City of Mesa
Deferred Compensation Committee
MEETING MINUTES
Monday, August 5, 2013, 11:30am
Mesa City Plaza, Suite 130
Personnel Conference Room 2

Members Present:	**Members Absent:**	**Great West:**
Chuck Odom (Chair)	Frank Hoglund	Scott Taylor
Mike Kennington (Co-Chair)	Michael Claspell	
Derek Witting		
Don Miller	**Innovest:**	**Other(s):**
Kimberly Call	Gordon Tewell	Bill Taebel
Mary Dellai	Jerry Huggins	Nikki Rosales
Michele Long		
Vicki Eden		

Meeting called to order at 11:30am by Mike Kennington

1. Approval of the May 6, 2013 minutes
   Mary motioned to approve the minutes
   Don seconded the motion
   None opposed

2. Innovest Quarterly Update

   The Markets
   The markets in the U.S. climbed in April and May, with May marking the 7th straight month of gains. June was a tough month as equity and bond market returns suffered. Overall it has been a great year and this was the best first half for U.S. stocks since 1990. International stocks were down .75% and as interest rates rose, bonds went down 2.32%. 2012 was a strong year and 2013 is proving to be strong so far, with the exception of bonds.

   Headwinds
   Bond yields are rising. Don't know what to expect in the future, because interest rates are hard to forecast. Global economic growth has been sluggish in the U.S. and continues to be puzzling all around. GDP was up 1.8% in the U.S., which is not a great increase, but it's headed in the right direction. Consumer spending was up as we came out of the recession, but it is starting to slow. Americans are not saving as much money either. Unemployment continues to drop, but at a slow rate. An increase in part-time jobs shows that the job market is still struggling. Brazil and China

were drivers of international growth in the past, but are starting to slow. China's growth has been in the wrong areas, with a lot of wasteful spending and big credit bubble.

Tailwinds

The positives are mainly in the U.S. Despite consumer spending, balance sheets look good. Inflation is pretty tame. The housing market continues to recover and appears to be pretty solid. U.S. Energy Production has seen dramatic growth in shale production. This is a long term positive trend for our economy, which makes up more competitive.

Quarterly Market Summary

The only positive areas were U.S. stocks. Emerging markets were a difficult place to be. One positive was high yield bonds, though a risky part of the market. The best two places in the U.S. market were consumer discretionary and financial stocks, whereas material and utility stocks were the worst. Technology has been in a tough place the last 12 months, but may start to improve, once this cycle passes. International markets have been difficult, especially emerging markets. Japan is one of the best places to be internationally.

Menu Coverage

At the last meeting, a decision was made to remove Davis NY Venture and replace it with Dodge & Cox Stock. This change will not take place, until August 15, 2013, and will be reflected on the next quarterly report. Also, fund options will be presented today, to possibly replace Janus Perkin Mid Cap Value.

Annual Fee Review

A new fee schedule will take effect, once the agreement is done with Great-West. At this time, no specific date has been set, but the intent is to have it done soon. The current revenue sharing includes Davis NY Venture. The replacement of this fund will change the revenue sharing from 16 bps to about 14.5 bps. The plan reduction, from 12 to 9 bps, will add to the decrease in revenue sharing and will bring it down to around 5.5 bps. At 5.5 bps, the current asset total will be about $75,000 a year. The third party plan fees are around $81,500, so there will be a bit of a shortfall on the revenue side, unless the assets continue to grow. The plan went from a very large revenue fund with Davis NY Venture, to a very low revenue sharing fund with Dodge & Cox. This is not a concern right now, but something that needs to watched going forward, so the revenue share class doesn't get pushed down too far.

Jerry provided a revenue sharing breakdown, which showed each investment option the plan has and the various share classes. An annual share class review should be done to see where the revenue sharing is coming from and determine if there is opportunity to reduce those fees. Based upon the annual fee review, there is nowhere to lower additional sharing at this point. The plan costs have been managed down to 53 bps, which is about half the cost as our peers, so the costs of the plan are being managed well.

