build wealth by meaningful equity exposure throughout the series and global diversification. Capital Group preserves wealth by having strategic investments in historically less volatile dividend paying equities, diversified fixed income, with attention to low equity correlation and a focus on down side resilience. Mr. Smet advised that the series is overseen by experienced portfolio managers that have been together for over 10 years. He explained that each manager has a personal ownership in the series as they are personally invested in these funds.

Mr. Smet referenced the glide path on page 16 and explained that a 20 year old would have a lot more growth funds such as bio-tech stocks and low dividend paying growth stocks. As the participant ages, the participant will have more fixed income and less equity. He referenced their competitors and advised that they stop at lowering the risk for the aged participant but Capital Group goes one step further by changing the type of equities as the participant ages. The older participants are moving out of the bio- tech stocks and into the bank stocks and utility stocks. Mr. Smet believes that changing the percent and the amount of equities is important, and it is equally important to also changing the type of equities to preserve wealth. Mr. Smet discussed the information on page 18, they are also changing the type of fixed income as the participant ages. Mr. Smet analyzed the returns of their funds on page 23, the 5 year rank is in the first percentile across the board in every series for 5 years and in 10 years they are mostly in the first percentile. Mr. Cottle inquired what they were comparing their results to and Mr. Smet advised it was with Morningstar. Mr. Smet advised that they have good returns but not because they are taking excess risk. He discussed the information on page 25, the sharpe ratio explains how much return per unit of risk which shows that Capital Group is not taking excess risk. Mr. Cottle inquired on likelihood the management team would retire or leave Capital Group. Mr. Smet advised that the benefit of having a group of 7 managers is that if someone retires there are still 6 more managers. He explained that the ages between the group of managing staff varies and Capital Group employees stay at Capital Group for long periods of time. Mr. Bowman expressed how important even a small increase in returns can dramatically improve outcomes. The impact of 50 bps would increase withdrawal by 6 years. Mr. Bowman summarizes fees on page 28 and repeated that Capital Group fees are among the lowest in the industry.

Mr. Canizal inquired what percentage of participants leave funds in their accounts. Mr. Smet advised 40% to 60% of participants leave funds in the account. Mr. Hovey advised that public safety employees retire around age 50 to 55. He inquired if the glide path would be adjusted for these employees. Mr. Smet confirmed that the glide paths would be adjusted. Mr. Hovey inquired how a public safety employee would select the appropriate glide path. Mr. Smet explained that they could automatically enroll the participants in the correct glide paths based on age and the participant can also chose to change the glide path if they want more risk. Mr. Nipp inquired how they simplify the communication to the participant given the large number of funds they have. Mr. Bowman advised the communication is based on goals and focus on risk to keep the information as simple as possible. Mr. Hovey advised that Capital Group track record is very impressive. Mr. Cottle informed Mr. Bowman that in the initial questionnaire sent to Capital Group asked for assets gained and assets lost by year. Mr. Cottle advised that information was not provided. Mr. Bowman advised he would provide Mr. Cottle the asset information requested. Mr. Cottle advised he did not need it right away but he did want the information soon.

- J. P. Morgan

Mr. Cottle introduced Ms. Avitabile and Mr. Carter. Mr. Hovey informed Ms. Avitabile and Mr. Carter that they had 30 minutes to present and answer questions. Mr. Carter informed the board that J.P. Morgan Asset Management is a top 10 manager of defined contribution assets and defined benefit assets. They are a leader on both defined benefit and defined contribution assets. Mr. Carter directed the focus to J.P. Morgan direct real estate (DRE) funds. They are target date funds with a 12 year track record and they are actively managed. Mr. Carter discussed the three main ideas are: diversification, tactical allocation, and communication/education. Mr. Carter explained that J.P. Morgan is invested in a large number of different asset classes that are diversified. Mr. Carter discussed that their DRE asset class is very unique. Mr. Carter explained how the direct real estate fund is a powerful diversifier because it removes the volatility concern. He continued to discuss tactical allocations and how they continue to make little changes to take advantage or protect investors. He explained the importance of educating the participants on the importance of investing.

Mr. Carter informed the board that their management team is very experienced. Four of the managers on the team designed and launched the funds. In 2014 they were recognized by Morningstar as the US asset allocation fund manager of the year. The funds performed exceptionally well in 2008 and it showed the resiliency of the glide path. Ms. Avitabile advised that the award was not for performance but for consistency.

Ms. Avitabile directed the board to page 3. She explained that J.P. Morgan's glide path development is focused on participant behavior research and long-term capital market return assumptions. They continue to add value by active management and tactical or short-term asset allocations. Ms. Avitabile explained that they look for trends to make small adjustments to increase gains. She referenced the graph on page 4. They have a set number of money the participant has to have before retirement age and they combine that with social security to get the participants 80% of their last income. She explained that they have a better worst case scenario because they are not taking as much risk. She reported that they also diversify within asset classes. They have several research teams and they mathematically make sure that the diversification is varied to add value at different times.

Ms. Avitabile reported that 77% of participants take all of the funds out of the account within 3 years after retirement. She explained that the funds are removed at a 20%, 30%, and 50% withdrawal rate. The fundamental purpose is to maintain the balances while the participant is withdrawing funds. She advised that for the investors that leave funds in the plan need to be able to beat inflation to continue to have a purchasing power. They do not leave anyone behind and even the oldest participants have 30% of equity. Ms. Avitabile discussed the information on page 7. She explained that their asset allocation views are informed by their Global Multi Asset Strategy Team, their propriety quantitative models, and bottom-up manager insights.

