

Deferred Compensation Plan BOARD REPORT 11-29

Date: May 10, 2011
To: Board of Deferred Compensation Administration
From: Staff
Subject: Investment Menu Implementation

*Board of Deferred
Compensation Administration
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Recommendation:

That the Board of Deferred Compensation Administration adopt recommendations from its Investments Committee and/or staff to:

- (1) Implement the balance of previously adopted changes to the Plan's investment menu in two phases, with the first phase including the DCP Bond Fund and DCP Large-Cap Fund, and the second phase including the DCP Mid-Cap, DCP Small-Cap, and DCP International Funds, with announcement of all changes occurring at the same time so that participants understand the broad scope of the investment menu redesign and have ample time to adjust their portfolios should they so desire;
- (2) Approve a proposed implementation timeline;
- (3) Approve a proposed procurement timeline;
- (4) Approve repopulating the Plan's Asset Allocation (or "Profile") Funds with the Plan's new composite core options once those options are fully implemented; and
- (5) Approve a proposed Plan Investment Policy Statement.

A. BACKGROUND: OBJECTIVES AND ACCOMPLISHMENTS

At the Board of Deferred Compensation Administration meeting on May 15, 2007, the Board directed its Investments Committee to develop a proposal for restructuring the Plan's core investment options. The core elements of the restructuring included:

- (1) Reducing the number of core investment options; and
- (2) Branding funds by the Plan rather than investment provider.

Implementing these concepts is consistent with the best practices of a number of large comparable plans, including the City of New York, State of California, and County of Los Angeles, which have already adopted similar investment models.

Following is a summary of actions already taken by the Board in support of developing this new investment menu, most of which were developed by the Investments Committee and subsequently adopted by the full Board:

Mar-08	Expanded the Plan's asset allocation funds from 3 to 5 by adding in "Ultra-Conservative" and "Ultra-Aggressive" portfolios.
Jul-08	Completed a survey of Plan participants for the purpose of gauging reaction to the potential for streamlining the Plan's investment menu.
Aug-08	Transitioned from prior SDBO provider Fiserv to full service provider Charles Schwab , adding stocks, bonds, ETFs, and an expanded universe of mutual funds to the menu for SDBO participants.
Various '08 - '09	Eliminated five funds for performance reasons which also helped consolidate the core investment menu (including the Fidelity Magellan Fund, Capital Guardian U.S. Equity Fund, Lotsoff Small-Cap Equity fund, Hartford Stock Fund and Hartford Advisers Fund).
Jul-09	Added a Mid-Cap index component to the Plan's asset allocation funds.
Jul-09	Eliminated Certificates of Deposit from the investment menu.
Jul-09	Consolidated the Plan's fixed account funds into a single "City of Los Angeles Stable Value Fund."
Sep-09	Restructured the Plan's Bank Deposit savings account to expand FDIC coverage using multiple providers and brand as a "City of Los Angeles FDIC-Insured Savings Account."
Apr-10	Approved consolidation of the Plan's actively managed large-cap funds with a single "DCP Large-Cap Stock Fund" comprised solely of a passively managed S&P 500 Index Fund; and approved creation of a "DCP Bond Fund" composed 50% actively managed/50% passively managed – NOT YET IMPLEMENTED.
May-10	Approved creation of a "DCP Small-Cap Fund" composed 34% passively managed/33% active growth/33% active value - - NOT YET IMPLEMENTED.
Jun-10	Approved creation of a "DCP Mid-Cap Fund" composed 50% passively managed/25% active growth/25% active value – NOT YET IMPLEMENTED.
Aug-10	Approved creation of a "DCP International Fund" composed 100% actively managed – NOT YET IMPLEMENTED.
Jan-11	Approved the use of a Fund Custodian to provided as-needed unitization services for separate accounts that might be included in the Plan's investment lineup – NOT YET IMPLEMENTED.

Included within this report are the final recommendations of the Investments Committee to implement the balance of fund changes previously adopted by the Board and to formalize the investment menu structure and procurement/termination provisions within an Investment Policy Statement.

B. OVERVIEW OF NEW INVESTMENT MENU

The investment menu adopted by the Board consists of three broad tiers:

TIER 1 - Profile Funds: Risk-based asset allocation funds providing participants a simple, low-cost means of achieving diversification consistent with individual risk tolerance.

TIER 2 – Asset Class Funds: Core funds branded with the name of the City's Plan and unique asset class.

