

Board of Deferred Compensation Administration INVESTMENTS COMMITTEE (Committee)

Committee Members

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REPORT 18-01

Date: September 17, 2018
To: Committee
From: Staff
Subject: Deferred Compensation Plan Investment Manager Searches

Recommendation:

That the Committee recommend to the Board of Deferred Compensation Administration approval of staff and investment consultant proposals with respect to a) the type of fund search process to be applied to upcoming investment management searches and b) the investment and evaluation criteria for each mandate.

Discussion:

At its July 17, 2018 meeting, the Board considered a report from staff regarding upcoming investment manager searches for the Deferred Compensation Plan investment menu (**Attachment A**). The Board (a) approved a proposed 2018-2019 investment manager search plan for the Deferred Compensation Plan investment menu and (b) directed the 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.

The Plan's Investment Policy Statement (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 which 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.

Staff has been working with Mercer to develop recommendations for the fund search type and search criteria. The table on page two of this report summarizes the recommended search option types for each active and passive fund category. Justifications for each fund search type are included in the attached reports from Mercer.

The Mercer report also contains recommended fund search criteria for each investment option. The search criteria utilize and provide further specificity with respect to the existing investment fund construction parameters already included in the Board's Investment Policy Statement.

Mercer will apply these search criteria against the applicable mutual fund universe of funds and, for each category, identify those funds which have met the criteria. The results of this screening will then be presented to the Investments Committee for further review and for the purpose of developing recommendations for fund selection to the full Board.

Unlike the prior search cycle, staff and Mercer are recommending that a number of investment mandates, mostly for the Plan’s passive managers, use a combination of mutual fund searches and institutional manager procurements. Staff’s and Mercer’s findings are that there may be opportunities for more favorable investment products available through a procurement and that engaging in both processes is the most prudent exercise of due diligence for certain mandates. The table below summarizes the recommendations, which are further detailed in Mercer’s reports and will be reviewed in detail at the Committee meeting.

Investment Mandate	Active or Passive	Incumbent Manager	Inception Date	5-Year End Date	Assets	Recommended Search Vehicle
Bank Deposit Account	n/a	East West Bank	10/1/14	9/30/19	\$171 million	Request for Proposal only (in process)
Bank Deposit Account	n/a	Bank of the West	10/1/14	9/30/19	\$171 million	Request for Proposal only (in process)
Stable Value	n/a	Galliard Stable Value	7/1/15	6/30/20	\$1.1 billion	Request for Proposal only
Core Bond Passive	Passive	Vanguard Total Bond Market Index	6/26/15	6/25/20	\$287 million	Institutional Manager Procurement and Mutual Fund Search
Core Bond Active	Active	Natixis Loomis Sayles Core Plus Bond	10/14/14	10/31/19	\$287 million	Institutional Manager Procurement and Mutual Fund Search
Large-Cap Core Equity	Passive	Vanguard Institutional Index	6/26/15	6/25/20	\$2.3 billion	Institutional Manager Procurement and Mutual Fund Search
Mid-Cap Core Equity	Passive	Vanguard Mid-Cap Index	6/26/15	6/25/20	\$192 million	Institutional Manager Procurement and Mutual Fund Search
Mid-Cap Value Equity	Active	RidgeWorth Mid-Cap Value Equity	3/20/15	3/19/20	\$96 million	Mutual Fund Search only
Mid-Cap Growth Equity	Active	Voya Mid-Cap Opportunities	3/20/15	3/19/20	\$96 million	Mutual Fund Search only
Small-Cap Core Equity	Passive	Vanguard Small-Cap Index	6/26/15	6/25/20	\$130 million	Institutional Manager Procurement and Mutual Fund Search
Small-Cap Value Equity	Active	DFA Small-Cap Value	3/20/15	3/19/20	\$131 million	Mutual Fund Search only
Small-Cap Growth Equity	Active	Hartford Small-Cap Growth HLS	3/20/15	3/19/20	\$131 million	Mutual Fund Search only
International Equity	Active	MFS Institutional International Equity	6/26/15	6/25/20	\$401 million	Institutional Manager Procurement and Mutual Fund Search
International Small-Cap Equity	Active	Brandes International Small-Cap Equity	6/26/15	6/25/20	\$105 million	Mutual Fund Search only
International Emerging Markets Equity	Active	DFA Emerging Markets Core Equity	6/26/15	6/25/20	\$105 million	Mutual Fund Search only

Staff recommends that the Committee recommend to the Board of Deferred Compensation Administration approval of staff and investment consultant proposals with respect to a) the type of fund search process to be applied to upcoming investment management searches and b) the investment and evaluation criteria for each mandate. Upon approval by the Committee, these recommendations will be forwarded to the Board.

Submitted by:

Isaias Cantú

Approved by:

Steven Montagna