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**PERSONNEL DEPARTMENT  
EMPLOYEE BENEFITS DIVISION**  
200 NORTH SPRING STREET, ROOM 867  
LOS ANGELES, CA 90012  
(213) 485-4846

April 20, 2010

Honorable Carmen A. Trutanich  
City Attorney  
200 North Main Street, Room 800  
Los Angeles, CA 90012

**DEFERRED COMPENSATION PLAN INVESTMENT MANAGER PROCUREMENT**

I am writing to you on behalf of the Board of Deferred Compensation Administration concerning procurement for investment options offered under the City of Los Angeles Deferred Compensation Plan (“the Plan”). The Plan is unique among benefits offered to City employees. Unlike other programs, the costs of this Plan are fully borne by its participants and all Plan assets belong fully and solely to those participants – no City assets are included.

The Board understands that its primary fiduciary obligation is to act in the best interests of Plan participants. It is paramount that the highest degree of scrutiny be given to matters directly affecting each and every participant’s ability to take maximum advantage of the Plan’s potential. In no area is this more critical than in the selection of investment managers. The capabilities and qualifications of potential providers, including both their performance records as well as fees, directly translate to the dollars, or potential dollars, that participants can accumulate in their accounts.

Given this, it is our objective to ensure that we design a procurement process leading us to the highest quality, best-of-class providers, with exemplary track records and competitive costs. Meeting that objective requires that we consider the broadest possible pool of investment managers. Consistent with this, it is crucial that all potential providers have equal access to being considered, and that the process and evaluation criteria for considering each potential fund be fully transparent.

The Board is considering a new process for investment manager searches which we believe can best meet our fiduciary obligations to act in the best interests of Plan participants. We are requesting guidance from your office with respect to how this proposed process can fit within the City’s general procurement rules.

## Background

The City's Deferred Compensation Plan includes three categories of third-party services and search processes: (1) administrative services; (2) consulting services; and (3) investment management services. The subject of this correspondence is **investment management services only**.

Investment management services can be offered under two specific investment vehicles: **mutual funds** (pooled investment vehicles governed by a prospectus and which do not involve execution of a contract with the City); and **institutional funds** (investment funds similar to mutual funds but utilizing different legal structures – separate accounts, commingled funds, variable annuities, etc. – and which require a contract with the City).

The Plan has a unique and complex history with respect to how it has selected investment options for the Plan. From its inception in 1983 until 1999, the Plan did not engage in competitive searches when it added or changed investment options. Rather, it provided instructions to its prior administrative services providers to make certain mutual funds available to participants. In addition, prior to 1995, the City did not use an outside consultant as part of its consideration process for selecting funds.

In 1999 the Board separated the Plan's administrative services contract from its process for selecting investment options. Even though the Requests for Proposal (RFPs) for investment managers had not been issued in the past, the Board began issuing them for investment management contracts in the interest of increasing competition. Relative to the prior process for choosing funds, this approach provided for greater competition, but it nevertheless also created substantial limitations.

## Procedural Limitations with Traditional Search Process

Following is a summary of limitations the Board has identified with the traditional search process:

- (1) Out of a potential universe of approximately 7,300 investment fund products (both mutual funds as well as institutional funds), the number of responses tends to be extremely weak; in recent years most of our searches have yielded only a few or in some cases no written responses.
- (2) A typical City search process requires that vendors first demonstrate compliance with the City's general contracting provisions both through formal attestations as well as submission of certain documents, which has the effect of screening out vendors who are unwilling or unable to comply with those requirements. While these contracting provisions apply to institutional funds, they do not apply to mutual funds. Thus, the screening process has the effect of unnecessarily removing from consideration many otherwise fully viable, excellent products for reasons which in the end will not apply to them (and, it should be noted, do not apply to the approximately 6,000 mutual funds currently available to participants through the Plan's Self-Directed Brokerage Option).

- (3) Requiring that prospective vendors submit written responses is a redundant and inefficient means of evaluating the data needing to be considered since the Plan's consultant already has all of the quantitative data (e.g. assets under management, operating expenses, manager tenure, etc.) that would be used to identify top firms. As a result, the very act of requesting information already in the Plan's possession acts to further limit, generally quite sharply and in our view unnecessarily, the number of firms that can be considered.

### **Potential Revised Search Process**

Unlike most other third-party services offered within the City, the mutual fund/institutional fund distinction creates entirely unique considerations and challenges. In studying the matter, the Board has attempted to identify a creative solution which can meet its fiduciary obligations to the highest degree, provide for the greatest competition, and provide the optimum level of transparency. The process we are considering involves steps outlined in Attachment A.

