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DEFERRED COMPENSATION PLAN BOARD REPORT 08-01



Date: February 5, 2008
To: Board of Deferred Compensation Administration
From: Staff
Subject: Self-Directed Brokerage Option

Recommendation:

That the Board of Deferred Compensation Administration (a) approve Charles Schwab as the new provider for the City's Self-Directed Brokerage Option (SDBO), replacing First Trust/OptionsPlus; and (b) direct staff to develop a transition plan and draft communication to all current OptionsPlus participants regarding this change for consideration at the next Board meeting.

Discussion:

At the Board's November 27, 2007 meeting, the Board directed staff and Great-West Retirement Services ("Great-West") to prepare a recommendation for migrating the City's Self-Directed Brokerage Option (SDBO) from the current provider to one of the two alternate providers available through Great-West. Staff has evaluated both providers and is recommending that the Board select Charles Schwab.

Staff identified five core factors to compare the two firms, as well as a scoring methodology to quantify the relative importance of each of these factors. Based on that scoring methodology, Charles Schwab received the highest staff rating, as follows:

Rating Factors	TD Ameritrade	Charles Schwab	% of Total Score
Participant Services	25	40	40%
Fees	27	27	30%
Investments	20	10	20%
Organizational Qualifications	2	5	5%
Plan Sponsor Services	5	5	5%
Total-->	79	87	100%

A summary comparison of key features of both providers is attached to this report. Following are the results of staff's evaluation.

A. PARTICIPANT SERVICES

PARTICIPANT SERVICES – OVERALL				
Points Possible-->		40	Weighting-->	40%
Charles Schwab		40		
TD Ameritrade		25		

Key Findings:

- The Charles Schwab website is substantially more user-friendly than TD Ameritrade’s site.
- Charles Schwab has more educational and planning resources available through its site.

Staff believes that the most important factor in assessing the qualifications of the two firms concerns the user-friendliness of the websites, which is how most participants will process transactions. As a result, staff invested substantial time in assessing both sites. Three staff members (Steven Montagna, Natasha Zuvich and Ashley Stracke) independently used “dummy” account log-ins on each site to conduct various sample transactions.¹ These staff members then convened after their review to discuss their individual assessments.

Each staff member independently found Schwab’s site to be superior. Some examples of this include:

- Schwab’s primary buttons were more intuitive and allowed for easy scanning of sub-categories;
- Schwab had a large number of easily accessible informational and educational tools, such as for college planning, retirement planning, etc.;
- TD Ameritrade’s symbol lookup feature did not work properly and required unnecessary and non-intuitive steps in order to loop back to the trading page;
- Schwab’s price quotes on stock and bond trades were real-time, while TD Ameritrade’s were delayed;
- Schwab had more user-friendly screens to compare CD yields and bonds.

¹ Staff strongly encourages Board members to sample both sites as well. Members may contact staff to obtain dummy account log-in information.

B. Fees

FEES – OVERALL				
Points Possible-->		30	Weighting-->	30%
TD Ameritrade		25		
Charles Schwab		25		

Key Findings:

- For the most likely transactions (those involving no-load mutual funds) there is essentially no difference in the fees charged by either provider;
- TD Ameritrade’s fee schedule is simpler to understand, while Charles Schwab’s is more complex and may present risk to participants of unintentionally incurring a fee (see page of the attachment, “Comparative Overview,” for full fee schedule);
- For load funds, TD Ameritrade has lower fees (\$50 for a “round-trip” purchase/sale of a fund, vs. \$70-100 with Schwab);
- Should the SDBO be expanded to include trading of individual stocks, Schwab’s fees for most trades would be less expensive.

Staff’s evaluation focused primarily on mutual fund transaction fees given that no decision has yet been made by the Board regarding expanding the SDBO to include trading of stocks and bonds. Below is a summary of mutual fund transaction fees for both providers. Because each provider structures its fees differently, it can be challenging to make apples-to-apples comparisons. In staff’s analysis, it may be most helpful to focus on the fees associated with the most likely transaction to take place, which in staff’s view would be an **electronic** purchase of a **no-load, no-transaction-fee fund** held for **longer than 90 days**. In such an example, the participant would not incur a transaction fee from either provider.

