

Investment Plans Committee

Regular Meeting
Minutes
January 27, 2010

A regular session of the Investment Plans Committee (IPC) was held on Wednesday, January 27, 2010 and convened at 8:35 a.m. and adjourned at 2:10 p.m. at 300 Lakeside Drive, 20th Floor; Oakland, California, 94612.

Committee Members or Alternate Members Present:

| | |
|------------------------|-------------|
| Elaine M. Kurtz, | BART alt. |
| Howard D. Jones, | SEIU |
| Robert Fernandez, | SEIU alt. |
| Carolyn Pope-Chappell, | ATU |
| Hubert LaViolette, | ATU alt. |
| Rube Warren, | AFSCME |
| Jean Hamilton, | AFSCME alt. |
| Kory Frost, | BPOA |
| Michael Pon, | BPOA alt. |

Committee Members or Alternate Members Absent:

Teresa Murphy, BART

Other Attendees:

| | |
|------------------|------------------------------------|
| Rose Roberts, | ICMA-RC |
| Russ Richeda, | Saltzman & Johnson (legal counsel) |
| Brandie Barrows, | Saltzman & Johnson (legal counsel) |
| Marcia Beard, | R.V. Kuhns (investment consultant) |
| Ben Taylor, | R.V. Kuhns (investment consultant) |
| Peter Horikoshi, | BART |
| Arne Stokstad, | BART |
| Carolina Lopez, | BART |

AGENDA ITEM 1 - Convene and Sign-in

AGENDA ITEM 2 - Public Comment

There were no public comments at the January 27, 2010 BART Investment Plans Committee's public meeting.

AGENDA ITEM 3 - IPC Chair Report - "Check-in" by IPC Members

Committee member Kory Frost announced that he would be leaving the meeting early.

Marcia Beard, the Investment Consultant reported that the ongoing dispute over governance of R.V. Kuhns has been resolved. The ownership of the firm will remain 100% employee owned. Marcia went on to announce that she is a board member and on the executive committee. Furthermore, Russ Kuhns will be retiring June 2010 and the name of the firm will remain the same.

AGENDA ITEM 4 - Discussion and Action Concerning Minutes – December 16, 2009

The Committee reviewed the minutes and approved the following motion:

Motion: To approve the December 16, 2009 meeting minutes with following modification:

Page 3 – Agenda Item 6: Change – Move the *Change* balance from each plan up to the Closing Balance for each plan and insert the correct *Change* Balance for each plan.

| 2009 | 457 Deferred Compensation | 401(a) Money Purchase Plan |
|--|----------------------------------|-----------------------------------|
| Opening Balance as of November 1, 2009 | \$371,564,348.32 | \$233,875,805.22 |
| Contributions | \$1,626,309.13 | \$139,626.35 |
| Roll-ins | \$0.00 | \$25,500.65 |
| Distributions | (\$815,796.88) | (\$882,922.19) |
| Adjustments | (\$13,731.57) | \$2,248.76 |
| Plan-to-Plan Transfers | \$0.00 | \$0.00 |
| Earnings | \$9,511,080.91 | \$5,258,158.18 |
| Service Fees | (\$295.21) | (\$16,000.33) |
| Closing Balance as of November 30, 2009 | \$381,871,914.70 | 238,402,416.64 |
| Change | \$10,307,566.38 | \$4,526,611.42 |

AGENDA ITEM 5 – Discussion and Action Concerning Legal Counsel Report

a) Legal Update

Legal Counsel Russ Richeda presented a Legal Update regarding the latest California Foundation for Fiscal Responsibility initiative, which would significantly increase eligibility requirements for public retirement defined benefit plans and reduce benefits for new hires. The Foundation lacks the

funding necessary to circulate the initiative petitions, without which it cannot obtain the signatures required to get the initiative on the next ballot. Legal Counsel also mentioned that a decision was issued in the *Lexin* case (criminal charges brought against members of the San Diego City Retirement Board), and that the substance of the decision would be the subject of a subsequent legal update.

