DEFERRED COMPENSATION PLAN
BOARD REPORT 07-42

EMPLOYEE BENEFITS DIVISION

Date: November 6, 2007

To: Board of Deferred Compensation Administration

From: Staff

Subject: Separate Account Transitions - Galliard Stable Value Fund and Hartford General Account

Recommendation:
That the Board of Deferred Compensation Administration receive and file the following information regarding transition of the Hartford General Account and Galliard Stable Value Fund into separate account structures.

Discussion:
The Board previously approved a restructuring of the Plan's fixed account assets involving transitioning both the Galliard Stable Value Fund and Hartford General Account from pooled accounts into separate account structures. In the short term, it is expected this will provide an immediate increase in yield for both accounts. In addition, over the longer term it will provide the Board and the Plan with greater flexibility in obtaining the most competitive managers and pricing for these assets.

The Board's consultant, Mercer Investment Consulting, Hartford Investment Management Co. and Galliard Capital Management have been working diligently and cooperatively in order to effect this transition under the most favorable terms possible. There have been two recent positive developments of which the Board should be aware:

- The transition of the Hartford funds will not require the City to execute a separate contract with a wrap services provider – Hartford will contract with State Street Bank & Trust Company to provide those services, thus eliminating the need for the City to issue a Request for Proposal for these services[1];
- The transition process for both of these funds is expected to begin January 1, 2008 and conclude no later than June 30, 2009, which will coincide with the termination dates for

[1] Mercer had previously advised that it would be prudent to secure the services of an outside firm to provide the "wrap" of Hartford's two accounts, rather than having Hartford do it directly. Staff had recommended and the Board approved issuing a Request for Proposal (RFP) for these services. However, subsequent to the Board action staff and Mercer pursued an alternative approach in which Hartford would contract out for wrap services without requiring a separate City contract for the wrap provider. This approach has streamlined the process considerably and will allow the Plan to expedite the transition.

both providers – no contract extension with Hartford will be required, as had originally been contemplated.

Following is more specific information regarding the terms under which both funds will be transitioned:

Hartford General Account
Current Assets: $290 million

Timing: Hartford will transition its funds from its pooled to a separate account under the following schedule:

January 1, 2008	-	$85 million
January 1, 2009	-	50% of remaining balance
June 30, 2009	-	100% of remaining balance

Transition: The transition of these funds will be seamless to Plan participants. There will be no change in how assets are reported via Plan reporting mechanisms.

Effect on Yield: Participants are expected to receive an immediate increase in yield on the overall portfolio given that the purchase of holdings in the new separate account is expected to involve higher-yielding offerings. The first installment of the transferred amount will be managed to the Lehman Aggregate Bond Index, which is currently yielding 5.34%. The second installment (one year later) will be managed to the Lehman Intermediate Government/Credit Bond Index, which is currently yielding 4.85%. This compares favorably with the current General Account declared rate of 4.10%.

Liquidity – A cash buffer in the Hartford General Account will be maintained for liquidity needs. Liquidity will subsequently flow from a hierarchy of holdings, with the General Account (currently the lowest yielding) being the first in line.

Fees - Fees will now be explicit and follow the following schedule: 0.25% of the first $100 million of assets, and 0.20% of assets greater than $100 million, with an additional administrative/custodial fee on the total portfolio capped at 0.10%. Total fees will thus be less than 0.35%, which compares favorably with the estimated investment management cost under the General Account, which Mercer advises could be as high as 1.50%.

Attached correspondence from Hartford provides further details on their transition.

Galliard Stable Value Fund
Current Assets: $113 million

Timing: Galliard will transition its funds from its pooled to a separate account over a two-three month period beginning in January 2008.

Transition - The transition of these funds will be seamless to Plan participants. There will be no change in how assets are reported via Plan reporting mechanisms.

Effect on Yield: Participants are expected to receive an immediate increase in yield of the overall portfolio given that the purchase of holdings in the new separate account is expected to involve higher-yielding offerings. Galliard will have a targeted duration in the portfolio of three years. The portfolio will be divided between Short, Intermediate and Broad Market Portfolios, with durations of 2.2, 3.6 and 4.7 years, respectively. Based on current interest rates, Mercer estimates that upon transition the Galliard rate will move up approximately 0.10-0.20% over the current rate of 4.81%.

Liquidity – A cash buffer, representing 2-10% of the portfolio, will be maintained in the Wells Fargo Stable Return Fund for liquidity needs.

Fees - Fees will 0.15% of the first $100 million of assets, 0.10% of assets on the next $100 million, and 0.045% on amounts in excess of $200 million. This represents a slight decrease in fees vs. the current operating expense of 0.15% and assets of $113 million.

Attached correspondence from Galliard provides further details on their transition.

Communications

The changes in these two offerings will be communicated via a special mailing to be issued in approximately the first week of December. This communication will also provide notice of the Board's other fund changes, including the addition of two asset allocation funds and elimination of three actively-managed funds.

Future Request for Proposal

Staff will begin working early next year on a Request for Proposal for management of the combined $400 million of Galliard and Hartford assets.

Submitted by: ____________________________
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Approved by: ____________________________
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