



## INVESTMENT COMMITTEE MEETING

Friday, September 3, 2004, 12:05 p.m.

Retirement Fund Conference Room

### MINUTES

#### I. CALL TO ORDER

The Retirement Fund Investment Committee Meeting was called to order at 12:05 p.m. Friday, September 3, 2004, in the Retirement Fund Conference Room. Investment Committee Chairman Wilfred P. Leon Guerrero officiated.

##### **Board of Trustees Present:**

Joe T. San Agustin

James J. Taylor, Ph. D.

Gerard A. Cruz

##### **Staff Present:**

Wilfred G. Aflague, Director

Paula M. Bamba, Administrative Services Officer

Pete Tajalle, Controller

Rosalia Bordallo, Investment Specialist

Vince Camacho, Great West Retirement Services

Jessica Chong, Recording Secretary

##### **Others Present:**

Rich Nuzum, Mercer Investment Consulting

#### II. ACTION ITEMS

##### A. APPROVAL OF MINUTES

Noted were corrections made to the minutes of August 6, 2004. First on page 3, Item C. Outstanding Receivables, the Guam Memorial Hospital's outstanding liability should read \$15.8 million instead of \$1.58 million. Second, Item D. Portfolio Review, "bonds" should be corrected to read "proprietary index". With those corrections duly noted, the minutes of August 6, 2004 was approved.

##### B. AFFIRMATION OF ACTUARY CONTRACT

The Investment Committee was tasked to review the Actuarial contract. Dr. Taylor indicated that he read the entire contract and found it to be more than adequate. Mr. Cruz agreed and stated that although he was not involved with the selection process he was involved with the interview of Milliman. He pointed out that the sooner the Actuary signs on, the sooner we may get a number that reflects the required contribution rate moving forward.

*On motion by Mr. Cruz to recommend Board's approval of the Actuarial contract, seconded by Dr. Taylor, with no objections, motion carried.*

### **C. ADOPTION OF REVISED INVESTMENT POLICY STATEMENT**

The Committee was provided the Investment Consultant's requested revisions. Dr. Leon Guerrero stated that he reviewed the recommendations but would like at least an additional month to go through it more thoroughly. Dr. Taylor asked if the IPS is revised whenever there are any additions or deletions in the investment management pool. He suggested incorporating some items as an appendix.

*Adoption of the revised Investment Policy Statement was tabled pending further review.*

### **D. DEFINED CONTRIBUTION PLAN RFP**

Ms. Bamba confirmed that five (5) proposals were received and all met the minimum qualifications. Dr. Taylor was appointed to oversee the evaluation process. As such, he will direct a memorandum to the Board to request their participation. Mr. Cruz recused himself from the selection process because of his relationship with one of the offerers.

## **III. INFORMATIONAL ITEMS**

### **A. STATUS OF INTERNATIONAL MANAGER CONTRACT FINALIZATION**

Dr. Taylor was concerned with the entry and exit fees imposed by GMO for their International Small Companies Strategy. Mr. Nuzum explained that the fees do not go to the investment manager but is paid to the fund and used to offset portfolio transaction costs caused by shareholder activity. GMO charges the fees to those specifically trading in or out. GMO thinks it's better to have this type of fee, penalizing those who go in and out, to benefit long-term investors. With the others, effectively the long-term investors underwrite the people who trade in and out. Mr. Cruz asked if the Fund would get additional value for the significantly higher amount it will cost to be in these funds. According to Mr. Nuzum, in terms of getting more value for the money, it's hard to justify. The additional cost is really for diversification on the emerging market category.

