

# Deferred Compensation Plan BOARD REPORT 11-51

Date: August 5, 2011  
To: Board of Deferred Compensation Administration  
From: Staff  
Subject: Fund Custodian Request for Proposal

*Board of Deferred  
Compensation Administration  
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## Recommendation:

That the Board of Deferred Compensation Administration approve the attached Request for Proposal for Fund Custodian Services pending final review as to form by Board Counsel and the Personnel Department's Administrative Services Division.

## Discussion:

In January 2011 the Board directed staff and the consultant to work together to draft a Request for Proposal (RFP) for a "Fund Custodian." A Fund Custodian is an entity providing unitization services for separate account Plan assets. Staff will define key terms and review the reasons for engaging in a provider search for this service.

Plan participants invest their assets within various investment funds making up the Deferred Compensation Plan investment menu. Each participant's holdings within a given investment fund are represented by the number of units or shares owned by that participant.

When investing in a mutual fund, share values are calculated by the mutual fund company. This information in turn is transmitted to the Plan's recordkeeper, Great-West Retirement Services, which provides reporting to participants.

Defined contributions plans, particularly large ones like the City's Plan, can use investment vehicles other than mutual funds. One of these investment vehicles is called a separate account.

Separate accounts are pools of money managed by an investment manager. Assets in the separate account are owned exclusively by "the plan," and unlike mutual funds they are not commingled with funds from other investors. In the retirement world, separate accounts have in the past been more common in the defined benefit arena where, for example, a pension fund might contract with an investment firm to manage a portfolio with a specific mandate. Because these pension fund investments tend to be large and the administrative/communication requirements small, pricing for separate accounts is generally lower than for mutual funds.

As defined contribution plans have grown larger, they have begun utilizing separate accounts to a greater extent. This is so they can take advantage of the more favorable pricing offered.

A separate account, however, merely holds a plan's aggregated investments in a particular investment option and does not typically provide unit or share values. In a defined contribution plan environment, the account thus still needs to be "unitized" to apportion each participant's share of the account.

As a result of the Board's restructuring of the Plan investment menu (see Board Report 11-55), it is anticipated that separate account products will be very competitive in upcoming procurement processes. As a result, the Board directed staff and the consultant to develop an RFP for Fund Custodian Services. The Fund Custodian would have the limited responsibility of providing unitization only for those separate accounts procured by the Plan which could not generate their own unit values or would do so at a more expensive cost than that charged by the Fund Custodian.

Mercer has a specific operation (Mercer Sentinel Group) which offers among its specialized services research and analysis of firms providing custodial services. Staff has been working with Mercer Sentinel to draft the attached RFP.

Mercer indicates that there are approximately 7-8 firms which can provide the type of custodial services which are being solicited in this RFP. Mercer maintains a database of custodial providers, and it is expected that all or virtually all firms that can provide the service already have information contained within the database.

The data points contained within the database are numerous. Firms may self-update those data points electronically, and Mercer then reviews the data. As a result, the RFP has been drafted to allow potential bidders to provide most of their data electronically. To meet the Plan's obligations for transparency of the criteria upon which the evaluation is based, the data points to be considered are all identified in the RFP. Vendors have the option of submitting or updating their information on paper, although it is not expected that they will use this approach and will instead prefer to update the database. Vendors who are not presently in the database may join. The RFP provides for a submission deadline which will prevent updates beyond that point.

Mercer will review the data and evaluate candidate firms based on the review/rating methodology as drafted in the RFP. Staff will then review this and provide a recommendation to the Board.

This RFP has not yet been reviewed by the Board's legal counsel or by the Personnel Department's Administrative Services Division, which oversees RFP and contract development for all Personnel Department procurements. As a result, staff is recommending that the Board's approval of this document be conditioned upon final approval/modification of the RFP as to form by these two reviewers. It is anticipated, however, that any changes should be minor, as the general language (that not specifically referring to the specific fund custodian services being sought) used in this document is virtually identical to language in the recently issued RFP for Plan Consulting Services.

Submitted by:

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Steven Montagna