DEFERRED COMPENSATION PLAN
BOARD REPORT 07-08

EMPLOYEE BENEFITS DIVISION

Date: March 6, 2007

To: Board of Deferred Compensation Administration

From: Investments Committee/Staff

Subject: Investment Menu Design Changes

Recommendation:
That the Board of Deferred Compensation Administration receive and file this report regarding issues under consideration by the Board's Investments Committee.

Discussion:
The Board's Investments Committee has been considering a number of potential changes to the Deferred Compensation Plan Investment menu. As a first step in its review process, the Committee asked its participants (including representatives from the Board's consultant, Plan Administrator and staff) to develop proposals for an "ideal" core investment menu if that menu was being designed for a wholly new program. Committee members also offered their own concepts for investment menu design changes.

Over the course of several meetings the Committee reviewed the various proposals and identified a range of key issues needing to be resolved. The Committee contemplated the option of continuing to review these issues in the Committee forum or taking the issues, one by one, to the full Board. Given the complexity of the issues under review, and the fact that many of these changes would represent a significant shift from the current investment structure, the Committee believed that it would be more beneficial to begin reviewing the issues at the full Board level. The Committee envisioned that a new issue might be presented at each Board meeting, with presentations on each from staff, the consultant and Plan Administrator as appropriate. The Committee continues to be open to having issues sent back by the Board for further study, but believed that it made more sense at this stage to have presentations on certain topics conducted before the full Board so those presentations would not have to be repeated.

Following is a summary of the key issues identified by the Committee:

Brokerage Window – The Committee considered recommendations from staff and the Plan Administrator that the Plan move to a fuller-service, wider-menu brokerage window. Staff recommended that the window be expanded to include trading of a fuller universe of mutual funds as well as bonds and exchange-traded-funds. The Plan Administrator recommended that the window include individual stocks as well. The Committee believed that the next stage of its review of this issue should involve a detailed comparison of the investment choices, fees and service features of the brokerage providers available through Great-West. Although the brokerage window affects a very small part of the participant population, the Committee felt that because the Board may be considering eliminating certain investments from its core investment menu it was important to determine if those options might continue to be made available to participants through the brokerage window.

Savings Options – The Committee considered a recommendation from staff that it retain both its FDIC-insured savings option as well as its stable value fund, vs. recommendations from the consultant and Plan Administrator that it only maintain a stable value offering. Staff argued that retaining both options was important to allow participants to take advantage of different interest rate environments.

Asset Allocation Funds: Risk-Based vs. Life-Cycle – The Committee considered a recommendation from its consultant to use Life-Cycle asset allocation funds, vs. recommendations from staff and the Plan Administrator that it retain its risk-based asset allocation funds. The consultant postulated that Life-Cycle funds helped protect participants from not shifting their investments to a more conservative posture as they grew older. Staff and the Plan Administrator suggested that Life-Cycle funds were inappropriate for the City's work-force, given the fact that many of its employees join the City's work-force at later age, and some segments can retire at much earlier ages than others. Committee member Richard Kraus suggested an alternative of using risk-based funds but creating a functionality with the Plan record-keeper allowing a participant to "pre-set" shifting their assets out of one risk-based fund to another as they neared retirement. Related to this discussion were proposals from staff and the Plan Administrator, as well as Mr. Kraus, that the risk-based offerings be expanded from three to five (adding in "Ultra-Conservative" and "Ultra-Aggressive" options).

Plan-Branded Funds – The Committee received recommendations from staff, the consultant and the Plan Administrator for consolidating the Plan's core investment offerings and "branding" them with the Plan, as opposed to by investment provider. Under the current structure, Plan participants identify their investment choices as being associated with the product provider (e.g. Fidelity, Hartford, American Funds, etc.). Some other larger 457 plans (e.g. City of New York and County of L.A.) have moved or are moving towards branding funds by the Plan and the asset class. For example, in the City's case, this might involve creating a "City of L.A. Large-Cap Fund" or "City of L.A. Bond Fund." The recommendations from staff, the consultant and the Plan Administrator identified several potential advantages to self-branded funds: (a) greater control over the composition of the underlying portfolio; (b) lower fees from the use of institutional products and money managers; and (c) greater ease for Plan participants to conceptualize their investment choices as representing asset classes, rather than choices between providers.

Plan-Branded Fund Composition – If the City's Plan were to move to self-branding, the Board (with the advice of its consultant) would determine the composition of the underlying portfolios. The portfolio structure would need to resolve questions such as the degree to which funds would be passively vs. actively managed; the weighting of growth vs. value; and how providers would be selected/monitored. The Committee identified the composition questions as sufficiently complex that it was appropriate to consider them separately from the general issue of whether the City's funds should be self-branded.

Managed Accounts – The Committee considered a recommendation from the Plan Administrator to consider “managed account” services, which would allow for Plan participants to pay a fee in exchange for having their assets externally reviewed, invested and rebalanced over time.

Staff is tentatively scheduling the brokerage window discussion for the Board’s April 17th meeting. A new issue will likely be calendared for each subsequent Board meeting, but scheduling will depend on the pace of consideration of prior issues as well as the scheduling of other items on the Board’s agenda.

Submitted by: ____________________________
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Approved by: ____________________________
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