TIER 3: Self Directed Brokerage Option: A brokerage window providing active investors with the fullest menu of mutual funds, stocks, bonds, Treasuries, Certificates of Deposit (CDs), Exchange Traded Funds (ETFs), etc.

The following table provides a summary of the investment menu categories. It also includes their composition structures as adopted by the Board.

Menu Offering	Composition Structure
TIER ONE	
1 DCP Ultra-Conservative Asset Allocation Fund	Blend of Core Asset Classes
2 DCP Conservative Asset Allocation Fund	Blend of Core Asset Classes
3 DCP Moderate Asset Allocation Fund	Blend of Core Asset Classes
4 DCP Aggressive Asset Allocation Fund	Blend of Core Asset Classes
5 DCP Ultra-Aggressive Asset Allocation Fund	Blend of Core Asset Classes
TIER TWO	
6 DCP FDIC-Insured Savings	3 Providers of FDIC-Insured Deposit Savings Accounts
7 DCP Stable Value Fund	1 Discretionary Stable Value Fund Manager (100%)
8 DCP Bond Fund	1 Active (50%), 1 Passive Manager (50%)
9 DCP Large-Cap Stock Fund	1 Passive Manager (100%)
10 DCP International Fund	1 Developed Markets (65%), 1 Emerging Markets (17.5%), 1 Small-Cap Manager (17.5%)
11 DCP Mid-Cap Stock Fund	1 Passive (50%), 1 Active Value (25%), 1 Active Growth Manager (25%)
12 DCP Small-Cap Stock Fund	1 Passive (34%), 1 Active Value (33%), 1 Active Growth Manager (33%)
TIER THREE	
13 Self Directed Brokerage Option	Stocks, Bonds, ETFs, etc.

D. IMPLEMENTATION

(1) Transition Status - The Committee has been reviewing options for implementing the new menu. Some of the menu changes have already been implemented. Others can be instituted on a near-term basis because the Plan already has investment managers in place capable of fulfilling the new composition structures adopted by the Board. Others must be instituted on a somewhat longer-term basis because procurement processes are required.

The Committee recommends implementing the remaining menu changes in two phases: **Phase 1** would include the DCP Bond Fund and DCP Large-Cap Fund since managers for both of these new options are presently available and new procurements are not required. **Phase 2** would include the DCP Mid-Cap, DCP Small-Cap, and DCP International Funds since managers for these options are not presently available and new procurement processes are required. The Committee recommends that **announcement** of all changes occur simultaneously so participants understand the broad scope of the investment menu redesign and have ample time to adjust their portfolios should they so desire:

	IMPLEMENTED	PHASE 1 1 st Quarter 2012	PHASE 2 3 rd Quarter 2012
TIER ONE			
DCP Ultra-Conservative Asset Allocation Fund	✓		
DCP Conservative Asset Allocation Fund	✓		
DCP Moderate Asset Allocation Fund	✓		
DCP Aggressive Asset Allocation Fund	✓		
DCP Ultra-Aggressive Asset Allocation Fund	✓		
TIER TWO			
DCP Deposit Savings Account	✓		
DCP Stable Value Fund	✓		
DCP Bond Fund		✓	
DCP Large-Cap Stock Fund		✓	
DCP International Fund			✓
DCP Mid-Cap Stock Fund			✓
DCP Small-Cap Stock Fund			✓
TIER THREE			
Self Directed Brokerage Option	✓		

(2) Timing of Changes - Staff recommends that initial announcement of these investment menu changes be targeted for a period of time after implementation of the Roth savings option. The initial communications for Roth will be concentrated around the period of late June through August 2011. Staff recommends that initial communication of the investment menu changes be included in the Plan's Third Quarter newsletter, which will be received October 2011, with implementation of Phase 1 to occur approximately late January/early February 2012, and implementation of Phase 2 to occur in approximately the third quarter of 2012.

This schedule would provide opportunities to communicate the changes in writing three times: prior to Phase 1 implementation, in both the October and January newsletters, as well as through a special mailing (timing to be determined). This will also provide ample time for participants to make adjustments to their portfolios should they so desire, and for staff to develop a comprehensive communications campaign, similar to that to be utilized for Roth implementation, involving the creation of custom materials, focus group testing, group meetings, and other media.

