DEFINED CONTRIBUTION PLANS TRUSTEE MEETING MINUTES
Wednesday, August 22, 2018

The Defined Contribution Plans Trustee Board of the City of San Diego held its regularly scheduled meeting. The meeting took place in the City of San Diego Council Committee Chambers. Location: 202 C Street, 12th Floor, San Diego, California. The meeting was called to order at 1:34 p.m. by Estella Montoya.

Trustees Present:	Julio Canizal (arrived at 1:46), Robert Davis, Gail Granewich, Gregg Rademacher, Abraham Hunt
Staff present:	Tom Brady, Estella Montoya, Quennelle Allen
Presenters:	Denise Jensen (Wells Fargo IRT) Jeff Nipp (Milliman) Ken Scott (Boston Trust) Mark Cushing (Boston Trust)

1. ACTION ITEMS

A. Roll Call (5-0) — Estella Montoya
Julio Canizal- Arrived at 1:46

B. Dispense with the reading and approval of the minutes of May 23, 2018.

MOTION TO ACCEPT THE MINUTES OF May 23, 2018: Gregg Rademacher
SECOND: Robert Davis
Approved (3-0)
Gail Granewich abstained

<u>Boston Trust Small Cap Presentation (Information Item taken out of order prior to Trustee Board's action item regarding the Boston Trust Small Cap Equity Fund to provide the Board with additional information for their decision to keep or replace as an investment option).</u>

Mr. Cushing introduced himself as the Managing Director and Mr. Scott is the Executive Managing Director and the Lead Portfolio Manager. Mr. Cushing stated their presentation is on their mission and vision, investment approach, and the execution of their investment approach. Mr. Cushing directed the board to page 2, Boston Trust was established in 1974. The firm assets under management are $8.4 billion. They have three portfolio strategies: multi-asset (55%), small cap (27%), and large-mid Cap (18%). Boston Trust is employee owned since 2004. Mr. Cushing and Mr. Scott are 2 of 40 shareholders of the company. Mr. Cushing explained that because the company is employee owned, they are long term investors. Therefore, Boston Trust and the City have aligned objectives. Mr. Cushing provided an overview of the small cap equity strategy. The investment approach is actively managed, broadly diversified small cap strategy investing in reasonably valued stocks of higher quality companies with sustainable business models. The small cap equity objective is to generate competitive returns with less risk over full market cycles and provide diversified exposure to the U.S. small cap. The small cap equity philosophy is that higher quality companies tend to deliver persistent economic returns, stocks of higher quality companies are systematically mispriced because investors fail to account appropriately for risk, and additional risks can be mitigated through a disciplined approach to valuation and broad diversification. Mr. Scott advised that they are in general providing participation in the rising market and protection in the down market. Higher quality companies are persistently profitable companies with sustainable business models.

Mr. Scott moved on to page 7 of the presentation which described the investment process. Every quarter they have a process to identify higher quality companies in terms of their profitability, stability, balance sheet sustainability, growth, and earnings quality. Mr. Scott explained that the small cap funds are diversified in terms of number of stock (90 to 100 stocks are any given time) and sector. Mr. Scott stated that they have not changed the investment process since the inception in 1998. Mr. Scott went on to page 8, he explained that the 90 to 100 holdings are diversified by sectors some of those sectors are communication services, energy, financials, health care, and technology. Mr. Scott confirmed that the investments range from 5 to 18 percent per sector.

Mr. Scott discussed the portfolio's financial characteristics from June 30, 2018 looking at the portfolio as if it is one stock. The City participants are invested in a set of companies that are more profitable than the benchmark. The returns on invested capital variability levels or risk are less and the growth rates are higher. The evaluation is significantly more reasonable than is the benchmark. Mr. Scott stated that the high-quality profile is a hallmark for Boston Trust for all their strategies. The City is invested in a portfolio that is taking considerably less risk than the benchmark. The investment performance has been updated through July 31, 2018. The small cap has outperformed the benchmark every year since the inception. Mr. Cushing reported that the small cap is showing a lower standard deviation than the benchmark. The Russell 2000 standard deviation is much lower in the last couple of years than it has been historically. Mr. Rademacher inquired why July 31, 2018 was selected for the overview instead of June 30, 2018. Mr. Cushing selected the date of July 31, 2018 because it was more recent data. Mr. Rademacher inquired if using the following month changed the outcome of the results provided. Mr. Cushing explained that it was randomly selected, and it would not drastically change results. Mr. Davis inquired what occurred to cause the small cap returns to be under the benchmark on year 5. Mr. Scott explained that it was due to the lack of volatility. He discussed that they participate in rising markets and protect in down markets and the high-quality approach succeeds when volatility is high. He explained that volatility was at a historically low on June 2018. The 5-year mark captures the years of low volatility.