Mr. Carter inquired if anyone had questions. Mr. Nipp inquired if the removal of managers is due to tactical decisions. Ms. Avitabile explained that the changes were made because they found better diversification opportunities, or due to underperformance, or maybe outperformance but with too much risk. Mr. Carter explained the information on page 9. They are set apart by being diversified across asset classes and within asset classes. Their allocation to real estate have low correlation to equities, a strong source of income, and inflation protection. J.P. Morgan glide path includes multiple sources of income such as social security and has inflation protection.

Mr. Cater discussed the importance of having easy to understand participant communication. He confirmed that if they were selected, they would work very closely with the City to ensure our communication was easy to understand. Mr. Cater explained that they have a partnership with the City of Milwaukee. He explained that they had very successful educational plan with them. They met with participants and talked about target date funds. They created a frequently asked questions information deck to encourage participation in the target date funds. He reported that they went the extra mile in education by offering webinars, custom posters and mailings. Mr. Cater finished his presentation by discussing fees. Their approach of active managers is an approach that resolves in higher fees, but they are still considered reasonable amid the market.

Mr. Cottle inquired if Mr. Carter could explain the SmartSpending fund. Mr. Carter discussed that it was a retirement income vehicle that is a decumulation aware mutual fund. The SmartSpending fund takes into account the current market value at the time the participant retires. Mr. Cottle inquired if the SmartSpending option was a separate product. Ms. Avitabile responded that it was a separate product.

E. Selection of Target Date Fund Manager and Removal of the Vanguard Lifestrategy Conservative Growth, Vanguard Lifestrategy Moderate Growth, and Vanguard Lifestrategy Growth Funds.

Mr. Hovey inquired on Milliman Finalist report page 5. He explained that he did not understand how they had information on the funds from 2005 prior to the inception of the account. Mr. Cottle advised that they wanted to show a historical track record.

Ms. Granewich inquired if they could select one passive account and one active account. Ms. Montoya informed the board that they would need to select one or the other. She also informed the board that our plan sponsor, Wells Fargo, will need to create a trading agreement. She explained that it was a procedural issue and should not affect the decision of which the target date fund manager is selected.

Ms. Granewich is focused on Capital Group and J.P. Morgan she felt that City employees would benefit from both. She was impressed with the J.P. Morgan team and the diversification that they offer. Ms. Granewich inquired if Mr. Cottle could expand on the public system and the Texas Teachers Ms. Avitabile mentioned. Mr. Nipp said that they had a strategic partnership where they hired four managers and allowed them to run an asset class portfolio.

Mr. Hunt inquired who was responsible to roll out the education of City participants. Mr. Hovey stated that Wells Fargo plays a significant role in the education of City employees. Ms. Montoya explained it was a partnership with Wells Fargo, the City, and the fund managers. Mr. Hunt stated that he was unsure how much of that needed to be weighed in when he makes his decision because he felt that J.P. Morgan had a better approach in the educational aspect. Mr. Cottle stated that he met with all of the presenters prior to the meeting. Mr. Cottle informed them that because of the time constraints, they wanted the firms to focus on the investments. He informed the firms that the education is handled by Wells Fargo, staff, and the fund manager.

Mr. Davis asked Mr. Cottle if he could elaborate further on the investment styles. Blackrock explained that they invest to retirement as their way to evade from risk. Mr. Nipp explained BlackRock and J.P. Morgan invest to retirement but they do not assume participants will take their money out while Capital Group stays through retirement to age 95. Mr. Nipp explained that BlackRock is the most aggressive and their curve is steeper. They make more money at the beginning because they will stop at retirement age. Mr. Cottle explained that it is not wrong, it is a different perspective.

Mr. Hovey explained that his vote goes to Capital Group. He believed that their net returns beat the competitors more often and the standard deviation was lower. He was really impressed with how well Capital Group has done. The diversification was broad and the funds are outstanding. He was overall very impressed. Mr. Canizal explained that nearly half of the participants leave their funds while the other fund managers did not have that success. Ms. Granewich inquired if it was an issue that Capital Group did no provide the assets gained and lost by year. Mr. Cottle advised that Mr. Bowman had a good response and he understand why the information was not provided because of omnibus accounting.

Mr. Cottle and Mr. Nipp reported that they was pleased with all of the firms. Mr. Cottle believes that the participants will benefit from any of the firms. However, the communication to the participant will be very important. Mr. Hovey inquired if staff had any comments. Ms. Montoya stated that she preferred Capital Group because they plan 30 years after retirement. She believes that would be beneficial to City employees. Mr. Davis noted that based on the metrics presented, expense ratio, returns, standard deviation, and sharp ratio, the firm stands out.

MOTION TO RECOMMEND CAPITAL GROUP AS THE TARGET DATE MANAGER: Robert Davis

SECOND: Gail Granewich

Approved: (5-0)

2. Staff Reports and Informational Items

Ms. Allen stated that Capital Group is on the Wells Fargo platform. She explained information is outlined on page 3 and they are in the table 1 schedule and it would take approximately 60 to 90 days to process the change request. The target date funds will be available to City employees by April 2018.

Ms. Jensen informed Mr. Cottle and Mr. Nipp that they will need to complete a form and it is to be signed by Ms. Allen. Ms. Jensen explained they will need to include the funds that the City will be adding and removing to ensure they adjust the correct ones. Mr. Brady stated that the City would not need to enter into a trading agreement with Capital Group. Ms. Jensen explained the City would not enter into the trading agreement and Wells Fargo already had a trading agreement with Capital Group.

3. Comments from Trustees Staff, administration

Ms. Montoya advised the next scheduled meeting will be in February. Mr. Hovey stated that they wanted to be involved in the employee communication materials. Ms. Montoya stated that they will have educational materials ready by the next meeting.

4. Public Comment

None

6. Meeting adjourned at 4:10 p.m.

Backup documentation is available at Risk Management.