Asset Allocation

There were good returns on the domestic equity side, but with international down and bonds down, the quarter ended pretty flat. Plan assets did grow about 1.1 million, or about 1%, during the quarter. There were some significant changes to asset allocations. Fixed income went from $8 million to $6.7 million in total assets. It looks like it may have been redistributed to large, mid and small cap equities. Also, the brokerage window moved from about $700k in cash to $3.2 million in cash.

Table of Returns

Large Cap Equities all had a positive performance, but most were still below the benchmark and their peers. Fidelity Contrafund's underperformance to the benchmark and its peers attributed to poor stock selection on the tech side. They were overweight in Apple, which was down 10% and didn't own Microsoft or Cisco, which were up. Aston Montag, the new large cap, did great the first quarter, but being overweight in consumer staples hurt them this quarter. Davis NY Venture had a good quarter, but is set to be replaced by Dodge and Cox, which actually outperformed Davis NY Venture. Mid Cap Artisan was in the top 25% for the quarter, due to a strong stock selection. Janus Perkins was in the bottom 20% and continues to underperform. Small Cap Equities did positive against the benchmark. Cambiar was in the bottom 30%, due to its overweight in energy. Kalmar ranked in the top 25%, with help from overweight in discretionary and consumer staples. International Equities did relatively good. They did better than the benchmark, but were still negative. The Mesa Custom Stable Value fund had good performance, but is still in a tough place. The market book value ratio dipped below 100%, meaning the portfolio market value is worth less than the actual money that has been invested in it. This is something to keep an eye on, because it will be part of the calculation of the crediting rate. T. Rowe Price Target Date Funds lagged behind the benchmark for plans under 2025. Plans from 2030 to 2050 outperformed the benchmark. The 1 year numbers show that T. Rowe Price has outperformed in every target date fund though. The 2030 fund is right at the benchmark, but ranks in the top 13% of target date fund managers. They tend to be more allocated on the equity side, than the fixed income side.

Manager Scorecard

There were no real changes from the last report.

- Fidelity Contrafund-Style Consistency, Asset Base
- MainStay Large Cap Growth I-People
- Davis NY Venture-Performance*, Overall
- Vanguard Mid Cap Index-Philosophy & Process
- Perkins MC Value-Style Consistency, Asset Base, Performance, Overall
- Vanguard Small Cap Index-Philosophy & Process
- Oppenheimer Global Fund-Organization
- American Funds EuroPacific-Asset Base
- Mesa/Great West Custom Stable Value-Philosophy & Process

**Major Concern*
All others listed as minor concern

Report Card

Same companies still on the report card and the only change is the Fidelity Contrafund.

- Fidelity Contrafund*-Trailing 5 years return below median
- Aston/Montag & Caldwell*-Rolling 3 year periods above median
- MainStay Large Cap Growth*-Changes in ownership or key personnel
- Davis NY Venture*-Risk adjusted return above median for 5 years, Trailing 5 years return below median, Rolling 3 year periods above median, Annual periods above median
- Allianz NFJ Dividend Value*- Risk adjusted return above median for 5 years, Trailing 5 years return below median
- Janus Perkins Mid Cap Value*-Manager adherence to style and philosophy, Trailing 5 years return below median, Rolling 3 year periods above median, Annual periods above median

**On the Watch List*

3. 401(a) Plans

Mike and Chuck have been researching 401(a) plans that other cities have. Phoenix, for example, offers 457 and 401(a) plans to their employees. 401(a) plans are an additional type of defined contribution plan that are available to corporations and governments, though not common in the corporate world. Innovest explained some of the pros and cons of this plan type. The biggest advantage of having an additional plan is that you can increase your contribution limits. An employee can participate in both plans and put $17,500 into each one. These plans have a voluntary deferral tax option, but not many people choose that option. Employees that have both 457 and 401(a) plans available usually have their employer contribution applied to the 401(a), in order to avoid claiming it as income and paying taxes on it. The hard part with a 401(a) plan is that is has a set contribution. It is adopted at a set percentage and would be the same for all employees participating in the plan. Also, the opt-out feature is a one-time, irrevocable option. If you choose not to participate in the plan, you cannot join later. Innovest indicated that they have seen 401(a) plans that apply to small groups such as department heads and city managers, but they are unsure if it could be done with a certain class of employees, such as public safety. You can withdraw for an emergency, but unlike the 457, it does not have early withdrawal provision, so you'll be hit with a tax penalty if the funds are taken out prior to 59 ½. A question was asked whether vacation or sick payouts could be applied to the 401(a) and, if so, is there a dollar limit. Innovest will need to research that further.

