



## BOARD REPORT 18-34

Date: July 17, 2018  
To: Board of Deferred Compensation Administration (Board)  
From: Staff  
Subject: 2018-2019 Investment Manager Searches

### Board Members

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### **Recommendation:**

That the Board (a) approve proposed 2018-2019 investment manager search plan for the Deferred Compensation Plan investment menu and (b) direct the Investments Committee to develop recommendations to the Board with respect to the type of search process (mutual fund or institutional manager procurement) to be applied to each investment mandate; proposed investment and evaluation criteria for each mandate; and recommendations for provider selections.

### **Discussion:**

This report provides a recommended search plan developed by staff and the Plan's consultants at Mercer Investment Consulting for investment mandates included within the core options for the City's Deferred Compensation Plan investment menu. Current five-year terms for the Plan's various providers will expire over a range of dates in 2019-2020.

Background will be provided regarding the Board's prior construction of the investment menu and established search process protocols as codified within the Plan's Investment Policy Statement (IPS). A recommended process and timeline for proceeding with investment manager searches in 2018-2019 will be outlined.

### **A. Background**

(1) **Investment Menu** - The Plan's IPS (**Attachment A**) outlines the objectives for and structure of the Deferred Compensation Plan investment menu. The IPS indicates that in constructing the menu the Board's governing principle is *"that an investment menu limited to a focused selection of distinct investment choices and consisting of investment options identified by asset class rather than investment provider will promote effective asset allocation strategies for plan participants."* The IPS defines the investment menu as being constructed of three basic tiers including investment options as outlined in the following table:

Asset Allocation Risk Profile Funds (Tier I)	Core Options (Tier II)	Brokerage Window (Tier III)
DCP Ultra-Conservative Fund	FDIC-Insured Savings Account	Schwab Self-Directed Brokerage
DCP Conservative Fund	DCP Stable Value Fund	
DCP Moderate Fund	DCP Bond Fund	
DCP Aggressive Fund	DCP Large-Cap Stock Fund	
DCP Ultra-Aggressive Fund	DCP Mid-Cap Stock Fund	
	DCP Small-Cap Stock Fund	
	DCP International Stock Fund	

Each investment option is branded by either risk level (in the case of the Tier I asset allocation risk profile funds) or by asset class (in the case of the Tier II core options). Tier III, the Brokerage Window, is intended to provide the broad universe of stocks, bonds, exchange-traded funds, and other mutual funds to active investors wishing to seek investments outside the Plan’s core line-up.

Each Tier I and Tier II option includes an underlying fund or funds consisting generally of multiple strategies and fund managers. The intent of branding the Tier I and Tier II options by **risk level** and **asset class**, respectively (rather than identifying options by fund manager or, in the case of target-date funds, by time of retirement), is to promote greater understanding by participants of their investment choices in the context of **investment risk/return** and **asset class diversification**. As discussed by the Board previously in developing its investment menu, the design of the menu plays a fundamental role in helping participants engage with and focus on risk management and investment diversification. This focus, in turn, allows participants in making investment decisions supporting their long-term retirement income security.

**(2) Search and Procurement Policy**

When seeking to fill investment mandates, the IPS provides that the Board may utilize mutual fund searches and/or institutional manager procurements to fill the various investment mandates comprising the Plan’s investment menu. Mutual fund searches are defined as a review of the broad universe of mutual fund investment vehicles available within a specific investment category and **for which a contractual relationship between the fund manager and the City’s Plan is not available or required**. An institutional manager procurement is defined as a review of proposals from managers of institutional investment products (e.g., separate accounts, commingled trusts, and bank deposit

accounts) within a specific investment category **for which a contractual relationship between the fund manager and the City's Plan is required.**

The Board has the option of selecting either a mutual fund search or institutional manager procurement, or combination of both, to conduct a search process. The Board makes this decision based on what it finds to be in the best interests of the Plan and its participants.

Generally, a mutual fund search provides an opportunity to consider virtually the entire universe of potential mutual fund providers offering fund products within the parameters of a specific mandate. An institutional manager procurement is limited to those firms who are aware of, choose to compete in, and can fulfill the City's procurement prerequisites before their product offerings can be considered.

