DEFERRED COMPENSATION PLAN MANAGEMENT BOARD

Minutes for the December 5, 2014 Regular Meeting
255 West Alameda, 5th Floor West Conference Room
Tucson, AZ 85701

Members Present:	Joe Barkenbush, Chair Dennis Woodrich, Elected Member Steve Postil, Elected Member Silvia Amparano, Finance Director
Staff Present:	Michael Hermanson, Plan Administrator Silvia Navarro, Treasury Administrator Allan Bentkowski, Treasury Finance Manager Veronica Natividad, Executive Assistant
Guests Present:	Betsy Conroy, Human Resources (arrived 10:20 AM) Ken Wedemeyer, ICMA-RC Michelle Martin, ICMA-RC Mary Inorio, ICMA-RC Bill Rowland, ICMA-RC (participated telephonically) Tracy Smith, ICMA-RC (participated telephonically)
Absent, Excused:	Curry Hale, Interim HR Director

A) Call to Order – Chairman Barkenbush called the meeting to order at 9:00 AM.

B) Consent Agenda
   1. Approval of Board Meeting Minutes from June 13, 2014
   2. Approval of Board Meeting Minutes from September 12, 2014

A motion to approve the consent agenda was made by Dennis Woodrich, 2nd by Steve Postil. The motion passed 4 to 0 (Curry Hale absent).

C) Investment Performance Review
   1. City of Tucson Plan Investments Report for period ending September 30, 2014
      a. Scorecard Metrics (pages 8-13)
      b. Watch List Report
   2. Funds to be considered for replacement in the future
   3. Request for replacement fund recommendations to ICMA RC for the March 6, 2015 meeting

ICMA's investment professional Bill Rowland, said in the last four years, the Equity Income fund had average performance, which was disappointing given it is a fund that historically has done well. The fund has underperformed this year and only outperformed about 20% of its peers. When looking at the ten year numbers it is in the top third of its peers but the last five years did not really contribute to that placement. The fund managers requested the Investment Risk Team review the Equity Income fund from several perspectives, as a result, it is getting a significant amount of senior level attention. The CIO has asked they evaluate the fund to determine what has changed and what needs to change. They made a small change earlier in the year which helped. They are taking this year's performance very seriously and are doing the research and they may have more to share with the Board at a later date. The fund is still managed consistent with their historical style and has a strong track record; it just needs extra attention which it will receive this coming year.

Joe Barkenbush asked if the underperformance was a result of a change in management or of bad decisions in stock selection. Bill answered, being cognizant of the fair disclosure rules, when they looked at some of the individual sub-advisors one of them picked bad stocks in the wrong sectors, were off in some of their sector bets, and some of the stocks underperformed. Management understands why the fund underperformed but they are not leaving it at that and are doing the research to find out what needs to be done beyond that to pull out of this difficult period and regain the more favorable performance everyone has become accustomed to from this fund. He was unable to give an estimate of when the Board should be able to see any changes.

Bill said most of the Milestone funds are performing okay this year except for the nearer dated retirement funds. During 2013, all of the ICMA funds except for the Retirement Income fund performed in the top quartile, and some of what was helping last year is hurting the Milestone funds this year. Specifically, what worked well last year is hurting them this year, particularly in the Retirement Income fund. Specifically, before May 2014, they were lighter in equity exposure, then a little more equity exposure was added to the Retirement Income and the 2010 target date funds because there was a feeling it was time to take a little more equity exposure risk in those funds while maintaining the lower duration. The lower duration is a defensive move because if interest rates go up fixed income funds with longer durations will suffer for it. They also have a quality bias which worked against them this year. In the spring, they added a high yield fund that will lengthen the duration a little bit to take advantage of some of the stronger returns seen from the lower quality bond funds. He emphasized it was not a steep change in how the funds are managed, it was an incremental change. They think over long term these funds are structured to continue to serve the participants well.

Michael Hermanson asked, if the funds were set on predesigned glide paths, how much can they change it. Bill answered when they think it is time to change the glide path they perform an analysis, go to the board of directors with recommendations, and with the approval of the board, will make changes to the allocations. Any type of a meaningful change to the glide path or composition of the funds along that glide path has to go before the board of directors.

Joe stated the shorter term funds seem to be doing worse than the longer term funds. Bill explained the reason for that is in the shorter dated funds, they are a little more conservative in the duration, quality, and equity than some of their peers. In the longer dated funds they know that those people have a longer period of time before they retire, allowing more opportunity to keep up with the markets as a whole so they are more aggressive with those funds with regards to the composition of the Milestone funds. The shorter term funds are more conservative with less volatility than others.

