



Investments Committee Report 21-02

Investments
Committee

Raymond Ciranna
Chairperson

Joshua Geller
Neil Guglielmo

Date: June 23, 2021

To: Investments Committee

From: Staff

Subject: Proposal for Refined Search Process for DCP Actively Managed Mandates

Recommendation:

That the Investments Committee approve the proposal from staff and investment consultant for executing the analytical process for the actively managed mandates for the Deferred Compensation Plan (DCP).

Discussion:

A. Background

The Board of Deferred Compensation Administration (Board) has taken a number of actions with respect to procurements and search processes for DCP investment managers. Following is a summary of the Board's actions to date regarding the search:

- On **June 18, 2019**, the Board directed staff to draft revisions to the DCP Core Menu Investment Management Services and Stable Value Fund (SVF) Management Services RFPs to include an evaluation process aligning with the Board's established mutual fund search process. The Board also asked staff to work with the City Attorney's Office and Office of Contract Compliance to identify all non-applicable provisions of the City's general contracting requirements for the investment of DCP funds.
- On **July 16, 2019**, the Board approved staff's proposed process to administer parallel mutual fund and institutional product procurement searches for all DCP investment mandates.
- On **January 14, 2020**, the Investments Committee (Committee) reviewed and approved staff's proposed revised RFPs.
- On **February 18, 2020**, the Board approved and authorized the release of RFPs for (i) DCP Investment Management Services and (ii) SVF Investment Management Services.

- On **August 17, 2020**, the DCP Core Menu RFP was released; responses were due October 1, 2020. Along approximately the same time frame Mercer executed the parallel mutual fund search process.
- On **February 16, 2021**, following Investments Committee review on October 30, 2020, and prior Board consideration at its meetings on December 15, 2020, and January 19, 2021, the Board selected Galliard Capital Management to complete its SVF procurement process.
- On **May 18, 2021**, the Board selected Vanguard to provide passive management services for the passively managed components of the DCP Bond, DCP Large-Cap Stock, DCP Mid-Cap Stock, and DCP Small-Cap Stock investment options, following prior consideration at its meeting on April 20, 2021.

Mercer and staff are now prepared to move to the final stage of investment manager review, which includes all of the DCP’s actively managed investment mandates. The DCP Core Menu includes active managers for the following DCP investment options and investment mandates comprising various percentages of the Core Menu funds and overall DCP assets, as follows:

DCP Core Fund	Active Mandate	Percent of DCP Core Fund	Assets as of 3/31/20
DCP Bond Fund	Core Plus Bond	50%	\$ 402,459,630
DCP Mid-Cap Stock Fund	Mid-Cap Growth/ Mid-Cap Value Equity	50%	\$ 240,449,004
DCP Small-Cap Stock Fund	Small-Cap Growth/ Small-Cap Value Equity	67%	\$ 319,667,198
DCP International Stock Fund	International Small-Cap/ Emerging Markets/ Developed Markets Equity	100%	\$ 712,142,473
TOTAL->			\$ 1,674,718,305
% of DCP Assets->			20%
TOTAL DCP ASSETS			\$ 8,528,938,319

All of the proposals submitted in response to the Board’s RFP were first reviewed by the Personnel Department’s Administrative Services Division (ASD) to ensure the applicable City’s general contracting requirements were met. All respondents were determined to have met the requirements necessary to proceed with further evaluation.

B. Evaluation Process

The RFP provides that the DCP consultant will prepare a report analyzing the responses across the various evaluation categories as delineated within the RFP Proposal Questionnaire. This report will combine both institutional funds proposed in response to the RFP as well as mutual

funds identified as a result of the search process. The RFP further provides that the analysis and findings will be reviewed and evaluated in collaboration with DCP staff and the Committee so as to allow the Committee to make recommendations for selection to the Board. The analysis includes the following evaluation factors:

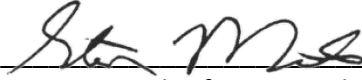
- *Organizational Background and Strength* – business strength and resiliency, tenure of senior professionals, commitment to retaining overall personnel, percentage of employee ownership and history of legal and regulatory proceedings.
- *Investment Experience* – firm history of managing assets within the proposed investment fund portfolio, the scale of portfolio assets under management, and depth/tenure of staff specializing in the strategy.
- *Investment Approach and Process* – manager process and capabilities with regards to building a portfolio and includes consideration of the amount of dedicated resources to the strategy, trading and research, the investment portfolio guidelines, typical number of portfolio holdings, typical portfolio turnover rates, and expected sources of value added versus the benchmark.
- *Investment Performance* – portfolio composite ranking relative to its peer group and relative to its benchmark, as well as the strategy risk-adjusted performance.
- *Portfolio Transition* – ability of each manager to assume the current portfolio and formulate a transition plan.
- *Administrative and Reporting* – manager’s capabilities with regards to interfacing with the DCP’s Third-Party Administrator (TPA), Voya, providing timely performance reporting for the DCP, supporting plan participant communications, and providing the City with back-office support as issues may arise.
- *Fees* – competitiveness of fees on a total cost basis including investment management fees.

