

Deferred Compensation Plan

INVESTMENTS COMMITTEE REPORT 15-01

Date: January 22, 2015

To: Investments Committee

From: Staff

Subject: Deferred Compensation Plan Passive Manager Searches

*Board of Deferred
Compensation Administration*
Eugene K. Canzano, Chairperson
John R. Mumma, Vice-Chairperson
Cliff Cannon, First Provisional Chair
Tom Moutes, Second Provisional Chair
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Recommendation:

That the Investments Committee review selections for the Passive Funds Search and select managers for the underlying passive components of the DCP Bond, Large-Cap, Mid-Cap, and Small-Cap Funds.

Discussion:

At its February 18, 2014 meeting, the Board adopted revisions to the Plan's Investment Policy Statement incorporating the option for a mutual funds search process for filling certain investment manager mandates as approved by the Board. The Board further approved recommendations for moving forward with a search schedule for the Plan's various investment options as recommended by staff. At its December 16, 2014 meeting, the Board approved the fund search type and criteria for the Plan's passive equity and bond investment options.

PASSIVE FUND SEARCH PROCESS

As passive funds seek to replicate the selections of a benchmark index, the more notable considerations for passive fund selection are how closely each fund seeks to track the selections and performance of its respective benchmark and how much the investment management fees might cost participants. Given this, the selection process for passive fund managers will differ slightly from the process the Committee recently conducted for the active fund managers as the latter involved comprehensive review of each firm's various methodologies and strategies. The passive fund evaluation is comparatively straightforward and concise. Staff recommends the Committee review the passive funds that have met the minimum approved criteria (as approved by the Board on December 16, 2014) as presented in this report and proceed with a recommendation for finalist funds to the Board. However, should the Committee believe additional information is necessary in order to complete its review of the passive funds, staff and the consultant will schedule an additional Committee meeting.

In order to aid the Committee in its review, the Plan's investment consultant, Mercer Investment Consulting (Mercer), conducted an initial search using its proprietary database and other resources and identified passive funds meeting the approved minimum criteria.

Mercer has prepared a comprehensive review and analysis of the viable funds, which is attached to this report for the Committee's review. Please note that unlike the active manager search reports, these Mercer reports contain summary tables within each search category listing those funds that both did and did not meet minimum qualifications. Further, please note that staff did not create rankings of funds that did pass the minimum qualifications requirements, as the comparative criteria are considerably less complex than was the case for the active manager reviews.

For each category, the attached Mercer report details:

- a) Initial Screening & Identification of Viable Funds
- b) Benchmark Descriptions
- c) Overview, Characteristics, & Portfolio Information of the Viable Funds
- d) Performance Information
- e) Information Related to Tracking Error vs. Respective Benchmark

PASSIVE BOND

The estimated size for the passive bond mandate is \$178 million (as of 6/30/2014). Currently, the Plan's DCP Bond Fund is 50% passive and 50% active (Vanguard Total Bond Market Index Fund Institutional Plus and the Loomis Sayles Core Plus Bond N, respectively).

The following criteria were used to screen for viable passive bond funds:

- Availability in mutual fund vehicle and open to new investors
- Compatibility with Empower Retirement (Empower) platform
- Strategy track record of 5 years or longer (specific vehicle may be shorter)
- Tracks the Barclays US Aggregate Bond Index
- Annualized tracking error relative to the benchmark should be within +/- 0.30% over the 7- and 10-year periods (or longest available)
- Minimum assets under management in strategy (all share classes) of \$1.5 billion or greater
- Investment expense ratio equal to or less than 0.20%

Seven (7) funds met the minimum criteria:

Fund	Net Expense Ratio (after revenue sharing)	Mercer Preferred Index Fund Provider ³
BlackRock Bond Index Fund K (WFBIX)	0.12%	
Dreyfus Bond Market Index Fund Basic (DBIRX)	0.15%	Y
Northern Bond Index Fund (NOBOX)	0.10% (rev share 0.06%)	
Principal Bond Market Index Fund Institutional (PNIIX)	0.14% (rev share 0.10%)	
State Street Aggregate Bond Index Portfolio (SSFEX)	0.09%	Y
TIAA-CREF Bond Index Fund Institutional (TBIX)	0.12%	
Vanguard Total Bond Market Index Fund Inst Plus² (VBMPX)	0.05%	Y

Benchmark: Barclays US Aggregate Bond, ²Barclays US Aggregate Float Adj

³ It should be noted that Mercer does not provide ratings for these funds as they are passively managed. However, Mercer did indicate which providers are considered recommended providers by its internal research team.

PASSIVE LARGE-CAP EQUITY

The estimated size for the passive large-cap equity mandate is \$1.64 billion (as of 6/30/2014, 36% of Plan assets). Currently, the Plan's DCP Large-Cap Fund is 100% passive (100% allocation to the Vanguard Institutional Index Inst. Plus fund).