During the last round of searches, the Board elected to pursue mutual fund searches exclusively for all investment mandates not requiring a contract with the service provider. The Board made this decision based on its findings that:

- Plan participants would be best served by allowing the Board to consider a much fuller universe of potential providers than would be available within a typical City procurement process;
- A sufficient number of products with institutional fund pricing was available through mutual fund offerings, and the broader universe of products available for consideration created a greater likelihood of finding lower-cost options; and
- The Plan would save the direct consulting costs and Board/staff time and resources associated with institutional manager procurements.

When the Board selects a mutual fund, implementation is relatively simple in that the only additional required step is opening up a Plan account within the mutual fund account on the Third-Party Administrator (TPA) recordkeeping system. When the Board selects a separate account or commingled fund, a contract must be developed and executed, and the service provider must meet all of the City's general contracting requirements.

Presently, only the Plan's FDIC-Insured Bank Deposit Account providers (East West Bank and Bank of the West) and Stable Value Fund provider (Galliard Capital Management) are contracted service providers. All of the Plan's other investment vehicles are mutual funds, generally utilizing share classes only available to institutional clients with a significant asset base in the mandate.

Incumbent investment manager relationships will be expiring between September 2019 and June 2020. Each provider is listed in order of 5-Year end date as indicated in the following summary table:

Investment Mandate	Active or Passive Management	Incumbent Manager	Inception Date	5-Year End Date	Investment Vehicle	Prior Search Type
Bank Deposit Account	n/a	East West Bank	10/1/2014	9/30/2019	Contracted Bank Deposit Account	Request for Proposal
Bank Deposit Account	n/a	Bank of the West	10/1/2014	9/30/2019	Contracted Bank Deposit Account	Request for Proposal
Core Bond Passive	Active	Natixis Loomis Sayles Core Plus Bond	10/14/2014	10/31/2019	Mutual Fund	Mutual Fund Only
Mid-Cap Value Equity	Active	RidgeWorth Mid-Cap Value Equity	3/20/2015	3/19/2020	Mutual Fund	Mutual Fund Only
Mid-Cap Growth Equity	Active	Voya Mid-Cap Opportunities	3/20/2015	3/19/2020	Mutual Fund	Mutual Fund Only
Small-Cap Value Equity	Active	DFA Small-Cap Value	3/20/2015	3/19/2020	Mutual Fund	Mutual Fund Only
Small-Cap Growth Equity	Active	Hartford Small-Cap Growth HLS	3/20/2015	3/19/2020	Mutual Fund	Mutual Fund Only
Core Bond Active	Passive	Vanguard Total Bond Market Index	6/26/2015	6/25/2020	Mutual Fund	Mutual Fund Only
Large-Cap Core Equity	Passive	Vanguard Institutional Index	6/26/2015	6/25/2020	Mutual Fund	Mutual Fund Only
Mid-Cap Core Equity	Passive	Vanguard Mid-Cap Index	6/26/2015	6/25/2020	Mutual Fund	Mutual Fund Only
Small-Cap Core Equity	Passive	Vanguard Small-Cap Index	6/26/2015	6/25/2020	Mutual Fund	Mutual Fund Only
International Equity	Active	MFS Institutional International Equity	6/26/2015	6/25/2020	Mutual Fund	Mutual Fund Only
International Small-Cap Equity	Active	Brandes International Small-Cap Equity	6/26/2015	6/25/2020	Mutual Fund	Mutual Fund Only
International Emerging Markets Equity	Active	DFA Emerging Markets Core Equity	6/26/2015	6/25/2020	Mutual Fund	Mutual Fund Only
Stable Value	n/a	Galliard Stable Value	7/1/2015	6/30/2020	Contracted Separate Account	Request for Proposal

## B. Search Process

Searches and procurements for specific investment categories generally follow the process outlined below.

