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DEFERRED COMPENSATION PLAN BOARD REPORT 09-03



Date: January 7, 2009
To: Board of Deferred Compensation Administration
From: Staff
Subject: Charles Schwab – Independent Investment Advisory Services

Recommendation:

That the Board of Deferred Compensation Administration refer to staff and the Plan consultant further study and development of recommendations with respect to permitting use of independent investment advisors (including a limited investment advisor referral service), and third-party-trading through the Plan's Self Directed Brokerage Option provider, Charles Schwab.

Discussion:

Staff is in receipt of two communications concerning services offered through the Deferred Compensation Plan's Self-Directed Brokerage Option (SDBO). Both communications are attached to this report. The first communication, dated December 2, 2008, requests that the Plan permit the use of independent investment advisors who have a relationship with Charles Schwab Institutional Group, a division of the SDBO provider, Charles Schwab. The second communication, dated December 30, 2008 indicates that a request was received from a participant to allow third-party trading of his account. Neither of these services is presently made available to the City's SDBO participants. Staff will address each issue separately.

Schwab Advisory Services

Charles Schwab Institutional Group provides a trading platform and business services for independent investment advisors who custody and invest their clients' assets at Charles Schwab. Charles Schwab currently provides these services to approximately 5,900 independent advisors. By execution of a Schwab Personal Choice Retirement Account® (PCRA) Limited Power of Attorney (LPOA) for a Schwab Investment Advisor, a participant may grant authority to an independent investment advisor that has a relationship with Schwab to trade in a participant's self-directed brokerage account at Schwab. A participant may also authorize Schwab to pay investment advisory fees to the independent investment advisor from their Schwab self-directed brokerage account.

Charles Schwab also provides an advisory service called "Schwab Advisor Network." This is essentially a referral service for participants directing them to a pre-approved list of independent investment advisors who have a relationship with the Charles Schwab Institutional Group. This is a subset of the 5,900 independent investment advisors noted above, and would become available as a part of permitting the use of independent investment advisors through the Charles Schwab Institutional Group.

Although Schwab offers a menu of other proprietary advisory services to retail clients, due to legal issues surrounding retirement plans, these services are not available to participants utilizing the Schwab self-directed brokerage account. The only referral service available to retirement plan accounts is the Schwab Advisor Network. Further, the service is only available to participants with investment assets of \$500,000 or more. If the service was made available in the City's SDBO a participant with \$500,000 or more in his/her account would be able to call Schwab and request a referral to a local financial advisor. There are approximately 200 nationwide, including in the Los Angeles area. Those participants who do not qualify for this referral service could independently utilize one of the other advisors who are a part of the Schwab Institutional Group. Schwab indicates that typically the use of an advisor in their self-directed brokerage account occurs because the participant already has a relationship with the advisor and not through a referral.

The advisors who have a relationship with the Schwab Institutional Group are not employed by Schwab although they do have access to Schwab's administrative infrastructure. All advisors must meet certain qualifications in order to become part of the Schwab Institutional Group, with more stringent requirements for those advisors who are a part of the Schwab Advisor Network. A participant who utilizes the services of an advisor is required to execute an agreement with the advisor that is a contractual relationship which Schwab considers completely independent of any services provided by Schwab. As a result, Schwab indicates it does not view itself as having any role or liability with respect to any interaction between the participant and advisor. Fees are set by the advisor and typically range between 1%-1.25%. However, fees are set by the advisor, not by Schwab. Schwab indicates that most of its retirement plan clients permit the use of investment advisors who are a part of the Schwab Institutional Group within their plans.

The Board has the option of making independent investment advisors available through the Schwab Institutional Group, which includes the Schwab Advisor Network referral services. However, staff recommends that the matter be referred to staff and the consultant for further study before taking any action. Issues that remain to be researched include the precise screening/qualifications used to establish a relationship with the Schwab Institutional Group and to determine membership in the advisor network; consultant and City Attorney comment on potential liability issues; the extent to which this type of service is utilized in other defined contribution plans; and the relationship of this type of advice service to any potential broader investment advice services that could be made available to Plan participants.

Third Party Trading – Schwab offers a service allowing participants to provide authorization for a third-party to trade the member’s account. This would mean the City’s SDBO participants could, if they wished, designate individuals other than themselves (presumably but not necessarily qualified financial advisors) to execute trades on their behalf. As with the prior issue, staff recommends that the matter be referred to staff and the consultant for further study before taking any action. Issues that remain to be researched include consultant and City Attorney comment on potential liability issues; and the extent to which this type of service is utilized in other defined contribution plans.

Submitted by: _____
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