Reviewing the model portfolios, Bill started with the All Equity Growth fund. Part of the challenge with respect to peers is that it is not like its peers. Morningstar categorizes it as a large blend fund, meaning most of the peers have 20% to 30% in fixed income and the All Equity Growth fund does not have any fixed income so by nature it will struggle with peer comparisons, some years it helps and others it hurts. Most of the equity exposure of its peers is in large cap stocks. In contrast, the All Equity has equity and includes mid-caps, small-caps, and non-US cap funds. Both small caps and non-US stocks have lagged this year, and that diversification in this fund has worked against it this year, but should provide long term stability. None of the model funds are doing well on a YTD basis, and they are looking at them to figure out if looking forward they need to make any changes to the portfolio structure. Comparing milestone and model portfolios they will do that type of a study, to make sure any necessary changes are made to the portfolio structure.

Ken clarified the model portfolios have missed the IPS (investment policy statement) for several quarters in 2014. It has been discussed whether or not, in keeping the fund lineup intact, if they are appropriate for utilization here.

Bill said from a fiduciary perspective, using the model portfolios as a suite of funds, he was comfortable with the funds, due to the prudent way they are managed, the resources used to manage them, and the underlying funds. He thinks it is appropriate for investors to ask about tough years like 2014.

Ken discussed what has been happening with the PIMCO total return fund. He said Bill Gross made a surprising move leaving the PIMCO and there has been a tremendous amount of discussion about whether it is an appropriate time for investors to leave the PIMCO total return fund. They are asking if the fund is imploding and if the management structure left behind is still solid. The three and five year performance numbers are still okay and the clients that have chosen to leave have done so for qualitative reasons.

Bill said that most funds have had a tough year, so it is not the performance of the funds; the real issue is the disruption at PIMCO. Some reports suggested that Bill Gross was leaving whether he wanted to or not. The challenge is how PIMCO will handle the new management structure, and the amount of assets leaving PIMCO.

Tracy Smith (ICMA) said they are looking into how the departure of Bill Gross impacted individual strategies. From the structural changes PIMCO has made in the months since Bill Gross left it would seem the key people that supported Bill in managing those funds are still in place and three have been promoted to act as a management team on that fund. Their concern lies in that even though these portfolio managers are seasoned professionals who have worked with PIMCO and Bill Gross for a very long time it is not clear how they might act and manage the fund as a team. She said their board recently voted to remove the PIMCO Total Return fund from their lineup and they have decided to maintain their other PIMCO funds. They still have a high degree of confidence in PIMCO as a firm and the people that support the management of the other funds.

Ken explained there have been some large institutional names that have pulled out of the PIMCO total return fund, like Charles Schwab, and there have been some names that have stayed. The concern is if you have a lot of assets getting pulled how much would be retained to meet the cash requirements for outflows, and would that affect the integrity of the portfolio.

Bill said the news on the T. Rowe Price Small Cap Value is that Preston Athey, who had been with the firm for over 20 years, has stepped down from the fund. Dave Wagner, his replacement, has made some changes to the fund. This is a fund that does not turn over its holdings very often; as the turnover has recently been around 6%, compared to its peers with turnover over between the mid 60% and mid 80%. So, it is more of a buy and hold fund which has worked well over longer terms with some periods of underperformance. The performance of the fund started to struggle in 2013, prior to Preston Athney's resignation, so the real question is are recent changes going to be sufficient to reverse the performance seen over the last year and a half to regain what has been an excellent long-term record.

Tracy Smith (ICMA) added; with many of the funds' top 20 holdings having been in the portfolio for a decade or more, while those holdings have matured over that length of time, their growth rate has slowed and that is being picked up by the market as unfavorable when it is really just the maturation of the growth cycle for these companies. She said they have also underperformed in comparison to their peers because of some of the stocks they don't own. They do not own many healthcare and specialty retailers because they do not meet the investment criteria for the portfolio and those are the companies that have performed well. It is the YTD performance that is dragging the numbers down. In this fund they tend to look for the risk return characteristics that will protect the fund on the down side and be able to keep up reasonably well in an up market. They have been spending a lot of time looking at this fund to make sure there is nothing wrong with it and that it is just going through a bout of underperformance because its style is out of favor.

Mary Inorio asked if Tracy would consider this fund manager as a deep discount value manager. Tracy answered no; she would describe them as high quality. They look for stocks trading at a discount but she would not describe them as a deep discount value manager because they have a bias toward quality, which has also hurt their performance over the last few years.