Evaluation will proceed through stages of consultant, Committee, and Board review. As the review process proceeds, the City has the option to request and consider updated performance information and portfolio characteristics from all RFP respondents. The City also has the option to request oral presentations of all of or the highest-ranked respondents prior to making a final selection.

The first step in the review process is the Committee’s consideration of the analysis and review prepared by Mercer Investment Consulting (“Mercer”). Given the large number of candidates, following discussions with staff, Mercer has prepared a proposal with respect to how to most efficiently conduct the analysis with the Committee (**Attachment A**). Briefly, following evaluation of all RFP respondents and mutual fund candidates on RFP evaluation categories, as part of its Phase 1 review Mercer would remove from the candidate list those funds not meeting certain key criteria applying to the evaluation categories and which would otherwise be the basis for ranking candidates in any event. This would allow Mercer to move immediately to Phase 2 of its process, which would involve the more detailed comparative analysis that has been provided to the Committee in the past for other mandates. Staff supports this approach because it would

move the evaluation process forward more efficiently and with a focus on the highest quality candidate funds. Staff therefore recommends that the Committee approve the proposal from staff and investment consultant for executing the analytical process for the actively managed mandates for the DCP.

Submitted by:



Steven Montagna, Chief Personnel Analyst



City of LA Deferred Compensation Plan

Proposed Active Manager Search Process

June 23, 2021

Devon Muir, CFA
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welcome to brighter

Background

- In August 2020, the City of Los Angeles Deferred Compensation Plan issued an RFP for DCP Investment Management Services covering all passive and active investment mandates within the Plan's custom fund core line-up, aside from the Plan's FDIC-backed option and Stable Value Fund.
- This was pursuant to the Board's prior direction to conduct both institutional product and mutual fund searches ("Search Streams") during the periodic procurement cycle the Board conducts by policy approximately every five years.
- Responses to the DCP Core Menu Investment Management Services RFP were received in October. As a whole, the RFP process appears to have been quite successful with numerous qualified proposers across each asset category.

Background

Search Candidates

- Detail on the RFP response yield is provided below:

	Passive Bond	Passive US Large-Cap Equity	Passive US Mid-Cap Equity	Passive US Small-Cap Equity	Active Int'l Small-Cap Equity	Active Int'l Dev. Markets Equity	Active Int'l Emerging Markets Equity	Active Core Plus Bond	Active Mid-Cap Value Equity	Active Mid-Cap Growth Equity	Active Small-Cap Value Equity	Active Small-Cap Growth Equity
Approx. mandate size as of 3/31/21 (\$M)	402	2,831	240	165	125	463	125	402	120	120	160	160
RFP responses	4	5	4	4	13	18	15	12	12	11	13	12
Mutual funds meeting/expected to meet screening requirements	3	4	2	2	15*	10+	10+	10+	10+	10+	10+	10+
Search process status	✓	✓	✓	✓	In process	In queue	In queue	In queue	In queue	In queue	In queue	In queue

*6 of the 15 mutual fund managers submitted RFP responses, and those vehicles will be evaluated with the Institutional Products.

