

Deferred Compensation Plan BOARD REPORT 15-20

Date: April 13, 2015
To: Board of Deferred Compensation
From: Staff
Subject: Stable Value Fund Manager Selection

*Board of Deferred
Compensation Administration
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Recommendation:

That the Board of Deferred Compensation Administration:

- a) Approve the recommendation from staff and the Board's investment consultant to select Galliard Capital Management as the provider of the DCP Stable Value Fund for a five-year contract term beginning July 1, 2015; and
- b) Instruct staff to draft a proposed contract for the selected provider and authorize the Board Chairperson to execute the contract, subject to agreement between the City and contracted provider as to all applicable terms and conditions.

Background:

The DCP Stable Value Fund is an investment option offered within the Deferred Compensation Plan's investment menu that seeks to protect principal while obtaining a higher rate of return than other conservative investment alternatives (such as money market or savings accounts). As of December 31, 2014, assets in the DCP Stable Value Fund option totaled \$968 million, or 21% of total Plan assets¹. Total assets invested in this option make it the second largest in the Plan next to the DCP Large-Cap Fund.

The DCP Stable Value Fund is currently being managed by Galliard Capital Management ("Galliard"). The current contract with Galliard will be expiring on June 30, 2015. As such, staff has conducted a procurement search to select a provider for the new contract term. The Plan seeks to contract with the selected provider for a five-year term beginning July 1, 2015. On December 24, 2014, the Plan released a Request for Proposals (RFP); responses were due on February 19, 2015.

A summary and evaluation of the responses received are outlined in this report.

Discussion:

Responses were received for the Stable Value Fund RFP from the following six (6) firms:

- 1) Galliard Capital Management, Inc. (Galliard)
- 2) Goldman Sachs Asset Management (GSAM)

¹ Total Plan assets as of 12/31/2014 were \$4,622,949,055 (excludes loans outstanding); per Mercer quarterly report.

- 3) ICMA-RC
- 4) Morley Capital Management, Inc. (Morley)
- 5) Pacific Investment Management Company (PIMCO)
- 6) Standish

All six responses were first reviewed by the Personnel Department’s Administrative Services Division (ASD) to ensure the City’s general contracting requirements were met. All respondents were determined to have met the requirements and were cleared for evaluation. The Plan’s investment consultant, Mercer Investment Consulting (“Mercer”), then evaluated all six firms according to the scoring criteria as indicated in the RFP. A detailed report of Mercer’s scoring and evaluation is attached to this report.

Following is an overview of the scoring:

Category - Rating Factors	Points	Galliard	GSAM	Standish	ICMA-RC	Morley	PIMCO
Organizational Strength and Continuity	50	50	25	46	38.6	46.3	36.8
Investment Experience	50	50	45.8	32.7	26.7	33.8	47
Investment Approach and Process	125	101	105	71	77	100	81
Performance	125	125	125	125	125	37.5	50
Portfolio Transition	25	25	25	25	25	25	25
Administrative and Reporting	25	25	15	15	15	25	25
Fees	100	83	83	100	81	79	72
TOTAL-->	500	459.0	423.8	414.7	388.3	346.6	336.8

As indicated by the table above, Galliard scored the highest number of points compared to the other respondents, followed by GSAM and Standish. Further explanation of how these firms were evaluated in each category is included in the attached consultant report (see Evaluation Factors summary on p. 4-6). Additional detail is found within the scoring table beginning on page 7 and within the scoring methodology explanation beginning on page 56). Following are highlights of the evaluation:

ORGANIZATIONAL STRENGTH & CONTINUITY

Galliard scored highest in the category of Organizational Strength and Continuity, in particular given the long tenure of the senior management overseeing the firm and portfolio management. Of note, changes in firm organization were made by GSAM, which recently acquired Deutsche Asset & Wealth Management’s stable value practice and Dwight Asset Management; and by PIMCO, which had significant changes in its senior management.

INVESTMENT APPROACH, PROCESS, & EXPERIENCE

Galliard scored highest in the category of Investment Approach, Process and Experience. As noted in Mercer’s report, Galliard manages the largest amount of separate accounts

and was among the highest in overall separate account assets. In addition, its dedicated stable value staffing is the largest among the proposers. The Board’s investment consultant focused on diversification as a strength, blending internal and external management of portfolio assets, rather than reliance on a single manager approach, in order to mitigate risk. Standish and PIMCO proposed using internal management only, while ICMA-RC proposed external management only.

