DEFERRED COMPENSATION PLAN
BOARD REPORT 08-44

EMPLOYEE BENEFITS DIVISION

Date: October 24, 2008

To: Board of Deferred Compensation Administration

From: Investments Committee/Staff

Subject: FDIC-Insured Savings Options

Recommendation:
That the Board of Deferred Compensation Administration approve a recommendation from the Investments Committee to restructure the Plan's FDIC insured savings options to (a) create a blended multi-vendor savings option; and (b) eliminate the Plan's Certificates of Deposit; and that the Board further approve staff's recommendation to approve the recommended criteria for the new blended FDIC-insured savings option and direct staff and Mercer to draft an RFP for these services and return to the Board with that draft and a proposed implementation timetable as soon as practical.

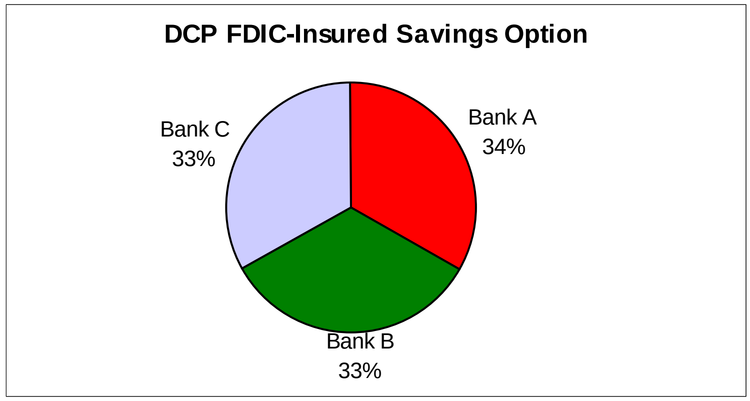
Discussion:
On October 10, 2008, the Board's Investments Committee met to continue its work on redesigning the Deferred Compensation Plan's core investments menu. The Board and the Committee have been engaged in this redesign process for several years and thus far have instituted the following changes to the Plan's core menu:

- Expansion of the Plan's asset allocation funds from 3 to 5 by adding in "Ultra-Conservative" and "Ultra-Aggressive" portfolios (completed March 2008);
- Issuing a Plan investments survey for the purpose of gauging participant reaction to the potential for streamlining the Plan's investment menu (completed July 2008);
- Adding a Mid-Cap index component to the Plan's core options and asset allocation funds (selection of mid-cap provider still pending);
- Consolidation of the Plan's fixed account options (the Galliard Stable Value Fund and Hartford General Account) under a single stable value provider (scheduled for 7/1/09); and
- Although not directly related, elimination of three funds for performance reasons which indirectly has helped consolidate the core menu (completed April 2008).

Given the recent focus on the Plan's FDIC insured options, the Investments Committee elected to focus on these options at its October 10th meeting. As a result of its review, the Committee is prepared to make the following recommendations.

FDIC Insured Savings Option

The Committee explored in greater detail a concept for restructuring the Plan's core FDIC insured savings option which had been initially presented to the Board at its September 30, 2008 special meeting. The concept involved creating a blended FDIC-insured savings option which would include multiple underlying bank providers, but from the participant perspective would be a single option (see graphic right).



The Committee reviewed this concept in detail and identified the following benefits:

(1) Multiple providers would multiply the FDIC insurance available to Plan participants by the number of providers; and
(2) In the event of one provider's potential insolvency or other factors requiring immediate contract termination, the Plan would have greater flexibility to move assets to other providers within the structure.

The contemplated composition of this product is similar to the structure already in place for the Plan's risk-based asset allocation funds (the "Profile" funds). In those funds, multiple providers comprise what is, from the participant perspective, a single investment option. The underlying performance of each provider is calculated on a daily basis to provide a blended rate of return.

The Committee considered what might be an optimal number of providers. The Committee first established that it should not be the objective of this option to provide complete FDIC insurance for all participants regardless of account size, but rather to expand the insurance in a way that balanced out the value of expanded coverage against the higher rates of return that would be expected to accrue to larger asset bases.

Given this, the Committee found that having two providers might be too few because in the event of one provider's insolvency or terminated contract, the option would be temporarily left with only one provider and only $250,000 in FDIC-insurance (until such time as a replacement provider could be found). The Committee found that three providers might be ideal because the option could still provide expanded FDIC insurance even in the event one provider is temporarily eliminated. In addition, from a pricing perspective, staff and Mercer indicated that $100 million in assets might be a good asset break point in order to achieve more favorable rates of return from potential vendors. Given that there are presently approximately $300 million of assets in this Fund, three providers would allocate approximately $100 million per provider.

It was further noted by Committee members that under this proposed structure, although participant assets in excess of $750,000 would not have full FDIC insurance, there would be very few participants impacted by this. In addition, if maintaining complete FDIC insurance for all their assets was an important objective, those individuals would always have the option to transfer excess amounts to the Plan's Self-Directed Brokerage Option (SDBO) to expand their FDIC insurance with other providers offered through the SDBO.

Certificates of Deposit

The Committee also reviewed the question of whether Certificates of Deposit (CDs) should continue to be offered as a core investment option within the Plan. Staff indicated to the Committee the staff view that CDs were not an ideal core option. Staff indicated that CDs were often confusing to participants because it was difficult for them to monitor expiring terms. Further, given the ability of participants to now purchase CDs through the SDBO, and given the interest in maintaining a streamlined investment menu, staff recommended that the product be phased out over the balance of any remaining CD terms (which would be five years from the beginning date of the phase-out, since the Plan presently offers CDs in 1-5 year terms).

The Committee agreed that CDs did not appear to be appropriate core options. The Committee is therefore recommending that the Board phase them out from the City's Plan. The Committee is recommending that the timing of that elimination coincide with the introduction of implementation of any blended FDIC-insured product.

Next Steps

The Board's consultant, Mercer Investment Consulting, has prepared recommended criteria for the new FDIC-insured option (see attached report). Staff recommends that the Board adopt the recommendations of the Committee to (1) create a blended FDIC-insured savings option and (2) eliminate the CDs from the Plan on a schedule that would coincide with introduction of the blended FDIC-insured savings option. Staff further recommends that the Board approve the recommended criteria for the new blended FDIC-insured savings option and direct staff and Mercer to draft an RFP for these services and return to the Board with that draft and a proposed implementation timetable as soon as practical.

Submitted by: ______________________________

Steven Montagna