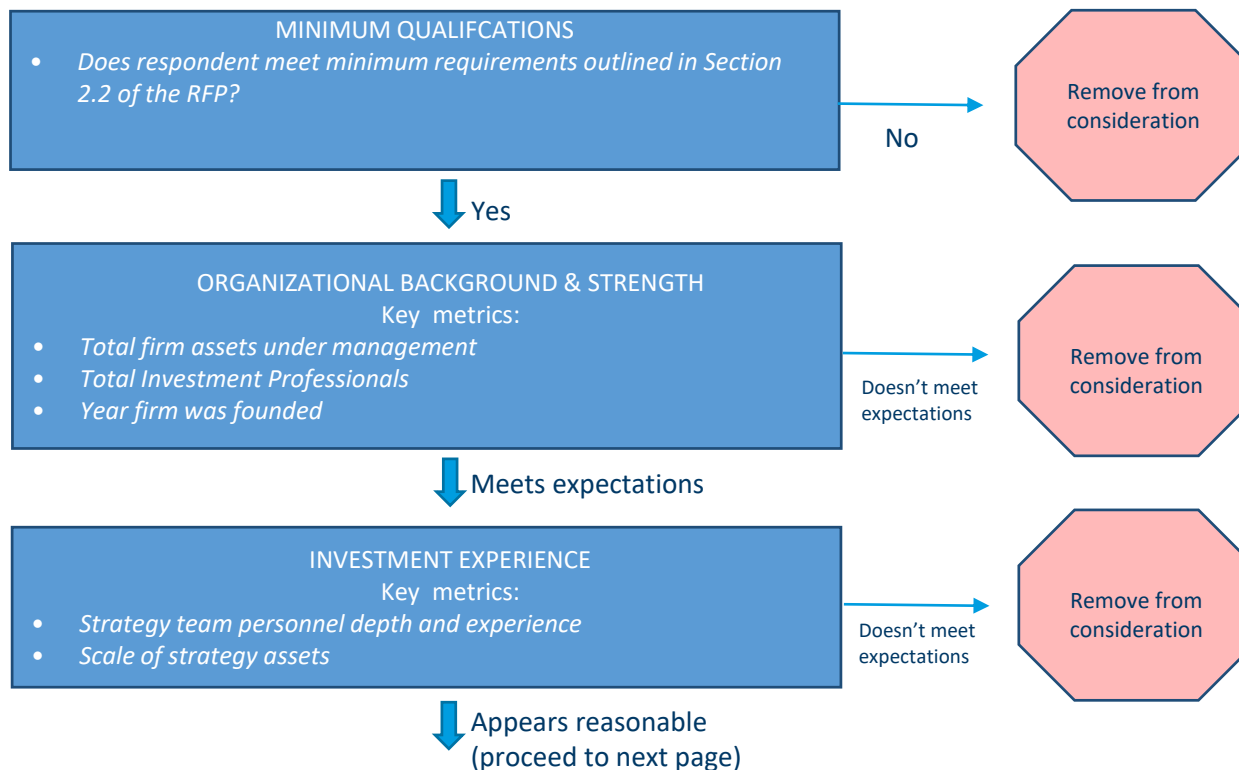
Background

- In the ensuing period, continuing through the first part of 2021, Mercer, staff, and the Investments Committee have focused on review and selection of finalists for the passive mandates in addition to the concurrent Stable Value RFP given these mandates represent the greatest amount of DCP assets. Furthermore, the Stable Value investment services contract extension is nearing expiration thus making it a priority.
- With the Board now having made its selections for these mandates, Mercer has transitioned to analyzing RFP responses for the actively managed mandates sought in the DCP Investment Management Services RFP as well as conducting the aforementioned mutual fund screening process for each mandate. **Given the volume of RFP responses and expected number of mutual funds that will emerge from the mutual fund screening process in each category, we are recommending that the Investments Committee undertake a multi-stage process in analyzing the list of candidates in both Search Streams.**
- In Stage 1, we will conduct a high level evaluation of all candidates (RFP respondents and mutual funds) based on the dimensions outlined in Section 5.1, Evaluation Process and Review Criteria of the RFP. From this analysis, we identify those candidates that readily stand apart from competitors in one more of the evaluation dimensions. Strategies that will emerge from Stage 1 will move to Stage 2 in which Mercer will conduct in-depth analysis akin to what we have recently provided for both the stable value and index fund providers.

