



Board Report 21-26

Date: May 18, 2021
 To: Board of Deferred Compensation Administration
 From: Staff
 Subject: Vanguard Passively Managed Fund Selection

Board of Deferred Compensation Administration
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Recommendation:

That the Board of Deferred Compensation Administration (Board): (a) finalize its approval of the selection of Vanguard to provide passive management services for the passively managed components of the DCP Bond, DCP Large-Cap Stock, DCP Mid-Cap Stock, and DCP Small-Cap Stock investment options; (b) approve a five-year contract term with Vanguard to provide management services for the Deferred Compensation Plan (DCP) passive bond and passive large-cap equity strategies, with the effective dates of the contract to be determined; (c) instruct staff to negotiate and draft a contract in consultation with Board counsel; and (d) authorize the Board Chairperson to execute said contract on behalf of the Board, subject to agreement between the City and the provider as to all applicable terms and conditions and all necessary approvals.

Discussion:

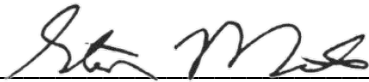
On April 20, 2021, the Board selected Vanguard to provide passive management services for the passively managed components of the DCP Bond, DCP Large-Cap Stock, DCP Mid-Cap Stock, and DCP Small-Cap Stock investment options, subject to further negotiations with Vanguard and a report back from staff and Mercer regarding options for fee reductions for the proposed collective investment fund structure for the passive bond and passive large-cap equity strategies. Subsequent to that meeting, Vanguard proposed revised pricing for the passive bond and passive large-cap equity collective investment trusts. The revised pricing is as follows:

Collective Investment Trust	Previously Proposed Pricing (Basis Points)	Revised Pricing (Basis Points)	Reduction
Vanguard Institutional 500 Index Trust	1.40	1.20	17%
Vanguard Institutional Total Bond Market Index Trust	2.60	2.50	4%

The Board's consultants at Mercer have prepared a report (**Attachment A**) finding that the proposed pricing appears competitive both relative to other responses to the City's RFP as well as the applicable investment universe of similar funds. Based on their review, staff recommends that the Board take final actions to proceed to contract execution for the passive bond and passive large-cap equity strategies. As the Vanguard Mid-Cap Index Fund Institutional Plus and the Vanguard Small-Cap Index Fund Institutional Plus are mutual funds, fees are not subject to individual client/investor negotiation. Mercer has confirmed that the proposed fund offerings provide the best available mutual fund pricing from Vanguard for these mandates.

To move forward with contract execution, staff recommends that the Board (a) finalize its approval of the selection of Vanguard to provide passive management services for the passively managed components of the DCP Bond, DCP Large-Cap Stock, DCP Mid-Cap Stock, and DCP Small-Cap Stock investment options; (b) approve a five-year contract term with Vanguard to provide management services for the Deferred Compensation Plan (DCP) passive bond and passive large-cap equity strategies, with the effective dates of the contract to be determined; (c) instruct staff to negotiate and draft a contract in consultation with Board counsel; and (d) authorize the Board Chairperson to execute said contract on behalf of the Board, subject to agreement between the City and the provider as to all applicable terms and conditions and all necessary approvals. The timing of the change from the incumbent passive bond and passive large-cap mutual funds managed by Vanguard to the collective trusts is subject to negotiation and execution of the required contract. Staff will provide ongoing updates to the Board so that it can be apprised of contract development and expected implementation.

Submitted by:



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Memo

To: Board of Deferred Compensation Administration
Date: May 18, 2021
From: Devon Muir and Ana Tom-Chow
Subject: Negotiation with Vanguard on pricing for US large cap equity index and US aggregate bond index funds

At the April 20, 2021 Board meeting, the Board reviewed passive investment manager candidates for all of the DCP's passive (or index fund) mandates. The four mandates are a US aggregate bond index fund, US large cap equity index fund, US mid cap equity index fund, and a US small cap equity index fund. These funds represent underlying holdings in the DCP's custom funds. After substantive review of staff's report and Mercer's accompanying analysis, the Board elected to approve the Investments Committee's recommendation to retain incumbent provider Vanguard for all passive mandates subject to further negotiation of pricing for two of the mandates in which Institutional Products were proposed,¹ the US large cap equity index fund and US aggregate bond index fund.

With this direction, Mercer has reviewed pricing of the subject vehicles with Vanguard, and Vanguard has proposed improved costs as illustrated below.

Fund	Initial proposal	Revised proposal	Comment
Vanguard Institutional 500 Index Trust (collective investment trust)	1.4 bps (0.014%)	1.2 bps (0.012%)	Proposed pricing appears competitive relative to other respondents to this RFP and also relative to the Mercer Mutual Fund US Equity Large Cap Index Universe (approximately top percentile of most cost effective funds).
Vanguard Institutional Total Bond Mkt Index Trust (collective investment trust)	2.6 bps (0.026%)	2.5 bps (0.025%)	Proposed pricing appears competitive relative to other respondents to this RFP and also relative to the Mercer Mutual Fund US Fixed Income Index Universe (top percentile of most cost effective funds).

¹ Institutional Products are defined as those that require a contract with the City (e.g., collective investment trusts or separate accounts) as opposed to mutual funds which are contracted directly with the Plan's TPA. It also should be noted that mutual fund vehicles for the US mid and small cap equity mandates were recommended by the Investments Committee and approved by the Board.

Fund	Initial proposal	Revised proposal	Comment
Vanguard Mid-Cap Index Fund Inst. Plus (mutual fund)	3 bps (0.03%)	3 bps (0.03%)	Mutual fund was Vanguard's most cost-effective vehicle, and is competitive relative to other respondents to this RFP and also relative to the Mercer Mutual Fund US Mid Cap Index Universe (top percentile of most cost effective funds).
Vanguard Small-Cap Index Fund Inst Plus (mutual fund)	3 bps (0.03%)	3 bps (0.03%)	Mutual fund was Vanguard's most cost-effective vehicle, and is competitive relative to other respondents to this RFP and also relative to the Mercer Mutual Fund US Small Cap Index Universe (approximately top percentile of most cost effective funds).

As detailed in the foregoing table, the revised proposed pricing appears competitive. Furthermore, the Board's initiative to negotiate with Vanguard has resulted in additional savings of approximately \$61,000, bringing total fee savings from the move to collective investment trust vehicles for the US large cap index and US aggregate bond index funds to an expected \$247,000 dollars annually.² **We recommend the Board approve the revised pricing and proceed in contracting with Vanguard for the subject funds.**

² Estimated fee savings calculations are annualized and are based on 3/31/2021 asset values.