DEFERRED COMPENSATION PLAN
BOARD REPORT 05-36

EMPLOYEE BENEFITS DIVISION

Date: December 2, 2005

To: Board of Deferred Compensation Administration

From: Staff

Subject: RFP for Investment Management Services

Recommendation:
That the Board of Deferred Compensation Administration suspend further consideration of responses to its recent Request for Proposal for Investment Management Services, and authorize its consultant, Mercer Investment Consulting, to conduct fund searches for a Core Bond and Core Mid-Cap investment manager.

Discussion:
Following approval by the Board, staff released a Request for Proposal for Investment Management Services on 8/25/05. The RFP sought proposals from firms for a Core Mid-Cap Fund and Core Bond Fund. Responses were due 10/26/05. Seven responses were received for the Core Mid-Cap and eleven for the Core Bond. Of those responses, three were disqualified as being non-responsive with respect to Standard Provisions requirements, leaving six firms eligible for consideration on the Core Mid-Cap and nine on the Core Bond. The breakdown of these responses (with disqualified firms noted in strikeout format) is detailed as follows:

Core Mid-Cap	Core Bond
GlobeFlex Capital	JP Morgan Asset Management
Victory Capital Management	Capital Guardian
Lazard Asset Management	John Hancock Advisers
Eagle Asset Management	ING Investment Management
Shenandoah Asset Management	Phoenix Investment Partners
Munder Capital Investment Management	McMorgan & Company
~~Times Square Capital Management~~	Morgan Stanley
	Metropolitan West Asset Management
	Barclays Global Investors
	~~Hartford Financial Services~~
	~~Fidelity Investments~~

Staff and Mercer had both expected that the number of RFP responses received would be much higher, with proposals in both categories numbering in the dozens. Given the low response level, staff asked Mercer to provide feedback regarding whether the proposals received constituted a valid pool from which a “best-of-class” selection could reasonably be made. Mercer conducted a brief review of the proposals against its database of investment providers/products. As a result of that review, only one of the non-disqualified firms in each category emerged as an “A” firm in the Mercer database. Given these findings, it was Mercer’s opinion that a “fund-search” process (a screening of the full universe of investment products for a given investment category) would yield a stronger result than limiting the Board to the RFP respondents.

Staff next spoke with Assistant City Attorney Noreen Vincent and Deputy City Attorney Richard Bobb. Staff asked whether, given the results of the RFP, the Board had the option of using an alternative search process to choose an investment provider. Ms. Vincent and Mr. Bobb indicated that the Board could do this because (a) it had diligently and in good faith attempted to use the competitive bidding process and (b) this process had not yielded a satisfactory pool of contenders.

The Board’s objective in its investment manager searches has been to ensure that a best-of-class selection can be made for Plan participants. It is possible to use an RFP process to secure such a result but the outcome is dependent upon receiving a critical mass of strong proposals. In the present case, based on Mercer’s feedback, it is staff’s view that a critical mass was not received and that were a selection to be made from this pool the Board could not be confident of having identified best-of-class products.

The low response was not due to a lack of awareness. The RFP was well-publicized and interest was strong - staff estimates that between 150-200 copies of the RFP were sent electronically to various firms making requests. Staff believes that the likeliest explanations for the low response on this RFP involve (a) the City’s Standard Provisions requirements, which have grown both in quantity and complexity in recent years, and (b) the awkward “middle ground” occupied by the City’s Plan between the worlds of retail mutual fund and institutional money management.

Potential vendors may have assumed that separate account/commingled fund products[1] would be preferred by the City due to their lower cost structure. Thus, this may have discouraged mutual fund companies from submitting proposals. However, institutional managers may also have been disinclined to bid due to the low asset amounts (at least initially) available to them for management in the City’s self-directed, defined contribution

[1] Separate accounts and commingled funds are distinguished from mutual funds in that they are products typically offered to large clients with substantial assets under management. The sharpest distinction is between a separate account and a mutual fund. In a separate account, an entirely independent account is created for the client. It may be based on a particular investment strategy and “mirror” a primary investment fund, but no funds other than the client’s are included within that account. By contrast, a mutual fund is a pooling of assets from a multitude of individual investors. Commingled funds may be thought of as a hybrid, in which, for example, the City of Los Angeles may be a client along with several other large institutional clients. A commingled fund would typically not include “retail” individual accounts in which someone outside one of the institutional clients could open up an individual account in the fund.

Plan. The Core Mid-Cap category represents a wholly new investment category for the City's Plan, while in the Core Bond category, incumbent funds under management are only $24 million, representing just 1% of total Plan assets.

Given the minimal RFP response, staff is recommending that the Board authorize its consultant, Mercer Investment Consulting, to conduct a fund manager search. In such a search, Mercer can consider both mutual fund and institutional management. Depending on the search results, the Board can consider whether a contractual relationship is necessary or desirable for any particular provider.[2]

Mercer's fund screening process will involve setting parameters and searching for candidate products consistent with the requirements/evaluation criteria established in the RFP. Mercer and staff would then present a summary of top candidates for consideration by the Board. At this time the Board could consider further review of the contracting issue. Mercer estimates that this process will take approximately 4-8 weeks.

With respect to what should be done with the current RFP, language within the RFP makes clear to vendors that the City is under no obligation to make a selection as a result of the RFP, stated as follows:

> *"The City reserves the right to withdraw this RFP at any time without prior notice. The City makes no representation that any contract will be awarded to any proposer responding to the RFP. The City reserves the right to reject any or all submissions."*

However, staff recommends that for the present the Board simply suspend its review of these RFP responses, rather than canceling, until the results of the fund manager search are completed. This will preserve all options for the Board going forward.

Submitted by: ___________________________
Steven Montagna

Approved by: ___________________________
Maryanne Keehn

[2] By way of background, mutual fund accounts opened through a recordkeeper (as opposed to separate accounts or commingled funds) do not require a direct contractual relationship between the fund provider and the City. This is presently true not only for those City core options which are not separate accounts or commingled funds (e.g. Fidelity Magellan, Growth Fund of America, etc.) but for the 2,000 mutual funds made available through the brokerage window.