b) Proposed Amendment to Both Plans Concerning Default Options

Per direction from the Committee during the December meeting, Legal Counsel presented Amendment No. 4 (renumbered as No. 6) to the Money Purchase Pension Plan and Amendment No. 5 (renumbered as No. 6) to the Deferred Compensation Plan, both revised to include domestic partners as default beneficiaries should a Participant die without designating a beneficiary. The Committee approved Amendment No. 6 and Amendment No. 6 in their final form with each Amendment to be effective January 1, 2010.

c) NAGDA Conference Feedback

Legal Counsel Russ Richeda presented a letter drafted by Legal Counsel to the NAGDA representative responsible for conference feedback outlining the Committee's comments regarding the 2009 conference, and the Committee's suggestions for the 2010 conference. The Committee approved the letter and moved to have it forwarded to the NAGDA representative.

d) Emergency Withdrawal Minutes and Documentation

Legal Counsel initiated a discussion regarding creating a record for Emergency Withdrawal decisions. After a discussion of the merits, Legal Counsel was directed to create a checklist indicating the reason for denial or approval in the form of a cover sheet which would be attached to each Emergency Withdrawal file. The checklist is to be one page, leave a space for comments, and be marked as "Privileged and Confidential."

8:50 a.m. – Committee member Howard Jones joined the meeting.

AGENDA ITEM 6 - Discussion and Action Concerning Investment Consultant Report

a) **Investment Performance Report for the Quarter Ended December 31, 2009**

In 2009, nearly all asset classes ended with strong gains. Only Real Estate and Treasuries posted losses. Most asset classes continued the rally that

began in the second quarter, as only Small Cap International Equities pulled back in the fourth quarter. The Federal Reserve held the Federal Funds Target Rate to a range of 0% to 0.25%; most global central banks held short-term target rates steady as well, though The Reserve Bank of Australia raised rates by 0.25% in December. Measured against a basket of international currencies, the US Dollar rose 1.6% during the fourth quarter but remains down for the year. Unexpectedly positive economic data from the US outpaced the data from other countries, which helped the dollar rebound some in the fourth quarter. Though the Consumer Price Index fell by a marginal 0.01% in the fourth quarter, the index ended the year up 2.72%. The rally in metals, however, suggests that investors fear impending inflation.

Fourth Quarter Equities

Global equities experienced exceptional gains throughout 2009 with Emerging Markets Equities leading the way, gaining 79% over the year. Despite such strong returns, most equity markets across the globe have not returned to their all time highs posted in 2007 or 2008. Once again, the equity rally was broadly based as nearly every sector in both the S&P 500 and the MSCI ACWI Ex US saw positive returns; only the financials sector of each index posted losses. In the US, large capitalization stocks outperformed small-cap stocks during the fourth quarter, while growth led value. Among international equities, Emerging Markets outpaced other regions while continuing to deliver incredible gains.

Fourth Quarter Fixed Income

Improving markets in other asset classes led to mixed results in Fixed Income. Treasuries, Agencies, and Long-Term Corporate issues posted losses in the fourth quarter, while gains in the other sectors of the Barclays Capital (BC) US Aggregate Index were much more moderate than in the previous quarter. For the year, Commercial Mortgage Backed Securities (CMBS) once again led all sectors of the BC US Aggregate Index with a 2009 return of 28.45%. Additionally, spreads have tightened across the quality spectrum, adding to the gains in this sector. Among broader fixed income markets, High Yield Corporate issues outperformed other sectors, posting gains of 6.19% in the fourth quarter and 58.21% for the year.

The Plans' funds outperformed their respective benchmarks in the quarter, with the exception of the RCM Large Cap Growth Fund, TIFI Foreign Equity Securities Fund and the Dwight Stable Value funds.

The IPC and investment consultant conducted their quarterly Investment Policy Review.