4. Mid Cap Value Search

Two candidates were presented as possible replacements for the Janus Perkins Mid Cap Value fund. Since our last meeting, Perkins used a put with Janus that is going to require Janus to buy the remainder of Perkins by the end of 2015. That means that the owners of Perkins have positioned themselves to exit the firm by 2015, which makes this search for a replacement even more viable.

John Hancock Disciplined Mid Cap Value

- John Hancock is the distribution firm, but the assets are managed by Robeco Boston Partners
- Manages about $116 billion, with $5 billion in this particular strategy
- Strategy dates back to 1997
- They have a variety of share classes, but the .98% expense ratio is probably the most appropriate, as we are trying to watch revenue sharing. That class shares 10 bps, which is the same that Perkins shares right now.
- Managed by two experienced individuals with a number of portfolio analysts
- They are a fundamental type manager, which looks stock by stock for firms with consistent cash flow and not a lot of debt. They buy stocks at a discount, for companies with improving business momentum.
- They are generally low in cash and have a mandate to stay within 0-5% cash holdings, unlike Perkins who lets cash build up.
- Have about 126 holdings right now

Touchstone TS&W Mid Cap Value Opportunities

- Touchtone is the distribution firm, with TS&W as the manager
- Partially owned by Old Mutual and 23% owned by TS&W employees. Like to see employee ownership.
- Have $6.2 billion in firm assets, with $775 million in this particular fund
- Strategy only dates back to 2001
- Would likely choose the expense ratio of 1.05%, with 25 bps of revenue sharing
- This fund has a sole manager, with 12 portfolio analysts. The fact that there is a sole manager generates minor concern.
- Their strategy involves screening market value, earnings potential and price action.
- They do allow greater cash build up, which is about 9% now.
- Smaller portfolio with about 68 stocks

The committee reviewed performance charts through a range of years. John Hancock appears to be consistent over the years. Touchstone had a couple difficult years in 2009 and 2010 and had a manager leave the fund in 2011. A few comments were made indicating that John Hancock appears to catch the upswings and have multi-managers, which is something the committee has looked for before. Also, some of the members indicated that Touchstone was too similar to Janus Perkins.

Derek motioned to replace the Janus Perkins Mid Cap Value fund with the John Hancock Disciplined Mid Cap Value fund, using fund JVMIX with an expense ratio of .98%.
Michele seconded the motion
None opposed

5. Great West Quarterly Update

Great West Marketing Awards

Scott presented three Communicator Awards of Distinction to the Mesa 457 Plan. The communicator award series was founded two decades ago and receives over 6,000 entries a year. The awards our plan won were for materials and information that was presented to participants. One was for the "Raise the Bar" flier and two of them were for areas of the custom website.

National Save for Retirement Week

Scott provided a handout on National Save for Retirement Week, which happens to be the same week as the employee benefits fair. Scott plans to promote it through the website, the newsletter and will see if an article can be posted on InsideMesa. His hope is that people will meet with him at the benefits fair to determine how much money they need to be saving and what their pension will be.

2nd Quarter Update for 2013

GW is on the city's new payroll system and it has been working successfully. They were also selected as the new provider for the Fire and Medical plan. The plan assets continue to grow. Scott pointed out that the number on the GW report was different than the Innovest report, because GW's number included loan balances and unallocated plan assets. Participant accounts are down by one, which means one more person closed their account than new accounts opened. The cash flow amounts varied from the first to second quarter, but it was pointed out that the first quarter included contributions made from vacation payouts. The contributions for the quarter totaled $2,311,596, including before tax contributions and rollovers.

There were 38 new loans issued, which is down a bit, and unforeseeable emergencies remain low, with only two this quarter. There were 18 outgoing rollovers, which is pretty normal, and two QDRO's. Some committee members were surprised that we have around 38 new loans issued each quarter. Scott indicated that that amount is down and it's only about 1% of plan participants.