Mr. Cushing discussed page 11, the small cap vs. Russell 2000 index. He explained that in the long run the small cap has outperformed the Russell 2000 index. The City of San Diego began investing in early 2009, which was towards the end of the bear market. The annualized return from the bull market from February 28, 2009 through July 31, 2018 was 17.8%. Mr. Cushing explained that their investment approach is successful because they understand that the market is cyclical. They have an approach that has proven to be effective and bring gains in the long run. Boston Trust small cap receives about a third of their returns from the free cash flow per share growth while Russell 2000 receives about a third of their returns from valuation expansion and income. The stronger fundamentals will have the stronger returns over time.

Mr. Scott reported that Russell 2000 is above historical average, due to higher valuation stocks becoming even more expensive. Mr. Scott advised that Boston Trust client portfolios are more reasonably valued than the benchmark. Mr. Scott explained that U.S. economic growth continues, supported by strong consumer confidence, lower tax rates, and higher government spending. He also reported that the Federal Reserve actions have led to meaningful increase in short term interest rates. He continued to explain that the U.S. small cap market are more domestically focused, and small cap companies should benefit from continued U.S. economic growth. Corporate tax reform will benefit profitable subset companies. Revenue and earnings growth among Russell 2000 companies remains healthy. Mr. Cushing is confident that their portfolio is positioned for success.

Mr. Nipp stated that Boston Trust small cap is invested in the mutual fund. He inquired if there is anything they do differently in managing the mutual fund portfolio. Mr. Scott answered that as an organization which includes all separate accounts, comingled funds, whatever vehicle that they are implementing they are fully invested. He explained that the stocks are bought in blocks across all the client accounts at the same time. Clients may have individual objectives and cash flows, but it is all managed as if it is one.

Mr. Nipp inquired if there is a way for the City to be invested in their strategy with less cost. Mr. Scott advised that there is a way to be invested with less cost. Mr. Scott proposed that the City join a collective investment trust for retirement assets. He explained this was proposed to the Board in 2008 and the Trustees at the time felt it was not suited for the City. Mr. Scott reported that they manage a variety of retirement collectives. He explained that they do not have a small cap collective right now, but they are ready to launch if the Board decides to move forward. They have confirmed with Wells Fargo that they could be bought and sold through the plan. The collectives help eliminate expense and allow for the advisory fee to be set independent of the mutual fund. He is unsure what the fee would be at this time, but he can provide it to Milliman soon. Mr. Nipp inquired if they had offered this to other clients. Mr. Scott advised that 3 clients are considering it. All 3 clients use Fidelity as the plan administrator. Mr. Nipp advised that the plan already has comingled collective trusts. Ms. Montoya confirmed that there are comingled funds in the plan. She stated that when the Board overviews the investment mapping they can highlight the comingled funds.

Mr. Hunt inquired what environmental, social, and governance (ESG) factors fall in the company selection. Mr. Scott advised that ESG factors are used in the consideration of the investments to the extent that the ESG factors are financially material. Mr. Scott advised that they have client specific socially responsible investing such as a client limiting their investments in tobacco. Mr. Scott advised that Boston Trust is viewed as an expert in the ESG factors. Mr. Davis inquired if they saw an increase in that market. Mr. Scott advised there is a lot of interest expressed by clients and consultants but the growth in that market is not extraordinary relative to the overall market. Mr. Cushing advised they have several state plans such as California and Washington. The portfolios they manage for them have comprehensive ESG screenings. They are intended to be a DC selection for participants who wish to opt out of certain industries. They have managed small cap portfolios with similar restrictions for many years. Mr. Rademacher inquired if there are any sectors in the small or mid cap that they avoid. Mr. Scott advised that the portfolio has exposure to all economic sectors and no sector is specifically excluded. He explained that it is difficult to find a reasonably valued higher quality company. For example, there are 100 to 150 bio tech companies and 90% of them don’t have any profits. The remaining 10% that are making a profit, the P/E ratio is 100 times earnings. They are not excluding bio tech companies, but it is a challenge to find one that meets the proper criteria. Mr. Davis inquired how many public clients they had. Mr. Cushing advised they had roughly 10 to 15 public or municipal clients.

Mr. Nipp informed the Board that he reviewed the Meeting Minutes from August and November 2008, which is when the presentations were being made and discussion on which firm to hire. He explained that they discussed the bull and bear markets and their investment approach. Mr. Rademacher informed Mr. Nipp that he appreciated the historical reference and the market capture analysis and wanted a more current capture.