He stated that it was his understanding that the Fund was going to sign discretionary investment advisory agreements with the selected managers. Mr. Nuzum asked, if the first six (6) are selected, which is really five (5) firms, and a contract is signed with each, and then a year or two from now the Board would like GMO to make some use of the emerging markets, it is still international equity and within the scope of the request for proposal - can the benchmark be changed or can their guidelines be changed to allow this vehicle. According to Ms. Bamba it is allowed based on the way the RFP is written. Ms. Bordallo suggested the authority be placed in the contract to allow the Board the discretion to allow for this type of change. Mr. Nuzum stated he was trying to reserve flexibility and that Mercer will be comfortable with selection of the first six and to move forward on that basis. The next step is to produce the draft investment management agreement and see if the managers have any suggested changes to it. He further recommended a memorandum be composed summarizing the evaluation process.

Mr. Cruz's main concern about GMO as it relates to the international small companies was that the Fund may be missing out on an opportunity because of the fee. The better performance of GMO versus the alternative is sufficient to make up for the entrance and exit fee. He felt it was worth keeping, although he did not hold the same opinion as it relates to emerging markets because it's a high premium to pay for diversification. He would be more inclined to keep number seven, GMO international companies strategies, because it does provide for potentially better performance with less chance of standard error. Dr. Taylor stated that his experience over time has been that 1.2% is the real killer, however he is willing to accept the seventh item, experiment with that and see how it works. Mr.

then would the funds be allocated to. Mr. Cruz suggested putting it into Capital because Capital and GMO in terms of performance are about the same.

*On motion by Mr. Cruz to accept the first seven companies recommended by Mercer, not to accept GMO at this time in relation to their emerging market strategy, and to move the \$17.9 million into Capital, seconded by Dr. Taylor, with no objections, motion carried.*

## **B. STATUS OF CUSTODIAL BANK REQUEST FOR PROPOSAL**

Management indicated that they were directed to hold the request for proposals for custodial bank services until the international fund market contracts were completed so the transfer can be made at one time. Mr. San Augustin pointed out that instruction to proceed with the RFP was given as noted in the Investment Committee meeting minutes of August 6, 2004.

## **C. DC PLAN BRIEFING**

Mr. Vince Camacho provided a contribution report for the Defined Contribution Plan, and the July performance report for the Defined Contribution investments. Mr. San Augustin asked if the Plan made money. Mr. Camacho and Ms. Bordallo answered in the negative for July, but yes for the quarter. Contributions from the General Fund, Department Of Education, Superior Court, Guam Memorial Hospital, and Guam Power Authority were not received for the pay period ending August 21, 2004. Contributions are due September 3, 2004. Mr. Cruz inquired if there is any specific reason for the delay, maybe a system issue, cash flow, or other problem. Mr. Camacho indicated that cash flow could be the problem for some agencies, but in the Superior Court's case it was their data. Mr. Aflague informed the Committee that he and the Controller send delinquency notices within a week of the past due date. He reminded them that this ties in with ability of any employee to retire if contributions are not current. A follow-up billing is sent out every week after that. Mr. Cruz asked if cash flow is an issue because it is close to the end of the fiscal year. Mr. Aflague confirmed that is the reason for many of the departments except for those pointed out with systems problems. Mr. Camacho acknowledged that the next two months are normally the worst not only for collections but for other issues. It's the beginning of the school year for the Department of Education, so there are hundreds of people to process in August prior to the school year.

## **IV. OPEN DISCUSSION**

### **A. INVESTMENT CONSULTANT BRIEFING**

Mr. Nuzum informed the Board that four meetings a year is covered within the realm of the contract, as such it would be useful to know how the Board would like to work with them. With most of the public funds of this size, the consultant would at least call in for every Investment meeting. Quarterly updates are on calendar quarters. September 30 would be the closing of the third quarter (Q3). Mercer tries to compare the Fund results to those of other managers. It takes about six to eight weeks to get the other manager returns in, as well as other public fund returns. The reports are usually ready to be shipped within six to eight weeks after the end of the quarter. Unaudited quantitative numbers could be available not long after the end of the quarter. Mr. Nuzum then stated that it would be useful for them to know how the Board would like to work with the consultants.