- Dodge & Cox Stock Fund remains below the three and five year policy expectations for performance relative to their policy benchmark. Per the Policy, the Fund is expected to perform above median in a universe of peers. Dodge & Cox's return was below median for both time periods. The IPC agreed that Dodge & Cox's performance improved dramatically in 2009 and would not make any changes at this time.
- PIMCO All Asset Fund remains below the three and five year policy performance expectation. The IPC agreed not to make any changes at this time. The Investment Consultant encouraged the IPC to consider a multi-manager approach for this option.
- Rainier Small/Mid Cap Equity Fund remains below the three and five year policy expectations for performance relative to its policy benchmark. Against its peer universe the Fund fell below the policy expectation for the three year period and for the five year period. The IPC agreed to take no action at this time since long-term performance for the Fund is strong and there have been no changes to the team.

b) **Investment Manager Review (and education on stable value funds) – Dwight Asset Management**

The Investment Consultant provided information on Dwight Asset Management stable value portfolios in anticipation of the presentation from Bill Gardner and Ron Heath. The Fund experienced disappointing returns in 2009 on an absolute basis (2.00% for DC and 1.95% for MP) and underperformed their benchmark, the 5 year CMT Rolling Average Index. Longer-term the stable value portfolios have performed well by beating their benchmark, net of fees, for the three, five and seven-year periods.

- c) As requested by the Committee, in advance of the presentation by Dwight, Ben Taylor of RV Kuhns provided education on stable value.

What is Stable Value?

Defining characteristics of stable value funds:

- Provide participant-level liquidity on a *book value* basis.
- Do not fluctuate up and down on a daily basis with the market.
- Provide returns through a credited rate of return determined through the use of a crediting rate formula.
- Involve an insurance company guarantee of some kind.
- Investments *primarily* include short or intermediate duration fixed income instruments of high credit quality.

Types of Stable Value Funds

Separate Account and Commingled Fund Structures

- The most common type of stable value fund.
- Assets are held by a custodian in trust, and managed by a professional fixed income manager.
- To provide book value liquidity into and out of the fund, the fund must have one or more “wrap” contracts.
- If any of the wrap providers default, or if an asset(s) is placed outside of the wrap, it is possible to obtain additional wrap coverage. If an asset(s) cannot be wrapped, then the fund will experience a market value adjustment to its net asset value (NAV).

How does it work?

The “wrap” issuer(s) receive fees to guarantee that participants can enter and exit the fund at the stated **book** value – regardless of the actual market value of the assets of the fund.

- A participant investing in the fund may pay **\$1.00** for assets worth \$1.05 or \$0.85.
- A participant leaving the fund will receive **\$1.00** for assets worth \$1.05, or \$0.85.

How can wrap issuers take the risk?

- Wrap providers **DON'T** pay every time a withdrawal takes place if the assets are worth less than 100% of the book value.
- The only time that the wrap providers have to provide cash to support the fund is when the *last assets are sold and there is still a positive book value balance to be paid.*

Example:

- A stable value fund has a market value that is 85% of the stated book value.
- The contract is terminated, and assets are paid out of the fund.
- Once all of the assets are sold, the wrap providers must make up the difference (15%).

“Wrap” providers have several additional protections:

- **Liquidity restrictions** – plan-sponsor initiated transfers are typically subject to a 12-month put.
- **Credit-quality wrap restrictions** – some contracts allow providers to “unwrap” certain securities if they fall below a given credit quality threshold.

- **Benefit-responsive wraps** – plan-sponsor actions that negatively affect the contracts can be cause for voiding them. Examples include: large scale layoffs, the introduction of a competing option (money market funds, for example), freezing cash flows into the fund, or encouraging participants through employee communications to divest from the fund.
- **Increased amortization of deficits through the crediting rate** – the credited rate of return can be lowered even when returns are positive to make the book value of the portfolio rise more slowly than the market value, bringing the ratio closer to 100%.