Mr. Nipp advised that was included in slide 11. They protect in a bear market and participate in a bull market. Mr. Nipp believes Boston Trust is consistent in their approach.

C. Direct staff to act on the Boston Trust Small Cap Equity Fund — Jeff Nipp

Mr. Nipp informed the Board that Boston Trust has been on the watchlist. He explained it was unusual for a fund to stay on the watchlist for that long and the current Board needed to revisit Boston Trust. Mr. Nipp advised that Boston Trust is the only small cap offered in the plan. Mr. Nipp informed the Board that an active decision should be made.

Mr. Canizal inquired why Boston Trust was on the watchlist if they overperformed in the last 10 years but underperformed in the last 5 years. Mr. Nipp advised that Boston Trust improved but not enough to get off the watchlist. Mr. Rademacher inquired if the return and standard deviation reported by Boston Trust was harmonious with the Milliman Report. Mr. Nipp explained that the standard deviation returns are lower than the benchmark. The returns deviate depending on the market. Mr. Davis referenced the Milliman August 2018 report that showed Boston Trust lost about 13 clients in 2015. He inquired why, and Mr. Nipp advised that they were likely hired by a lot of clients in 2009 when they had a strong relative performance in the bear market. He advised that clients likely lost their patience in the bull market.

There is always some turnover rate and it is not always related to performance. Mr. Davis inquired if there are any key factors to consider in determining how to proceed with Boston Trust. Mr. Nipp advised that it depends on the type of manager or managers the Board wants to have in the small cap option. The decision was made in 2009 to have a quality, defensive, actively managed small cap. Mr. Nipp explained that Boston Trust was initially hired because the small cap market is already the most volatile part of the market. He explained that the philosophy was to hire a small cap manager that had a defensive approach.

Mr. Canizal inquired what options they had if they wanted to replace Boston Trust. Mr. Nipp said that the Board must determine if they wanted a small cap manager or managers. Secondly, if they want one manger, would they want a passive index fund, noting that this is the cheapest option. Due to the nature of the market, there are many reasons not to have a passive index fund. The Board could also hire an active core manager or a growth and value manager. Mr. Rademacher stated that with the target date funds available, he is not inclined to add any more individual funds to choose from. He explained that he feels that with the proper active manager the fund can succeed. He also appreciates the historical data that showed why the Board selected Boston Trust. Mr. Rademacher explained that he feels comfortable keeping Boston Trust on the watchlist until they meet their benchmark. He stated that he wanted to look at a full cycle and verify that they are doing what they were hired to do. Mr. Nipp advised that they can do more captures to see if Boston Trust is following their investment strategy. Mr. Hunt agrees with Mr. Rademacher and stated that the previous Board was well informed in the selection of Boston Trust.

Mr. Nipp stated that if the Board decided to keep Boston Trust they should also determine if they are interested in the collective trust fund. Mr. Nipp advised that it is worthy of consideration. The expense ratio on a mutual fund is 1% but 25 basis points is rebated back to plan participants making the net cost 75 basis points. The collective trust would likely be less than 75 basis points. Mr. Brady advised that if the City could save the participant fees there would be no reason not to participate in the collective trust. Mr. Brady advised that it would be the same investments and no difference in the returns. The City already has collective trust funds in the plan. Mr. Brady informed the Board that there is no legal distinction between the two funds. Mr. Canizal informed the Board that they would not be able to decide to take part in the collective trust at this time because it is not an action item on the agenda.

Ms. Montoya advised that at this meeting it's a decision to keep Boston Trust or to release them as the small cap manager. She advised that based on the discussion a motion would need to be made to keep Boston Trust. Ms. Montoya explained that the next meeting will include an information item and an action item to determine if they will move forward with a collective trust. Mr. Brady stated that the Board may want to consider changing the watchlist criteria. Mr. Nipp advised that he has made some edits on the investment policy statement and the watchlist and it is included in the materials.

MOTION TO REAFFIRM RELATIONSHIP WITH BOSTON TRUST SMALL CAP EQUITY FUND: Gregg Rademacher
SECOND: Abraham Hunt
Approved (5-0)

D. Review and Approve FY 2019 Trustee Board Budget — Estella Montoya

Ms. Montoya discussed the memorandum related to the proposed budget for FY 2019. The budget for the DC Trustee Board operational cost resides within the Risk Management fund budget. This year the proposed budget reflects an increase in $40,415 from prior year. One of the major changes was the elimination of the Employee Benefits Administrator position that was a budget reduction of $96,781, which was offset by increases in salary and fringe. The largest component contributing to the increase was fringe changes related in staffing that had lower cost retirement factors. Ms. Montoya advised there was an additional decrease in the non-personnel budget of $6,256 due to decrease allocations of rent and information technology. Mr. Canizal inquired on the training budget. Ms. Montoya advised the Trustee Board training budget increased from $5,344 to $5,381. Ms. Montoya reminded the Board that the training budget is available for the Trustees to attend any out-of-town trainings.