The following criteria were used to screen for viable funds:

- Availability in mutual fund vehicle and open to new investors
- Compatibility with Empower platform
- Strategy track record of 5 years or longer (specific vehicle may be shorter)
- Tracks the S&P 500 Index
- Annualized tracking error relative to the benchmark should be within +/- 0.30% over the 7- and 10-year periods (or longest available)
- Minimum assets under management in strategy (all share classes) of \$10 billion or greater
- Investment expense ratio equal to or less than 0.10%

Six (6) funds met the minimum criteria:

Fund	Net Expense Ratio (after revenue sharing)	Mercer Preferred Index Fund Provider ¹
BlackRock S&P 500 Stock Fund K (WFSPX)	0.05%	Y
Northern Stock Index Fund (NOSIX)	0.08% (rev share 0.02%)	Y
Principal LargeCap S&P 500 Index Fund Inst (PLFIX)	0.06% (rev share 0.10%)	
Schwab S&P 500 Index Fund (SWPPX)	0.07% (rev share 0.02%)	
State Street Equity 500 Index II Portfolio (SSSYX)	0.06%	Y
Vanguard Institutional Index Fund Inst Plus (VIIIX)	0.02%	Y

Benchmark: S&P 500

¹It should be noted that Mercer does not provide ratings for these funds as they are passively managed. However, Mercer did indicate which providers are considered recommended providers by its internal research team.

PASSIVE MID-CAP EQUITY

The estimated size for the passive mid-cap equity mandate is \$136 million (as of 6/30/2014). Effective March 20, 2015, the Plan's DCP Mid-Cap Fund will be comprised of the following underlying allocations: 50% passive, 25% active growth, and 25% active value (respectively: the Vanguard MidCap Index Inst. Plus, Voya MidCap Opportunities Fund R6, and RidgeWorth Mid-Cap Value Equity I funds).

The following criteria were used to screen for viable funds:

- Availability in mutual fund vehicle and open to new investors
- Compatibility with Empower platform
- Strategy track record of 3 years or longer (specific vehicle may be shorter)
- Tracks the Russell Mid Cap Index or a similar index (e.g., S&P MidCap 400 Index or CRSP US Mid Cap Index)
- Annualized tracking error relative to the benchmark should be within +/- 0.30% over the 7- and 10-year periods (or longest available)
- Minimum assets under management in strategy (all share classes) of \$1 billion or greater

- Investment expense ratio equal to or less than 0.20%

Four (4) funds met the minimum criteria:

Fund	Net Expense Ratio (after revenue sharing)	Mercer Preferred Index Fund Provider ³
Columbia Mid Cap Index Fund R5 (CPXRX)	0.11% <i>(rev share 0.10%)</i>	
Northern Mid Cap Index Fund (NOMIX)	0.09% <i>(rev share 0.06%)</i>	Y
Principal MidCap S&P 400 Index Fund Inst (MPSIX)	0.12% <i>(rev share 0.10%)</i>	
Vanguard Mid-Cap Index Fund Institutional Plus² (VMCPX)	0.06%	Y

Benchmark: S&P MidCap 400 Index, CRSP US Mid Cap Index²

³*It should be noted that Mercer does not provide ratings for these funds as they are passively managed. However, Mercer did indicate which providers are considered recommended providers by its internal research team.*

PASSIVE SMALL-CAP EQUITY

The estimated size for the passive small-cap equity mandate is \$106 million (as of 6/30/2014). Effective March 20, 2015, the Plan's DCP Small-Cap Fund will be comprised of the following underlying allocations: 34% passive, 33% active growth, and 33% active value (respectively: the SSgA Russell 2000 Index, Hartford SmallCompany HLS IA, and DFA US SmallCap Value Portfolio funds).

The following criteria were used to screen for viable funds:

- Availability in mutual fund vehicle and open to new investors
- Compatibility with Empower platform
- Strategy track record of 3 years or longer (specific vehicle may be shorter)
- Tracks the Russell 2000 Index or a similar index (e.g., S&P SmallCap 600 Index or CRSP US Small Cap Index)
- Annualized tracking error relative to the benchmark should be within +/- 0.30% over the 7- and 10-year periods (or longest available)
- Minimum assets under management in strategy (all share classes) of \$1 billion or greater
- Investment expense ratio equal to or less than 0.25%

Six (6) funds met the minimum criteria:

Fund	Net Expense Ratio (after revenue sharing)	Mercer Preferred Index Fund Provider ⁴
BlackRock Small Cap Index Fund Class K¹ (BDBKX)	0.16%	Y
Northern Small Cap Index Fund¹ (NSIDX)	0.09% <i>(rev share 0.06%)</i>	Y
TIAA-CREF Small-Cap Blend Index Fund Institutional¹ (TISBX)	0.16%	
Columbia Small Cap Index Fund R5² (CXXRX)	0.15% <i>(rev share 0.10%)</i>	
Principal SmallCap S&P 600 Index Fund Inst² (PSSIX)	0.16% <i>(rev share 0.10%)</i>	
Vanguard Small-Cap Index Fund Inst Plus³ (VSCPX)	0.06%	Y

Benchmark: Russell 2000¹, S&P SmallCap 600², CRSP US Small Cap³

⁴It should be noted that Mercer does not provide ratings for these funds as they are passively managed. However, Mercer did indicate which providers are considered recommended providers by its internal research team.

Submitted by: _____
Esther Chang

Approved by: _____
Steven Montagna