Ken said if you look at the absolute returns at the 3 and 5 years, where they are lagging, they are still close to the benchmark. Michael said it sounded like the Board is headed toward making some replacement decisions and the question would be are we identifying the funds to be replaced today or just wait until the next quarterly meeting. He said, from a communicating with participants perspective, it would be better to have one complete announcement versus several announcements in one year about fund changes and recommended waiting until the March 6, 2015 meeting.

Ken advised because of the requests for movement out of PIMCO, they had added a January 23 movement from PIMCO only, for any clients that want to do this. It would be a movement of its own and a letter of its own, and if they chose to wait it would not happen until February or later. Because ICMA's board of directors voted to remove the PIMCO Total Return fund from their lineup, all of their customers were going to have to move out of the Total Return fund but they have selected alternative funds available. Ken also advised that the management change went from one manager making all of the decisions to a team of managers who used to work with him and know the system well. Michael stated the TSRS Board consultant Callan & Associates had not given any cause for concern over PIMCO, so they could wait to take action on it.

Allan Bentkowski asked if the Board could continue to participate in the PIMCO Total Return fund even though ICMA-RC had chosen to remove it. Ken answered the Board had the option to invest in the fund instead of the trust.

Ken said the Oppenheimer International Bond continues to struggle though not as greatly as the last time they looked at it. The three and five year numbers have picked back up and there have not been any management changes. They seem to be going in the right direction but there are alternatives available that would meet all of the IPS standards. If the Board was looking to make some decisions on changes this would be something where they would look at the alternatives.

Michael Hermanson said they could look at alternatives today or they could wait and look at alternatives in March and make a decision for replacement. The Board decided to make a decision about a replacement for Oppenheimer at the March 6, 2015 meeting.

Ken said Goldman Sachs Mid Value had been on the watch list for the last four quarters and they have recovered as the markets have moved up, even with the volatility in the quarter. Those numbers are pretty good compared to their peers. He recommended they remove Goldman Sachs from the watch list.

Ken said the RS Global Natural Resources has a very small allocation. There is a Vanguard Commodities Index that is in the top decile because the assets are so small in this sector. If the Board was planning on making changes at this meeting they would look at it. He did not see them making a rapid recovery on the RS fund. He said they added it because people asked specifically for gold exposure a couple years ago and if the Board stays with them with the assets this low the amount of revenue is incidental.

Michael stated it was originally considered to be a commodities position. Ken said in the Morningstar ranking category for Vanguard Materials fund it had ones across the board and there was an alternative in Vanguard if they want to keep allocations in that sector. Michael said Vanguard had very little money in energy, and 87% in basic materials. Joe said with Vanguard they would still have a natural resource offer there but at a lot less cost. Michael asked Ken if he would request some replacements for the RS Global Natural Resources since it was on the watch list.

Joe pointed out that there were not many stars on the watch list but Oppenheimer Developing Market and the Nuveen Real Estate were they are meeting all the watch list criteria. Ken said at the beginning of last year there was a little concern because they were at the bottom of the second quartile but they have recovered nicely. It is hard to be a star in that sector because everyone has the same assets.

Michelle Martin said that for those committees whose goal was to streamline the fund lineup including reducing the number of funds available, they have eliminated their model portfolios and moved participants into the age appropriate milestone funds. There are two schools of thought here; one is for the model portfolio because it is a static portfolio and the amount of risk can be controlled, it helps when trying to manage money and take distributions. That cannot be done with a milestone portfolio because it keeps aging and the opportunity for distribution is lost. The primary goal for this is to simplify the lineup and make it easier for people to get involved in the plan. It is not unusual to see more money in the models when the money has been there for a long time because historically, that was the only option they had. Anyone looking for a prefixed portfolio would go into a model. As a result, they had a plan with a large amount of money in the Model portfolios that got moved into the age appropriate milestone. The main concern was educating participants because they were the ones who selected a portfolio based on the amount of risk they wanted to take and now they were being defaulted into something based on their expected retirement age. They offered a lot of education on this, and it turned out not to be a small issue because people seemed to understand the idea of the age-based funds and they also like the idea that if they never look at the portfolio again it will always be appropriate to their age and time pricing. Ken said if the Board decides they want to make that change some education would be recommended to inform participants of the reasons why.

Mary Inorio stated there are some people who have chosen their portfolios because they do not want it to age; they want it to stay aggressive until it is closer to their time to retire. Allan Bentkowski said it seemed like the milestone fund would be best for someone who does not know what to do. The model portfolios are great if they have any knowledge about investing and so they have to consider the level of understanding of the common participant.

Michelle said the premise was if someone selected their investments based on the level of risk they wanted to take the average person is taking less risk than they need to in order to reach their goal. People tend to have a tendency to be more conservative, the milestone funds are then eliminating that by selecting investments based on the time horizon and investment professionals will determine the amount of risk that should be taken based on that time horizon.