### **Questions Regarding City Procurement Requirements Relative to Proposed Process**

In reviewing this proposed process, the Board is raising three questions of the City Attorney's Office:

- (1) Given that fund selection processes prior to 1999 did not involve competitive searches insofar as selection of mutual funds is concerned; and given that the City's Plan has not engaged in competitive searches for the approximately 6,000 funds made available to participants through the Plan's Self-Directed Brokerage Option; is the City's Plan required to issue a Request for Proposal as part of a competitive search process to add new investment funds to its core options? If the answer to this question is yes, how would such a requirement be consistent with the search process in effect prior to 1999 and the current availability of investment funds through the Self-Directed Brokerage Option?
- (2) Section 10.15 of the City of Los Angeles Administrative Code (LAAC) and section 371 of the City of Los Angeles Charter addresses the rules regarding competitive bids, but the LAAC and City Charter also provides for certain exceptions to these requirements. Are there any exceptions within the LAAC or Charter that would apply to investment manager searches for the Deferred Compensation Plan? Certain of these potential exceptions include (with emphasis added on that language which we think may be applicable):

*"10.15(2) Contracts, as determined by the contracting authority, for the performance of **professional, scientific, expert, technical, or other special services** of a temporary and occasional character for which the contracting authority finds that competitive bidding is not practicable or advantageous."*

*"10.15(9) Subject to the requirements of Charter Section 1022, contracts (including without limitation those, as determined by the contracting authority, for the performance of professional, scientific, expert, technical or other special services), where the contracting authority finds that the use of competitive*

**bidding would be undesirable, impractical or impossible or where the common law otherwise excuses compliance with competitive bidding requirements. For purposes of this Section, and for construing the same term in Charter Section 371(e)(10), the term “undesirable” shall mean and include only such situations in which the nature of the subject of the contract is such that competitive bidding would work an incongruity or be unavailing or would not produce an advantage, with sole reference to the public interest and in light of the purposes to be accomplished.”**

(It should be noted that the Board, in asking this question, is not granting that its proposed revised search process is not a competitive one. In fact, we would argue that it is more competitive because the broadest possible number of candidates are being considered. Our question goes to the threshold question of whether a requirement for a search process in this instance even exists.)

- (3) For the purpose of considering both mutual funds and institutional funds simultaneously, does the proposed procurement process outlined within this correspondence meet the intent and obligations of the City’s procurement rules? If not, where specifically does it fall short?
- (4) If an RFP requiring a written vendor response is required, can mutual funds be exempted from having to demonstrate compliance with the City’s Standard Provisions?

As with many rules and processes, situations and circumstances will arise from time to time that may not be explicitly addressed by the language of the rule or how it has been applied in the past. In those cases it is imperative that we seek solutions which are both creative and which do not fail to lose sight of our most important objectives and responsibilities. As always, our goal is to act in the best interests of our participants. Please do not hesitate to contact the Deferred Compensation Plan Manager, Steven Montagna at (213) 978-1621 if you have any questions. We look forward to your response and moving towards a well-considered solution.

Respectfully submitted,

Eugene Canzano, Chairperson  
Board of Deferred Compensation Administration

### Potential Revised Search Process

1. **Plan staff and consultant draft proposed selection criteria** for a given investment category.
2. **Board** considers, potentially modifies, and then **adopts selection criteria**.
3. **Staff and consultant issue a Request for Proposal in the form of a public notice** informing interested vendors that any products they offer meeting the search criteria will be considered; that a response is not required assuming their fund data is already maintained on the consultant's database, which in most instances will be the case; and that if their fund data is not on the consultant's database they are eligible to provide that data, without limitation, to the consultant to ensure that their product will be considered if it meets the Board's criteria.
4. The Request for Proposal as described above would indicate that **vendors are not required to demonstrate compliance with the City's Standard Provisions until and unless a contract is required/executed**.
5. **Consultant and staff conduct an investment manager search of all potential products against consultant provider database**, applying the search criteria as set forth by the Board and ensuring that all providers within the database or who have otherwise requested consideration are evaluated; additionally, all documents associated with the evaluation, rating, and ranking of candidate products would be fully transparent public documents and available for review by interested parties.
6. **Consultant and staff prepare a list of top-scoring firms**, the number of which would be determined on a case-by-case basis (as dictated by the Board) taking into consideration factors such as the investment mandate and size of the potential provider pool.
7. The Board **considers the finalists**.
8. The **Board chooses a fund**.
9. If the chosen fund is a **mutual fund**, the Plan Administrator is directed to **activate this option on its trading platform**.
10. If the chosen product is an **institutional fund** requiring a direct contract between the City and vendor, **the vendor will be required to execute a contract with the City and meet all of the City's 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.