DEFERRED COMPENSATION PLAN
BOARD REPORT 06-32

EMPLOYEE BENEFITS DIVISION

Date: October 4, 2006

To: Board of Deferred Compensation Administration

From: Staff

Subject: Recommendations from Investments Committee re Core Actively Managed Bond Fund

Recommendation:
That the Board of Deferred Compensation Administration (a) approve the addition of the PIMCO Total Return Fund to the Deferred Compensation Plan investment menu, replacing the incumbent MSIF Trust Core Plus Fixed Fund; and (b) adopt one of the Investments Committee's considered strategies for eliminating the incumbent Fund.

Discussion:
Fund Selection - 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 investment offerings in the Core Actively Managed Bond investment category. The Board referred investment manager interviews of these finalists, Hartford Investment Management Company and PIMCO, to the Board's Investments Committee.

The Investments Committee interviewed both finalists on September 8th, 2006. Based on these interviews, as well as on additional discussion with the consultant representative present at this meeting (Marina Batliwalla), the Committee is recommending that PIMCO's Total Return Fund replace the incumbent MSIF Trust Core Plus Fixed Fund as the City Plan's Core Actively Managed Bond offering.

In PIMCO's interview, Senior Vice President Mark A. Romano indicated that the Total Return Fund adheres to a "core-plus" strategy which seeks to outperform its benchmark Lehman Brothers Aggregate Index. Mr. Romano presented information demonstrating that the Fund had consistently met its objective over 3, 5 and 10 year periods. Ms. Batliwalla indicated that the Fund scored highly in Mercer's analysis and would represent a strong and stable core bond offering for the City's Plan. Returns for this Fund were stronger than for the Hartford Fund, and investment management fees were lower. In addition, the Committee felt that the PIMCO Fund was stronger on a risk-adjusted basis.

Transition Issues - Should the Board approve the Committee's recommendation, there was further related discussion at the Committee meeting regarding options for eliminating the incumbent fund. Because of the potential reaction of Plan participants to elimination of a Fund, Committee members felt it was important to present alternatives and discuss them with the full Board.

The Committee identified the following alternate approaches for eliminating an incumbent Fund:

- *Option A: Simultaneous Introduction/Elimination of Replacement/Incumbent Funds* – Under this option, the Board would establish a target date for simultaneous elimination of the incumbent fund and introduction of the replacement fund. For example, January 1, 2007 might be established as a transition date, at which time assets from the incumbent fund would be transferred to the replacement fund. Sufficient time would be allowed to properly communicate the change to Plan participants.

- *Option B: Immediate Introduction of Replacement Fund/Deferred Elimination of Incumbent Fund* – Under this option, the Board would immediately introduce the replacement fund and announce the future elimination of the incumbent, but would defer that elimination for some period of time (the Committee discussed a range of six months to a year). For example, the replacement fund could be added by December 1, 2006, but the incumbent fund not eliminated until June 1, 2007. Within this interim period both funds would be offered simultaneously (i.e. contributions and transfers in and out of the incumbent fund would be permitted up until the deferred transition date).

- *Option C: Immediate Introduction of Replacement Fund/Deferred Elimination of <u>Frozen</u> Incumbent Fund* – Under this option, the Board would immediately introduce the replacement fund and announce the future elimination of the incumbent, but would defer that elimination for some period of time (e.g. six months to one year).). For example, the new fund could be added by December 1, 2006, but the incumbent fund not eliminated until June 1, 2007. Within this interim period the incumbent fund would be "frozen" so that new inflows would not be permitted, although participants would have the ability to transfer funds out of the incumbent.

The Committee believed it was important to balance the following concerns:

1. Ensuring that participants received sufficient advance communication regarding the elimination of an incumbent fund so that they had adequate time to consider their options;
2. Not maintaining for too long an incumbent fund which, pursuant to a rigorous selection process, has already been identified as less than "best-of-class" compared to the replacement fund;
3. If the incumbent and replacement funds are going to be offered side-by-side for some period of time, resolving the question of whether the incumbent should be eligible to receive new employee contributions/transfers up through the point that its assets are fully liquidated.

Given the range of views expressed in the Committee meeting, and the Committee's desire to have the matter presented to the Board as a discussion item, staff has not developed a specific recommendation regarding any one of the identified options. In staff's view, any option would be acceptable provided it is properly communicated.

Submitted by: ______________________________
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