Joe said they were losing their money in the plus fund so if they eliminated that option, participants could move their money into milestone funds with higher risk and rewards while keeping the money in the program instead of moving it to an IRA. Ken said this was a big move because 50% of the plan is in the plus fund. It is a big enough change that it is going to affect a lot of people so they can get in front of them to provide education.

Michelle said they were adding the managed accounts for retirees who can manage their distribution and they have a retirement income advantage so it would give them a platform to talk about what the participant wants to accomplish and provide them with the tools that will assist them in reaching those goals. Ken said, in the interest of full disclosure, when the Board makes this decision because they adjusted share classes on both the models and the milestones there will be no effect on the revenue if matching models to milestones. The milestones have become highlighted because the industry as a whole is focusing on them and they have become the default in so many plans.

Michael explained that generally, participants tend to not make decisions; they set it and leave it. That is why the Board has the job of making decisions for them in many cases. This provides two large opportunities to manage in order to help the participants. One is the model portfolios may be replaced by milestone funds, and second, have some kind of educational series on that idea in addition to the plus fund. He said there was over $100M in the stable value plus fund and about $32M in the model portfolios which combined amounts to about 60% of the entire account. If they make the changes, the educational program would need to be performed on a large scale. Although, he predicted we could roll the education program out and very few people would sit in on the discussion.

Michelle explained it would be interesting if the people who are in the plus fund with no intention of moving out because they want to be safe and are happy with it understood the guarantees in the Retirement Income Advantage funds where you got the upside potential of the market with the guarantee that you will receive payment on whatever was invested in the fund for the rest of your life. People typically have to hear about this concept several times before they start to understand it, but when you start to drill down about investors in the plus fund it is what they are looking for. What it often comes down to is, that they are looking for guaranteed income for lifetime.

Ken asked the Board to consider which funds they wanted alternatives for at the March 6, 2015 meeting. He then gave a brief summary of the snapshot report. At the end of the quarter they were at $240M in the main plan, the IRAs had a little bit of growth. There were no big surprises, Stable Value moved down in terms of the total portfolio but the market has been growing. The cash flow is out of the plus fund and the bonds.

Cumulative returns were -0.4% because of the volatility of the market. They have $184M from participants aged 50 or above out of the total $242M. Participation trends have dropped in active participants.

Michael explained that the drop in active participants was due in part to the employee counts are not growing, as not all the retiring employees are being replaced, and the people who are hired are not necessarily staying on. As a result, they are not going to have an upward trend in participation if there is not an upward trend in employment. The only way to gain active participants is to approach each department and target the people who are not currently participating.

Ken explained the transaction trends show large amount of asset inflows above the line. Rollouts for the year were about $8.5M of that amount over $6M is moving to Nationwide, most of that was driven by Galloway Asset Management.

The Board requested alternatives for Oppenheimer International Growth, RS Global Natural Resources, and T. Rowe Price Small Cap.

Michael asked how the educational rollout went for the California firm that eliminated the model portfolios and moved participants into the age appropriate milestone fund. He said they needed to consider how they would implement any changes and how they would educate participants on the options made available to them.

Ken asked if they would like to have samples distributed before the board packet. They could begin planning to add it into their 2015 education plan so if the decision is made at the next Board meeting they are ready to begin. He said they would prepare the samples and give them to Michael for distribution to the Board.

D) Educational Programming Report, new enrollment incentive [1]
   1. Number of presentations
   2. Attendance
   3. Year to date New Enrollments with incentive

Mary said ICMA-RC had met their contractual obligation for onsite seminars for October 1, 2013 to October 1, 2014. She was onsite for 145 days as opposed to the contractual obligation of 140 days. ICMA completed 72 on site seminars with approximately 485 attendees. She also completed 413 individual consultations and had 315 transactions. ICMA had 137 enrollments in the 457 Plan over the course of that year, 8 IRAs and $5,749,000 in roll-ins. With the expected number of people retiring this year, so she anticipates many of them will be rolling in before they leave.

The YTD numbers were 138 days on site, 57 seminars with 354 attendees, 361 consultations, and 347 transactions. There were 174 enrollments in the 457, 8 in the Roth IRA, and $6.7M in rollins. Mary is planning to have seminars for people to learn their retirement options and she thought it would be helpful to include a brief presentation to the Public Safety Personnel. She said Tom Axline had held 17 seminars with 328 attendees; he did 15 financial plans and had 73 transactions. She gave a brief overview of the topics he covered at those seminars. She explained they had done some social events and sent out emails and have had an encouraging number of enrollments resulting from them. She provided the Board with a list of some seminar and presentation topics they would like to incorporate for next year. She also advised Tom Axline had been promoted so there would be getting a new financial planner.