How should stable value funds be monitored?

Stable value funds should be evaluated on the basis of:

- The quality and risk profile of the underlying fixed income fund management, excluding the wrap contracts completely.
- The positioning of the portfolio with respect to cash and credit quality, as both can serve as buffers in volatile markets when there are substantial cash inflows and outflows.
- The strength and comprehensiveness of the wrap structure. Best practice is to have 4-6 wrap providers for diversity.
- Participant and plan-sponsor level liquidity. Funds that offer strong crediting rates at the expense of plan sponsor flexibility are a poor tradeoff and should be avoided.
- The transparency of the risk profile of the fund.

AGENDA ITEM 7 – Fund Manager Update: Dwight Asset Management

- a) Bill Gardner and Ron Heath, Senior Vice Presidents and Portfolio Managers attended. Dwight was founded in 1983 and had \$69 billion in assets under management as of December 31, 2009. Bill and Ron assured the Committee that Dwight continues to be exclusively focused on institutional fixed income. They are a subsidiary of Old Mutual.

Bill and Ron were upfront about what a difficult year 2009 was for the stable value industry, also indicating that Dwight had a decline in assets under management in 2009.

Bill and Ron reviewed the change in management (CIO and CEO) that Dwight experienced in 2009, most of which was expected and reviewed with the Committee during 2009. Dwight has refocused their approach to adding alpha within their portfolios by putting less emphasis on Asset Backed Securities (ABS) and CMBS as well as some corporate credit, and they hope to be able to seek additional alpha through their new cash portfolio management team.

In response to what Dwight has heard from their clients and the consultant community, they will be rolling out changes to their stable value strategy in 2010. Bill and Ron reviewed their thoughts on how the strategy will be structured in the future with three areas of focus:

Asset Structure

- Amortizing strategy
- Broad market exposure
- Liquidity management

Wrap Contract Structure

- Finite maturing contracts
- Standardization of terms
- Duration adjustment formula

Dwight Enhanced Liability Model (ELM)

- Matching asset structure to plan liability profile

Dwight will ask to present to the Committee once the strategy is ready for implementation.

AGENDA ITEM 8 – Discussion and Action Concerning Recordkeeper Report -

a) The Recordkeeper reviewed the following monthly reports:

- BART 401(a) and 457 Transaction Summary Reports
- BART 401(a) and 457 Fund Information Reports
- BART 401(a) and 457 Fund Detail Reports
- BART Fund Reimbursement Reconciliation Report
- BART IPC Web Activity Report

| 2009 | 457 Deferred Compensation | 401(a) Money Purchase Plan |
|--|----------------------------------|-----------------------------------|
| Opening Balance as of December 1, 2009 | \$381,871,914.70 | \$238,402,416.64 |
| Contributions | \$2,156,975.58 | \$110,646.92 |
| Roll-ins | \$0.00 | \$446,942.96 |
| Distributions | (\$1,825,287.14) | (\$937,437.50) |
| Adjustments | \$425.44 | \$16,408.96 |
| Plan-to-Plan Transfers | \$0.00 | \$0.00 |
| Earnings | \$6,009,923.73 | \$3,216,873.24 |
| Service Fees | (\$75.00) | (\$16,053.51) |
| Closing Balance as of December 31, 2009 | \$388,213,877.31 | \$241,239,797.71 |
| Change | \$6,341,962.61 | \$2,837,381.07 |

b) The Recordkeeper reviewed the following quarterly reports:

- Participation Report
- Participant Status Report
- Average Account Balance by Age
- Enrollments
- Allocations
- Fund Transfers
- Phone Call Activity
- Asset Allocation by Age
- Premier Program overview

The annual summary for the last three years was also provided on the total assets, contributions, distributions, rollouts and earnings.

c) The Recordkeeper provided a legislative update report on the following topics:

Fee Disclosure, RMD Waiver, Target Date funds hearings and the Roth 457 IRA. The Record keeper also shared results on a survey that was completed by NAGDCA regarding the interest in Roth 457 IRAs.

d) The Recordkeeper reported that the following participant communications occurred:

- Announcement about BlackRock purchase of Barclays Global Investors (Quarterly statement message and BART IPC web site)
- Message in Account Access related to the ability to increase 457 contributions through BART's auto escalator feature

The two-part Beneficiary Designation webinars will be available on the BART IPC web site by January 29, 2010. In the upcoming quarterly statement, the onsite education schedule will be included for the time period of May – August. The schedule is always available on the BART IPC web site. The Record Keeper will work with staff on the 2010 schedule for Bill Eagan, the Certified Financial Planner™ assigned to BART.

e) The Recordkeeper reported that 1099Rs were mailed during the week of January 20th. This year the IRS permitted masking the first five digits of the social security number. Electronic copies will be available in Account Access in February.

AGENDA ITEM 9 - Discussion and Action Concerning

a) 2010 Participant Day

The Committee discussed ideas that may help target more employees to attend this year's participant day event. Some of the ideas discussed were:

- Retirees
- Mid Term Participants
- New Employees
- Beneficiary Workshop
- Target Retirement Date Funds
- Marketing Posters (post in advance)
- Door Prizes

The Committee requested to have the save the date flyers in March and posters to be distributed to off site locations in April. Committee members will bring more ideas to the next meeting.

b) Form 700 for 2009

Staff handed out the Form 700 packet for 2009. Committee members were asked to bring completed forms to the next meeting. Staff will provide information to committee members about the value of gifts that may be reportable on the form.

AGENDA ITEM 10 - Discussion and Action Concerning

a) Monthly Budget Review & Vendor Reconciliation Report

Staff presented the monthly budget review and vendor reconciliation report for December 2009, both were accepted as received. Staff also presented the revised proposed budget for 2010 that included a lower participant fee from \$3.50 to \$1. The Committee adopted the revised budget and requested that the lower fee be effective February 2010.

b) Workshops/Seminars

Staff reported that invitations to the upcoming PLANSPONSOR webcast and the CALAPRS General Assembly seminar have been e-mailed to committee members. Committee members were asked to contact staff to register for these events.

c) 2007 Audit

Staff presented the Management Discussion and Analysis (MDA) report and a revised draft financial statement for the plans. The Committee approved to have the MDA and financial statement sent to the auditors. Staff announced that the Certified Public Accountant (CPA) hired by the

Committee has agreed to prepare the financial statements for the plans.

d) Accountant Review of Quickbooks File

The CPA who is working on the 2007 audit QuickBooks files reviewed the entries made by staff and made recommendations on correcting some of these entries. He will be meeting with staff to take a closer look at the back up documentation to determine if the entries are categorized correctly so that a financial statement from QuickBooks can be generated to match the financial statement that was submitted to the auditors.

e) 2010 Meeting Calendar

Staff handed out a revised meeting calendar that included the manager presentations and emergency withdrawals.

AGENDA ITEM 11 - Closed Session Pursuant to Government Code Section 54957.10: Hardship Application(s)

The Committee adjourned the meeting at 2:05 p.m. to enter into closed session to consider one Emergency Withdrawal Application that was approved. The Committee reconvened the public meeting at 2:10 p.m.

A closed session of the Investment Plans Committee was held on Thursday, January 14, 2010 and convened at 1:00 p.m. to consider one Emergency Withdrawal Application that was denied. The Closed session was adjourned at 1:25 p.m.

A closed session of the Investment Plans Committee was held on Thursday, January 19, 2010 and convened at 10:05 a.m. to consider one Emergency Withdrawal Application that was approved. The Closed session was adjourned at 10:15 a.m.

AGENDA ITEM 12 - Adjournment

The Committee adjourned the meeting at 2:10 p.m.