PERFORMANCE AND PORTFOLIO RISK

Galliard scored well in the performance evaluation category even though other providers achieved higher nominal performance returns. The Stable Value Fund is distinct from the Deferred Compensation Plan’s bond and equity investment menu offerings in that it is intended to be an interest-bearing, principal-protected investment. Participants approach this investment option with that expectation and as a result, the evaluation of performance relative to risk is of even greater significance than it would be in the evaluation of pure bond and equity investments. The investment consultant’s evaluation of performance, as guided by staff, contains three levels of evaluation:

- Overall portfolio returns
- Relative returns of underlying sub-managers (as compared to appropriate peer universes)
- Risk-adjusted returns (as compared to appropriate peer universes)

The evaluation of performance returns, therefore, should be understood as involving two separate but related principles: **performance** and **risk**. Higher rates of return are thus not necessarily weighted more highly if the strategies taken by the investment manager to achieve those returns are creating greater risks for the participant’s investment.

Following is a performance overview of each firm’s stable value account composite returns:

	3 mo	9 mo CY	1 yr	3 yr	5 yr	7 yr	10 yr
DCP Stable Value	0.45	1.34	1.85	2.42	2.87	-	-
Galliard	0.46	1.33	1.80	2.32	2.75	3.29	3.82
GSAM	0.55	1.64	2.22	2.62	2.94	3.35	-
ICMA-RC	0.59	1.77	2.39	2.75	3.15	3.62	4.04
Morley	0.33	0.94	1.25	1.51	1.95	2.50	3.07
PIMCO	0.80	2.38	3.20	3.87	4.30	4.51	4.83
Standish	0.54	1.63	2.19	2.50	2.89	3.30	3.72
BENCHMARK	0.26	0.78	1.05	1.07	1.10	1.54	2.61

* Gross performance for period ending September 2014

Morley underperformed relative to the other respondents. While PIMCO had strong performance at the composite level, its proposed underlying strategies had below median

performance and risk (as measured by information ratios of the strategies as defined on page 26).

PORTFOLIO TRANSITION

All proposers, including Galliard, received the maximum number of points in this category, as no portfolio transition issues were identified with any provider.

ADMINISTRATIVE AND REPORTING

As noted in the consultant’s report, this evaluation category focused on a vendor’s ability to interact with the Plan’s third-party-administrator, particularly as that relates to calculating a daily net asset value (NAV) for recordkeeping and daily account valuation purposes. Galliard and several other firms received top scoring in this category, while GSAM, ICMA-RC, and Standish all indicated limitations (or lack of clarity) in their ability to calculate a NAV.

FEES

Galliard scored second highest in the Fees category. Galliard has proposed two different structures. The first is to continue the current product structure, which it should be noted will result in an increase of 2 basis points. The second is to increase the external management of the portfolio from 20%-30%, which would result in an increase of 4 basis points. Staff and the consultant will review the relative considerations of these two approaches at the Board meeting. The table below compares the respondents’ fee structures relative to the current fee structure.

	Investment Management Fee	External Management Fee	Wrap Fee	Additional Fees	TOTAL
DCP Stable Value (Galliard incumbent manager)	0.060%	0.039%	0.176%	0.000%	0.28%
Galliard (continue current)	0.075%	0.039%	0.173%	0.015%	0.30%
Galliard (increase external mgmnt)	0.075%	0.052%	0.173%	0.015%	0.32%
Goldman Sachs	0.084%	0.036%	0.20%	0.000%	0.32%
ICMA-RC	0.050%	0.102%	0.16%	0.012%	0.32%
Morley	0.051%	0.088%	0.17%	0.020%	0.33%
PIMCO	0.165%	0.000%	0.18%	0.020%	0.37%
Standish	0.063%	0.000%	0.19%	0.005%	0.26%

SUMMARY & RECOMMENDATION

Galliard scored well across all categories. Given Mercer’s and staff’s evaluation and assessment of the responses, staff recommends that the Board approve the selection of Galliard Capital Management as the provider of the DCP Stable Value Fund for a five-year

contract term beginning July 1, 2015; and instruct staff to draft a proposed contract for the selected provider and authorize the Board Chairperson to execute the contract, subject to agreement between the City and contracted provider as to all applicable terms and conditions.

Submitted by: _____
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Approved by: _____
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