NAGDCA Comparison

The 2013 NAGDCA study included 89 governmental 457 plans. The average plan participation rate was 23%. The exact number for Mesa could not be provided this quarter, but according to previous quarters, it's usually greater than 60%. Scott indicated that very few departments have less than a 50% participation rate. The average plan participant account balance is $47,000, whereas Mesa participant account balances are a little over $50,000. The average annual plan participant contribution was $4,219 and Mesa's was almost $4,400.

Investment Advisory Services Usage

There are 6 participants utilizing the advice service and 336 participants in the fully managed accounts. Between these numbers and the participants enrolled in model portfolios and target date funds, an increasing amount of employees are taking advantage of assistance in allocating their assets. Overall, it may be a good thing for them, as it tends to generate a bigger return.

On the Horizon

Scott went over upcoming changes and items that still need to be decided on. The new contract will be in place soon and will have a lower fee, changing from 12 bps to 9 bps. One item that the committee has discussed before is online deferral recordkeeping by GW. This would allow GW to collect participant's contribution decisions and forward them to the city. The other item discussed was adding a Roth option. Scott asked if the city still wanted to move forward with the Roth option. It was discussed at a prior meeting, but no action was taken, because it still had to be presented to the City Manager. A comment was made that it would be best to start this option at the same time the Fire and Medical plan is converted to Great-West, which is set for November 1, 2013, to avoid any confusion to participants.

Mike motioned to approve adding the Roth contribution option to the 457 plan, beginning November 1, 2013
Don seconded the motion
None opposed

After the vote took place, it was further discussed whether or not to allow participants with a qualifying event to convert their pre-taxed balance to a Roth account. This would primarily apply to retirees, or people that have severed employment with the city, and they would need to understand that they would be responsible for paying the taxes on the amount converted. Also, money from the account cannot be used to pay the required taxes. GW would send the participant a 1099 form and they would be required to file it with their annual taxes. Participants would need to be educated on the benefits and stipulations of the Roth option. Scott mentioned that they could include information in a newsletter and provide seminars.

Don motioned to make the Roth conversion option available to participants with a qualifying event, to begin on November 1, 2013
Kim seconded the motion
None opposed

The committee decided to include three changes in one vote.

- Online Deferral Recordkeeping-This would allow participants to choose their contribution amounts online and GW would forward that information to the City of Mesa. Currently this is done using a paper form.
- Signatureless Withdrawals (for severed employees and retirees only)-A signature would still be required from the participant, but not from the city. GW is now getting payroll feeds, which include termination dates, so they have the information required to know if the participant is eligible for a withdrawal. Active employees would still require signatures for withdrawals, but this would save time for retired employees that are trying to make a withdrawal from their account.
- GW Certification of Incoming Rollovers-Currently, if someone has an outside account that they want to roll assets from, into our plan, a signature is required from an authorized city signer. Their signature certifies that that type of account can be rolled over into our account. By allowing GW to do the certification, it would be sent to their home office to be

reviewed by a staff member that is familiar with the regulations for rollovers. The participant would still need to provide an account statement to certify that it can be allowed as a rollover.

There are no additional costs to add these features to the plan and they would all take effect on November 1, 2013.

Mike motioned to allow online deferral recordkeeping, signatureless withdrawals and GW certification of incoming rollovers
Kim seconded the motion
None opposed

There were three items that were brought up again, that the committee chose not to change at this time.

- Plan document- GW has offered to manage our plan document. Scott reminded the committee that our plan document must be updated to stay in compliance with IRS regulations. Bill indicated that he would like to know more about the history of our plan document and understand where some of it came from. Some committee members were concerned about being able to keep it current on our own. Scott indicated that he would speak with Lisa Tilley to see if she could draft a plan document. The committee could then review it to see what portions of the plan document can be maintained by GW and what portions need to remain the city's responsibility.
  Said we need to keep it current and accurate. No cost to add it.
- Automatic enrollment-This feature would automatically enroll all eligible employees into the plan, unless they opted out. The committee does not feel this would be widely accepted by employees and is not interested in this option.
- Online enrollment-This feature would require payroll data feeds on all eligible employees. Again, the committee is not interested in this option, as they are unsure about providing that type of information.

6. Next Meeting will take place on November 4, 2013

7. Meeting Adjourned at 1:50pm