Mr. San Augustin inquired if the quarterly report would include an evaluation of each investment manager, indicate poor or good performance, identify to what degree they are moving, and a recommendation to continue using them or cease trading. Mr. Nuzum pointed out that any recommendation would be on the first page of the executive summary. The only recommendation at this point was to move ahead with the international RFP process. Mr. San Augustin wanted to know what mechanism, if any, is in place to halt trading by a manager who is not performing adequately. Mr. Nuzum assured the Committee that they would not wait for the report. Most of their firing recommendations come about because of personnel or organizational changes, rather than performance.

That recommendation is usually out within a week or so after the change. The Board can call a special meeting and decide whether to stop trading on that portfolio or not. Firing recommendations that are performance related are judgment calls at best. They have done studies in which underperformers were fired, more money was given to outstanding performers, and the account ended up underperforming the market as a whole because of style.

Mr. San Agustin asked if Mercer would be able to detect if any of the investment managers are operating outside the investment law, and if so, would they be able to stop that trading. Mercer can detect some of it after the fact but the monitoring mechanism currently in place is not as strong as they would like. Ideally, an automated compliance monitoring by the custodian would be in place, backed up by reporting by the managers.

When Mercer came on board, Aberdeen and Lazard were the two they were most concerned about. The next one they recommended terminating was Citigroup Provance. Their allocation may be reduced as the international managers are implemented. The Board was not comfortable with firing them because it would mean two fixed income managers, each having twenty-five percent of the Fund's assets. Mr. Cruz added that Citigroup's mandate was long-term duration, so in that mandate they actually did okay compared to the others. Ms. Bordallo reported that the Fund was looking to replace Aberdeen and Murray. Request For Proposals for all three bond managers were issued and the interviews were scheduled on the date Typhoon Pongsona hit. Mr. San Agustin interjected that an RFP wasn't necessary to fire someone. Ms. Bordallo pointed out that the managers would have to be replaced. Mr. San Agustin asked how long it would take to hire someone. Ms. Bamba pointed out that as far as regular professional services it should not take long. The RFP closed in December; the investment consultants' analysis took about two to three months. Mr. Leon Guerrero recalled in June the Chairman asked to hold back on all decisions. Mr. Nuzum claimed that two to three months is not normal, they should be able to do it in two to six weeks if the candidates are high enough quality that they see them quite a bit. If it were someone they have never heard of, then they would have to do due diligence and that would take some time.

To address the question regarding how the Investment Committee or Board want to interact with the investment consultant, Dr. Taylor reaffirmed that a report would be given every quarter and as such wished to know if that included a face-to-face meeting with the Consultant. Mr. Nuzum answered in the positive and added that they usually try to piggyback on that whatever progression or strategic issues the Fund is dealing with. The next presentation would be mid to late November or early December and covers the third quarter. Dr. Taylor expressed concern that they have not had the chance to review the performance of each manager. He would like to have some interaction with the Consultant and not have to wait until November to start reviewing performance. Mr. Nuzum indicated that it was part of the morning agenda that they did not get to. Mr. San Agustin acknowledged that it is a learning curve for all of them. The problem with meeting in November, according to Mr. Leon Guerrero, is that they will be out of sync the following year. He suggested since the first quarter ends on March 30, they should meet in April.

Mr. Nuzum reiterated that the fastest thing to calculate is the returns for that quarter. Ms. Bordallo or the Consultants can do that within a few days after the end of the quarter. Doing the attribution analysis on the managers, getting their explanation of why they added or didn't add value, and finding out about any personnel or organizational changes takes a few weeks. The Consultant does not issue the report until they have compared the Fund's performance against other public funds and how the Fund's managers are performing against other managers with similar mandates. The comparison is what takes six to eight weeks. The managers have to get all their returns, do their composites and get those out, and have their auditors review it.

