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DEFERRED COMPENSATION PLAN BOARD REPORT 06-25



Date: June 22, 2006

To: Board of Deferred Compensation Administration

From: Investments Committee/Staff

Subject: Recommendations from Investments Committee re Mid-Cap Equity Fund & Investment Option Review

Recommendation:

That the Board of Deferred Compensation Administration (a) approve the addition of the Lazard U.S. Mid Cap Equity Fund to the Deferred Compensation Plan investment menu; and (b) authorize initiation of ongoing quarterly investment manager/performance reviews to be conducted by the Plan consultant.

Discussion:

Mid-Cap Fund - Following the Board's recent consideration of an investment manager search conducted by the Board's consultant, Mercer Investment Consulting, the Board identified two finalist firms/investment offerings in the Mid-Cap investment category. The Board referred investment manager interviews of these finalists, Lazard Asset Management and Vanguard, to the Board's Investments Committee.

Several days following the Board meeting, Vanguard indicated that it was closing to new investors the mid-cap offering under consideration by the Board. As a result, the Committee went forward with its interview of Lazard at a meeting held on June 21, 2006.

Based on its interview, as well as on additional discussion with its consultant representatives present at this meeting (Marina Batliwalla and Ian Shea), the Committee is recommending that the Lazard U.S. Mid Cap Equity Fund be added to the City's Deferred Compensation Plan investment menu.

In Lazard's interview, Portfolio Manager Christopher Blake and Vice President Stephen Simpkin indicated that by design the fund strictly adheres to its mandate and execution strategy in terms of stock selection and sell discipline. They indicated that while the Fund may under-perform its benchmark during short-term periods of sharp advances in the mid-cap arena, it will also tend to out-perform during short-term periods of significant declines while maintaining a consistent record of out-performance over the long term. Ms. Batliwalla

and Mr. Shea reiterated that the Fund scored highly in Mercer’s analysis and would represent a strong and stable core (i.e. growth and value blend) mid-cap offering for the City’s Plan.

Should the Board approve the Committee’s recommendation, staff will work with Lazard and the Plan Administrator regarding the selection of an optimal share class (to provide the lowest possible expense ratio), the timing of implementation and communications to Plan participants. Barring any unforeseen complications, the new Fund may be made available within approximately 30 days of Board action.

There was further related discussion at the Committee meeting regarding the appropriateness of including this Fund in the Plan’s asset allocation funds or whether the Board should consider the addition of a passively-managed mid-cap Fund as well. This matter will be reviewed in greater depth by the Committee as it considers broader issues concerning the overall design of the Plan investment menu.

Investment Review – At the June 21 meeting, as well as at its previous meeting, the Committee considered the issue of regular investment manager performance reviews to be conducted by the Plan consultant. The Committee is recommending that the Board approve quarterly consultant investment reviews to begin immediately. This would be in accordance with current best practices in the defined contribution field and provide a higher level of investment monitoring/oversight.

Mercer has indicated that its costs for conducting these reviews would be \$18,000 per quarter, or \$72,000 annually. These amounts have already been included within budget estimates previously prepared by staff and adopted by the Board, and therefore would not represent an unbudgeted additional cost.

Bond Fund – The Committee has not yet had an opportunity to conduct interviews of Bond Fund finalists, another task referred by the Board. Staff is working to schedule a Committee meeting and these interviews as soon as practical.

Submitted by: _____
Steven Montagna

Approved by: _____
Maryanne Keehn