Joe Barkenbush asked if the seminar schedule could be put in the retiree newsletter.

Mary said that she was already in contact with Claire regarding the retiree luncheons and she could get the information about the seminars to her.

E) New Enrollments receiving a $50 incentive Program
   1. Participation for 2014
   2. Discussion of auto-enroll / negative enrollment approach for new hires
   3. Review of Administrative Allowance Account, consideration of Enrollment Incentive Program for 2015

Michael Hermanson explained until a couple days ago the City had provided a $50 incentive to 190 participants who had not had an account established before. Most of the new participants came from the new employee orientation presentations.

Mary said that when she gives a presentation at new employee orientation about 50% of the new employees enroll then and there. She said that they no longer have access to those employees after the orientation because she has no ability to contact them via phone or email. Frank Flocco in HR has been sending a follow up email to the employees after the orientation. She said part of the problem with new employee orientations was that the attendees tend to be overwhelmed by the amount of paperwork and they put aside anything that does not have to be done immediately. She said she had met with an employee who had been with the City for almost 10 years who was just starting a new 457 account. When she asked him why now he told her he always meant to and just never got around to it. She would like to streamline the enrollment process to make it as simple as possible rather than having to make a lot of confusing choices in hopes this would increase the number of people enrolling. She suggested opening a shell account automatically defaults to the milestone fund and a deduction of $10 so that new employees can just choose to open an account without having to make all the decisions until later when they are no longer feeling overwhelmed.

Ken Wedemeyer explained that a form stating the employee was opting in would still be required because auto enrollment with negative election was not allowed in Arizona.

Mary advised that one of her other clients in Arizona has a 457 plan where they contribute an initial amount for all the employees as part of their compensation. The employee is not required to participate in the 457 unless they want to add their own deductions to it. She still makes a presentation at their new employee orientations. They have found since implementing this program every employee participates because they do not have to contribute to it but 85% contribute, through pay deductions, to their 457 accounts, which is a large increase from before this program was implemented.

Michael advised ICMA should produce a prototype quick enrollment form for approval from the City Attorney's office. The form should include whether they want to enroll, whether they want the minimum enrollment amount or to have more deducted, and a designation of beneficiary. He suggested that ICMA develop a baseline so they are able to compare the numbers once quick enrollment is implemented.

Michael stated there was $212K as of September 30, 2014 in the Administrative Allowance Account. In conjunction with the review of that account balance there is usually a large allocation at the end of the year that is added to the account based on an annual review. He said they would probably end up with an amount close to $300K at the end of the year. The standing decision the Board has always made is to allocate the excess earnings back to the members' accounts as close to the end of the year as possible. TSRS is usually reimbursed around March and it goes into Fund 72.

Joe suggested including any amounts distributed from the Administrative Allowance Account on the ICMA statements sent to participants. Ken said it could be included in the fourth quarter statement if that was what the Board decided. He also said they could include a smaller amount on a statement earlier in 2015.

Silvia Amparano suggested sending an email, instead of a letter, in the quarter the money is distributed saying the account is giving back to the members and they should see it in the next statement. Michelle Martin stated they have included letters from boards and committees with statements to participants in the past and they could do the same for this Board if they chose so retirees would receive the information as well instead of only active employees with a work email address.

A motion was made by Steve Postil to with the quick enrollment process for the 457 account, to continue the $50 enrollment incentive, and to clarify what the minimum deferral amount is, use a $10 minimum deduction per pay period on enrollment, 2nd by Dennis Woodrich, and approved by a vote of 4 to 0 (Curry Hale absent).

A motion was made by Steve Postil to set aside $65K to fund the $50 enrollment incentive for 2015, 2nd by Dennis Woodrich, and approved by a vote of 4 to 0 (Curry Hale absent).

F) 2015 Deferred Compensation Board Meeting Calendar Dates

Joe Barkenbush listed the meeting dates of March 6, 2015, June 5, 2015, September 4, 2015, and December 4, 2015 and confirmed they were all to be held at 9:00 am.

G) Call to Audience – None heard.

H) Adjournment

A motion was made by Dennis Woodrich to adjourn the meeting at 11:20 AM, 2nd by Silvia Amparano, and passed by a vote of 4 to 0 (Curry Hale absent).

Approved:

Joe Barkenbush 3-6-2015 03-06-15

Joe Barkenbush, Chairman of the Board — Date

Michael Hermanson, Plan Administrator — Date