Mr. San Agustin asked if the Consultant would be able to provide a flash report or red flag on a manager they may be concerned about. In terms of performance, they cannot with the current set up. Mr. Nuzum indicated that they would like to get online access to the Fund's custody data, and report off of that for both compliance and performance, and attribution analysis. They currently monitor on an

ongoing basis personnel and organizational changes. He noted that the Board might want to tighten up the contracts with existing fund managers to make it very clear that if the Fund loses money after they have a personnel or organizational change, and the Fund was not notified, the manager will be held liable. They would like to make it very explicit. Mercer has that with other clients and they feel that they have it in place enough that if something happens with one of the Fund managers they are likely to hear about it.

Mr. San Agustin asked if they have had an opportunity to review each one of the investment management contracts. Mr. Nuzum replied that they have not gone through them and try to revamp them. He pointed out that there were at least seven major things that the former Board accomplished in the first two years working with them. There are thirteen or so that they would like to take up with the current Board. The revamping of the contracts is number eight, but the Committee or Board could make that a top priority if they want to. Mercer's focus is on whether the Fund's managers beat the benchmark they've been given.

Dr. Leon Guerrero inquired how soon after the end of the quarter can Board receive a performance report. Mr. Nuzum indicated they might be able to provide a flash report that would have performance numbers versus benchmarks within ten business days at most after the end of the quarter. Mr. San Agustin stressed that he wants a statement to the fact that the managers are in compliance with statute. To be able to give provide that fully, Mercer requires upgraded data provided by the custodian. Mr. Tajalle suggested Mr. Nuzum provide some input as on what to include in the Custodial Bank RFP scope of services that would enable Mercer to perform the kind of monitoring Mr. San Agustin is requesting. The ideal set up, according to Mr. Nuzum, entails online access of the Fund's custodial accounts to anyone from the Fund and Mercer. Access would be limited to viewing what is being held in the account in real time, just as the investment managers are seeing. Trading will not be possible. There will be associated costs.

In summary, Mercer will be able to provide quantitative performance reports within ten days after the end of the quarter. A full and best practice report will be eight weeks after the end of each quarter. Dr. Leon Guerrero deemed two months to be appropriate if there are no concerns. Mr. Nuzum pointed out that if they felt it necessary to red flag anyone for something other than performance or even for performance, it would not be in the performance report. The Fund will receive correspondence in between the quarters.

Mr. Nuzum communicates with Mr. Tajalle or Ms. Bordallo at least every other day either through email or telephone conversations. Mercer has researchers whose full time responsibility is to cover each of the managers. Although communication is not on a day-to-day basis, Mercer hopes that in the event if something bad happens in terms of personnel or organization they would hear about it and be able to advise the Fund. For this reason, Mr. Nuzum wanted to stress again the importance of including something in the contract to make it mandatory that if something bad happens and the Fund loses money as a result, the managers will be held liable. He emphasized that the burden of proof will be on the Fund, the method to calculate damages is not specified, but there are things that can be done from a legal standpoint to make that a bit tighter.

Dr. Taylor was not too concerned about waiting eight weeks for a report, but he would like to understand in greater depth what the managers are doing and why and November is too far off. Mr. Nuzum advised the Committee that he or either of the other two consultants would be more than happy to come out whenever they would like to meet. It would just be an issue of going beyond the four meetings a year stipulated in the contract. Travel cost is approximately two thousand dollars. If the work requested is quite significant cost might run up to approximately ten thousand dollars. Mr. Cruz suggested a teleconference or videoconference.

Mr. Nuzum gave notification that they were overdue for the annual due diligence sessions with the incumbent managers. The managers would need at least four to six weeks notice on that. He suggested setting a meeting date. A half-day with the incumbents and a half-day with strategy issues. If it's scheduled in November, they could also look at the Q3 report.

**VII. ADJOURNMENT**

There being no further business before the Investment Committee, on motion by Trustee Gerard Cruz, seconded by Vice-Chairman James Taylor, with no objections, the meeting was adjourned at 1:35 p.m.

**Respectfully submitted,**

  
**VIVIAN D. MANTANONA**

**AFFIRMED:**

  
**WILFRED P. LEON GUERRERO, Ed.D.**  
**Chairman**