- 1) A determination must be reached by the Board as to whether a mutual fund search and/or institutional manager procurement best meets IPS objectives for that particular investment mandate and is in the best interests of the Plan and its participants.
- 2) The Board adopts the selection and evaluation criteria.
- 3) If the Board elects a mutual fund search, the Investment Consultant and staff work together to search for qualifying mutual fund investment strategies, applying the search and evaluation criteria as set forth by the Board. The Investment Consultant and staff prepare a list of top-scoring firms. The Board's Investments Committee typically reviews the search results and considers the recommendations of staff and consultant, and other relevant data, in developing a recommendation for the full Board. Once the Board elects a fund, the Plan's TPA is directed to activate that fund for the City's Plan within its recordkeeping platform.
- 4) If the Board elects an institutional manager procurement, the Investment Consultant and staff work together to draft a Request for Proposal (RFP) in the form of a public notice informing interested vendors that any investment strategies meeting the published search criteria will be considered; that a response as to the specific investment mandate criteria is not required assuming their fund data is already maintained on the Investment Consultant's database, but a response to the RFP questionnaire regarding the City's general contracting requirements is required in order for the fund to be considered; and that if the proposer's fund data is not on the Investment Consultant's database the proposer can provide that data, without limitation, to the Investment Consultant to ensure that the investment strategy will be considered if it meets the Board's criteria. The Investment Consultant and staff rank the responses to the RFP based on the Board's adopted selection and scoring criteria. The Board's Investments Committee reviews the fund listing and considers the recommendation and all relevant data in arriving at a recommendation for the full

Board. Once the Board selects a fund, the vendor is required to execute a contract with the Board and meet all of the City’s applicable general and specific contracting requirements – if it is not able to do so, the search will be brought back to the Board to make another selection. Once a contract is executed, the Plan’s TPA is directed to activate that fund for the City’s Plan within its recordkeeping platform.

For the 2018-2019 process, staff recommends that the Board direct the Investments Committee to develop recommendations to the Board with respect to the type of search process (mutual fund or institutional manager procurement) to be applied to each investment mandate; proposed investment and evaluation criteria for each mandate; and recommendations for provider selections. Staff believes that this approach provides for the greatest level of continuity for the Committee in considering all material aspects of the search and selection process. This broad and thorough consideration should best support the Board in reaching its conclusions.

### C. Timeline

Staff has developed a tentative timeline for proceeding in 2018-2019 (**Attachment B**) to ensure that all processes are completed promptly before expirations of 5-year terms in 2019-2020. This timeline may need to be modified based on the availability for scheduling meetings and the time involved to conduct analysis and generate reports for Investments Committee and Board approval.

Submitted by:

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Isaias Cantu

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**PROPOSED TIMELINE: 2018-2020 INVESTMENT MANAGER SEARCH AND SELECTION PROCESS**

<b>FUND PROVIDER SEARCH COMPONENT</b>	<b>TENTATIVE TARGET COMPLETION DATE</b>
Board approves proposed investment manager search process	July 17, 2018
Investments Committee convenes over multiple meetings to develop (a) recommendations for search process type (mutual fund and/or institutional manager procurement); (b) criteria for Plan investment mandates; (c) results of FDIC-Insured Bank Deposit Accounts RFP; and (d) refined phased timeline for each search	August-October 2018
Board adopts Investments Committee search types, search criteria, and refines search and implementation timeline	October 17, 2018
Consultant conducts mutual fund searches (Group A, the composition of which is to be determined)	October-December 2018
Consultant/staff develop RFP for Stable Value Fund and any other approved investment mandates	October-December 2018
Board selects Investments Committee recommended FDIC-Insured Bank Deposit Account providers	December 18, 2018
Board approves Investments Committee-recommended draft RFP(s) for Stable Value Fund and any other recommended investment mandates	January 15, 2019
Investments Committee convenes to review Group A mutual fund manager search results	January-February 2019
Board selects providers for Group A mutual funds	March 19, 2019
Consultant conducts mutual fund searches (Group B, the composition of which is to be determined)	March-April 2019
Investments Committee convenes to review Group B mutual fund manager search results and responses to RFP(s)	May-June 2019
Board approves Investments Committee-recommended providers for Group B mutual funds and RFP(s)	July-August 2019
Implementation of provider relationships	October 2019 through July 2020