MOTION TO APPROVE THE FY 2019 TRUSTEE BOARD BUDGET: Gail Granewich
SECOND: Gregg Rademacher
(5-0)

2. STAFF REPORTS AND INFORMATIONAL ITEMS

- **<u>Boston Trust Small Cap Presentation – taken out of order during the meeting (discussion included above)</u>**

- **<u>Wells Fargo Update & Second Quarter Report</u>**

Ms. Jensen reminded the Board that at the last meeting Mr. Rademacher inquired how Wells Fargo communicates with the participants and what is the thought process that goes into the communication strategies. Ms. Jensen directed the Board to page 4 of the Quarterly Report. The communication is different depending on the participant need. The Wells Fargo philosophy is to get everybody to a retirement ready stage and meet the participant on the path they are on. The participants fall under these categories: early saver, mid-career, pre-retiree, and retiree. The communication is broken down in those segments to do strategic individualized communication campaigns to the participant. The communication materials that target an early saver is different than the communication materials that target a retiree. For the last 30 years, the focus has been on the accumulation stage. The accumulation stage occurs in the early saver to the pre-retirees. As an industry, Wells Fargo has done well in the accumulation stage by getting participants in the plan and accumulating that money. The industry has been very successful in getting employees to put money into defined contribution plans. Ms. Jensen advised that the helpful tools that helped participants accumulate funds were auto enrollment, deferral increase products, and target date funds. On the other end of the spectrum is the decumulation stage. There has been less discussions on the decumulation stage, but the industry is changing and now there is more of a focus on this by providing financial education sessions, online retirement income planning, one-on-one conversations through the service center. The additional services that many plan sponsors are focusing on include: investment education, managed account programs, and access to financial advisors. If the Board is interested in the additional services, she can provide the Board with more information. The call center is an additional resource that is offered to all participants. Ms. Jensen explained that they cannot provide financial advice through the call center

Ms. Jensen advised that 1 in 4 have an account with Wells Fargo, either a retirement account or a banking account. The online investment tools are available to all of Wells Fargo's clients. This creates leverage from a technology stand point because more funds are being put into these tools. Wells Fargo is committed to enhancing the digital experience. For all City participants the retirement income estimator tool is the first thing they see on the dashboard. The retirement income estimator helps the participants prepare for retirement. The participant can input any other funds such as: an IRA, social security, or any other retirement account to assist in determining what their retirement income reflects.

Ms. Jensen provided a recap of the Target Date Fund campaign. There were 7 meetings across 7 locations that had a total of 312 total attendees. Notices were mailed to 7,782 participants and emailed to 6,659 participants. The notice was included in the quarterly report and it was a notice on the online dashboard message. The webinar was also posted online on the participant website.

There were 3 additional webinars in April, May, and June. Ms. Jensen advised that they track how their campaigns are succeeding. In April, the notice was sent to 6,421 participants and 27 registered to attend. In May, the notice was sent to 3,535 participants and 10 registered to attend. In June, the notice was sent to 6,555 and 23 registered to attend. Ms. Jensen explained that the retirement income conversation campaign targeted 161 participants that were age 57. Out of those participants, 28% opened the email and 69% clicked links and went into the retirement income planning center. Mr. Hunt informed Ms. Jensen that the safety population retires as early as 55. He feels this notice should be sent at age 53-55. Ms. Jensen advised that this was a global campaign throughout Wells Fargo's entire book of business. She advised that a plan-specific campaign such as the Target Date Fund is specific to the City they look at age of retirement for City employees.

Ms. Jensen reported that they tracked how many participants moved funds out of the managed income fund and into the target date fund. As of August 1, 2018, in the 401k 119 participants, in the SPSP 58 participants, in the SPSP-H 36 participants moved funds out of the managed income fund and into the target date fund.

Ms. Jensen reminded the Board that at last quarterly meeting Mr. Hunt asked if there is an identifier to track a first-time login. She explained that there is no specific way to track a first-time login, but she is researching if there is an alternative way to track. Ms. Jensen stated that the annual notification will be sent with the QDIA, participant fee disclosure, and September statements on September 30, 2019. Ms. Jensen advised there is an operational change in the way Wells Fargo processes address changes and distributions. She explained that the change was to protect the participants from fraud. If a participant calls the call center to change their address and also requests a distribution on the same day, there will be a hold for 10 days on their account. She informed the Board the change was an additional control to stop fraudulent distributions. Ms. Jensen advised that they also stopped sending distribution checks via FedEx because the payment is easy to intercept.