(3) Investment Manager Migration – As implementation proceeds over the next 8-14 months, certain incumbent managers will be retained while others will be eliminated. The following table summarizes the Plan's current investment managers relative to migration to the new menu over that time period:

Menu Category	Current Provider(s)/Fund(s)	Migration
TIER ONE		
DCP Ultra-Conservative Asset Allocation Fund	Current Blend of Index Funds + SVF	Move to Blend of Core Funds + SVF
DCP Conservative Asset Allocation Fund	Current Blend of Index Funds + SVF	Move to Blend of Core Funds + SVF
DCP Moderate Asset Allocation Fund	Current Blend of Index Funds + SVF	Move to Blend of Core Funds + SVF
DCP Aggressive Asset Allocation Fund	Current Blend of Index Funds + SVF	Move to Blend of Core Funds + SVF
DCP Ultra-Aggressive Asset Allocation Fund	Current Blend of Index Funds + SVF	Move to Blend of Core Funds + SVF
TIER TWO		
DCP Deposit Savings Account	Bank of America	Retain
	City National Bank	Retain
	Bank of the West	Retain
DCP Stable Value Fund	Galliard Capital Management	Retain
DCP Bond Fund	Vanguard Institutional Index	Retain
	PIMCO Total Return	Retain
DCP Large-Cap Stock Fund	Vanguard Institutional Index	Retain
	Growth Fund of America	Map to Vanguard S&P 500 Index
	Investment Co. of America	Map to Vanguard S&P 500 Index
	Hartford Capital Appreciation	Map to Vanguard S&P 500 Index
DCP International Fund	DWS EAFE Equity Index	Eliminate pending procurement
	Fidelity Diversified Intl.	Subject to competitive search
DCP Mid-Cap Stock Fund	Vanguard Mid-Cap Index	Retain
	Lazard Mid-Cap Institutional	Eliminate pending

		procurement
DCP Small-Cap Stock Fund	SSgA Russell 2000 Index	Retain
TIER THREE		
Self-Directed Brokerage Option	Charles Schwab	Retain

(4) Procurement Schedule

Due to the scope of the project and the considerable time, resources, and costs involved with conducting procurement processes, the Committee looked for areas where existing options could be utilized such that all procurement processes were not occurring simultaneously. The Committee also took into account existing contractual relationships or recently conducted search processes. Finally, the Committee incorporated all of this into a long-range plan for conducting procurements on a recurring schedule.

The new menu will have 14 total investment manager mandates. The Committee recommends that initial procurements for those mandates be administered as follows:

Year Search Process Concludes	Investment Manager Search
2012	Active Growth Mid-Cap Manager Active Value Mid-Cap Manager Active Growth Small-Cap Manager Active Value Small-Cap Manager Active Developed Markets International Manager Active Emerging Markets International Manager Active Small-Cap Markets International Manager
2013	Passive Bond Manager Active Bond Manager Passive Large-Cap Manager Passive Mid-Cap Manager Passive Small-Cap Manager
2014	Bank Deposit Managers Stable Value Manager
2015	None
2016	None

Following initial implementation, the Committee is recommending that procurements for each mandate be conducted on a rolling five-year basis. The above cycle would repeat itself beginning in 2017 and continuing ongoing.

(4) Asset Allocation Funds – The Committee is recommending that the Plan’s Asset Allocation (or “Profile”) Funds be repopulated using the new core options once those options are fully implemented. Currently the Profile funds are populated by the Plan’s index funds and the Stable

Value Fund. Under the Committee's recommendation, this would continue to be the case until all of the new core funds are established, virtually all of which will be composite blends of a mix of underlying funds. The exception would be the DCP Bond Fund, which will need to be part of the Profile Funds upon its inception due to recordkeeping and communications logistics which would make it impractical to continue using the Vanguard Bond Index fund.

The Committee's recommendation is based on the considerable amount of process used in developing these core offerings, and in particular in arriving at conclusions that including some active management represent a superior model to creating all-passive funds.

(5) Manager Selection Timeline

As Committee members are well aware, procurement processes are lengthy and involve a number of steps either required by the City's procurement rules or built into the Board's decision-making process. The volume of simultaneous activity that would be required in this particular group of searches will also add to the time involved. The Board's consultant Mercer has developed a tentative timeline (Attachment I) for the initial group of manager searches.

E. INVESTMENT POLICY STATEMENT

At its April 18, 2011 meeting, the Committee reviewed a draft a Investment Policy Statement developed by staff and the consultant. The Committee made revisions and requested that the edited version be brought back to the full Board. The revised version includes the Committee's edits in Track Changes format (Attachment II).

The Investment Policy Statement document is fully reflective of the changes to the Plan's core investment menu as previously adopted by the Board. The document also proposes revisions to the Plan's procurement and fund elimination policies. Staff recommends that the Board adopt the Investment Policy statement.

Submitted by: _____
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