FEES	TD Ameritrade			Charles Schwab		
	Buy	Sell*	Exchange*	Buy	Sell*	Exchange*
Mutual Fund Fees (web only)						
No-Transaction-Fee Fund	\$ -	\$ 25	\$ 25	\$ -	\$ 49.95	\$ 49.95
No-Load	\$ 25	\$ 25	\$ 25	\$ -	\$ -	\$ -
Load	\$ -	\$ 25	\$ 25	20% discount off Broker Assisted, min \$39, max \$49.95		
	* no fee if held 90 days			* no fee if held 90 days		
Mutual Fund Fees (broker assisted)						
No-Transaction-Fee Fund	\$ -	\$ 25	\$ 25	\$ 25	\$ 25	\$ 25
No-Load	\$ 25	\$ 25	\$ 25	\$ 25	\$ 25	\$ 25
Load	\$ -	\$ 25	\$ 25	0.7% of principal min \$39, max \$74.95		

With respect to trading of individual stocks and bonds, TD Ameritrade’s transaction fee is \$15 if the trade is made on its website, vs. \$12.95 for a trade with Schwab on it’s website (plus \$0.015 for each additional share). Staff did not assign a relative scoring advantage to either provider in the Fees category given that on the most likely trades the two vendors were relatively equal, with each one having relative advantages/disadvantages for other types of transactions.

C. INVESTMENTS

INVESTMENTS – OVERALL				
Points Possible-->		20	Weighting-->	20%
TD Ameritrade		20		
Charles Schwab		10		

Key Findings:

- TD Ameritrade has substantially more mutual funds to choose from.

TD Ameritrade offers 13,000 mutual funds, which effectively represents the entire fund universe, while Schwab offers 3,200. Given this, TD Ameritrade was scored substantially higher in this category.

However, one consideration for the Board is that in a review of the most frequently used investment funds utilized in OptionsPlus, there was very little difference between the two providers. Both appeared to offer virtually all of the funds currently used in OptionsPlus.

From a practical point of view, then, the additional mutual funds offered by TD Ameritrade may not offer a material benefit to Plan participants. What the SDBO offers which the City's core options cannot provide is the ability to invest in (a) niche or specialized investment categories and (b) actively managed funds boasting a strong performance record. For example, with respect to the former, suppose a participant wishes to invest in a European stock fund as opposed to a broadly diversified international fund. Even though TD Ameritrade apparently offers 10,000 more funds, and would thus presumably offer more choices of European funds, participants should still be expected to have ample choices of European funds within Schwab's offerings (which, it should be noted, are approximately double the number of choices offered by OptionsPlus). Similarly, if a participant is looking for fund managers who have outperformed their benchmarks by wide margins, there should also be ample such managers to choose from within Schwab.

D. ORGANIZATIONAL QUALIFICATIONS

ORGANIZATIONAL QUALIFICATIONS – OVERALL				
Points Possible-->		5	Weighting-->	5%
Charles Schwab		5		
TD Ameritrade		2		

Key Findings:

- Charles Schwab works with a larger number of plans and manages a larger number of participant accounts.
- Charles Schwab offers retail outlets, which might be perceived as a positive or negative for our participants.

Both firms are established and reputable providers of self-directed brokerage services, but Schwab has a size advantage: while TD Ameritrade has approximately 2,500 plans and 20,000 participant accounts, Schwab has 8,800 plans and 122,000 accounts. Charles Schwab is also unique in providing a large number of retail outlets, which wouldn't necessarily but could be used by our participants for support. The Board should be aware that while this additional level of service might provide certain convenience benefits to some Plan participants, it also presents the potential that Schwab sales staff could use a participant's presence in the brokerage window to market products and services outside the City's Plan.

E. PLAN SPONSOR SERVICES

PLAN SPONSOR SERVICES – OVERALL				
Points Possible-->		5	Weighting-->	5%
TD Ameritrade		5		
Charles Schwab		5		

Key Findings:

- No meaningful differences were identified in the area of plan sponsor services.

Staff was not able to identify any appreciable differences in support services available to Plan staff. Both providers received full scoring in this category.

Conclusion:

Staff has compared both alternate providers and reached a determination that Charles Schwab would provide the best replacement to the existing First Trust/OptionsPlus program. Although TD Ameritrade offers more fund choices, the user-friendliness of the Schwab website and the fact that it has a much deeper penetration of the marketplace provides a welcome contrast to the limited service capabilities and narrow market presence of the incumbent. Upon approval from the Board, staff further recommends that the Board direct staff and Great-West to work together to develop a transition plan and timetable, as well as communication materials to OptionsPlus participants, for consideration at the next Board meeting.

OptionsPlus Update:

First Trust is the incumbent provider for the City's current brokerage window, OptionsPlus. The City does not have a direct contractual relationship with First Trust – that relationship exists between Great-West and First Trust. In late December, following the Board's approval for discontinuing OptionsPlus and replacing it with an alternate provider, Great-West advised First Trust of the Board's intentions.

Subsequently, on January 17, 2008, Great-West notified staff that it had received correspondence from First Trust indicating that they were attempting to raise fees in the OptionsPlus program. In a letter to First Trust dated January 24, 2008, Great-West responded that, per its contract with First Trust, the City of Los Angeles did not consent to any fee increases. Both communications are attached to this report. Great-West

indicates that, to date, a response to its letter has not been received from First Trust. Staff will keep the Board advised of further developments.

Submitted by: _____
Steven Montagna

Approved by: _____
Maryanne Keehn