- **Review of Revenue Sharing**

  Ms. Jensen advises that revenue sharing is the arrangement where the plan record keeper receives a portion from the fund company in return for offering that fund in their platform. Historically, revenue sharing was used to pay for the plan expenses and administrative expenses. Due to PPA and transparency many plan sponsors have moved to other arrangements. Ms. Jensen explained that there are 3 main options to revenue sharing. The record keeper can keep revenue sharing to offset plan expenses. The plan sponsor retains the funds in an ERISA bucket within the plan to offset plan expenses. The plan retains the revenue sharing but it is paid back to the participant account for the participants that are invested in the accounts that offer rebating funds. The fee agreement that all record keepers have with the plan sponsor is the governing document that determines what to do with revenue sharing. The agreement with Wells Fargo and the City of San Diego is that all the revenue share is rebated back to the participant upon receipt.

  Mr. Nipp advised that three funds in the DC portfolio provide revenue sharing. Boston Trust small cap fund has a net expense ratio 1.00%; the revenue share is 25 basis points. Dodge & Cox international stock fund has a net expense ratio .63%; revenue share is 10 basis points. Oakmark equity and income fund has a net expense ratio .78%; revenue sharing 35 basis points. Ms. Jensen advised that in a participant perspective they see the revenue sharing online as earnings. Mr. Brady advised that on a legal perspective the ideal option is to have the funds rebated to the participant.

- Second Quarter Investment Report

  Mr. Nipp directed the Board to page 5 of the investment report. He explained that the Vanguard life strategy funds have been removed and replaced with the target date funds. Total assets are almost 1.2 billion. Most of the funds have positive investment gains except for international equity. In total the target date funds are 15.8% of the assets. The managed income fund continues to go down, it was 32.7% at the beginning of the quarter and 32% at the end of the quarter.

  Mr. Nipp stated that, other than Boston Trust, all other funds on the watchlist should stay on the watchlist. Mr. Nipp advised that they included a new graph in the investment report pages 10 and 11. He advised it was an executive summary of performance as a quick glance of funds that are under performing or over performing. Mr. Nipp reminded the Board that Oakmark fund was removed from the watchlist at the last meeting. He advised that they lagged this quarter, but it was not unexpected. Oakmark is a conservative, value equity fund and it did not do well in the quarter.

Mr. Nipp informed the Board that for international equity Dodge & Cox is the value manager and Invesco is the growth manager. Mr. Nipp explained that both international funds are more moderate. Mr. Nipp informed the Board he met with Dodge & Cox. He explained that they had very little change and they continue to have the same investment team. They have a long-term approach, low turn-over, driven by company fundamentals. Dodge & Cox struggle macro driven environments. He explained that if it is not company fundamental oriented Dodge & Cox tend to struggle.

Mr. Nipp advised that Invesco is underperforming their growth benchmark. They have their own version of quality growth. They focus on earnings, quality, valuation. He reported that Invesco continues to be consistent in their investment approach. Mr. Nipp advised it is appropriate to keep Invesco on the watchlist. Mr. Nipp reviewed if there is an overlap between Invesco and Dodge & Cox. There are 9 stocks they own in common and all of them are small positions in the portfolio. The City is getting diversified holdings in the two portfolios. Columbia Threadneedle has announced that the head of the stable value team has retired, and they have hired his replacement. Mr. Nipp advised that he can set up a meeting to have the new head of the stable value fund meet the Board.

Mr. Davis inquired if Dodge & Cox does not typically get to the macro environments. Mr. Nipp advised that they focus on company fundamentals. For example, they did a lot of work in Italian banks. However, they did not perform well because of the election Italy had in the last quarter.

- Review of the Investment Policy Statement

Ms. Montoya informed the Board that staff and some of the Trustees must attend another meeting at 3:30. Mr. Nipp advised Mr. Brady to review the investment policy. Mr. Rademacher advised he had no concerns or questions on the investment policy. Ms. Montoya requested the Board to review the investment policy statement and submit any questions to Ms. Allen and it will be an action item for the next meeting in November.

3. COMMENTS FROM TRUSTEES, STAFF, ADMINISTRATOR, ATTORNEY

None

4. PUBLIC COMMENT

None

The next meeting is scheduled for November 28, 2018 at the City Administration building at 1:30.

Meeting adjourned at 3:28 p.m.

Backup documentation is available at Risk Management.