Background

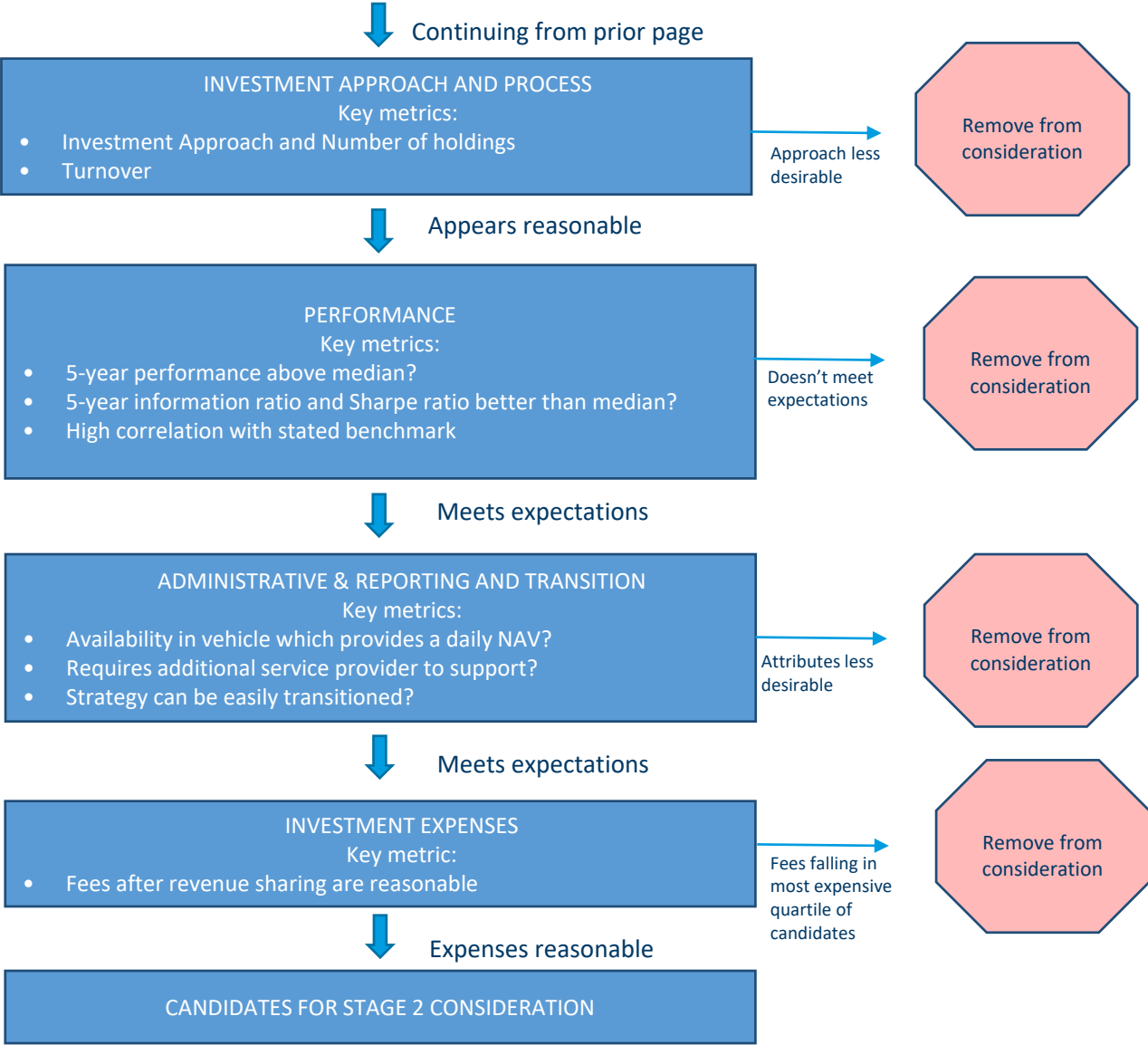
Stage 1 Evaluation Process

- **Illustration of Stage 1 process:** We provide an illustration of the general process we propose below and also include a detailed example illustrating how this approach would apply to the Active International Small Cap Equity category in the Appendix for further context.



Background

Stage 1 Evaluation Process



Background Timeline

Task ID	Task Description	Task Duration (Days)	Start Date	End Date	Investments Committee Meeting Date/Tentative Meeting Date	Performance Data
1	Passive US Bond			Completed		4Q20
2	Passive US Large-Cap Equity			Completed		4Q20
3	Passive US Mid-Cap Equity			Completed		4Q20
4	Passive US Small-Cap Equity			Completed	March 19, 2021	4Q20
	Stage 1 Deck - present to Investments Committee				June 23, 2021	
	Stage 1 for all asset classes	30	June 17, 2021	July 17, 2021	July 26, 2021	1Q21
5	Active International Small-Cap Equity	7	July 17, 2021	July 24, 2021	August 16, 2021	1Q21
6	Active International Developed Markets Equity	7	July 24, 2021	July 31, 2021		1Q21
7	Active International Emerging Markets Equity	7	July 31, 2021	August 7, 2021		1Q21
8	DCP International Stock Fund Finalist Report	7	August 7, 2021	August 14, 2021	September 7, 2021	2Q21
9	Active Core Plus Bond	14	August 14, 2021	August 28, 2021		2Q21
10	DCP Bond Fund Finalist Report	7	August 28, 2021	September 4, 2021	October 11, 2021	2Q21
11	Active US Mid-Cap Value Equity	14	September 4, 2021	September 18, 2021		2Q21
12	Active US Mid-Cap Growth Equity	14	September 18, 2021	October 2, 2021		2Q21
13	DCP Mid Cap Stock Fund Finalist Report	7	October 2, 2021	October 9, 2021	November 15, 2021	2Q21
14	Active US Small-Cap Value Equity	14	October 9, 2021	October 23, 2021		3Q21
15	Active US Small-Cap Growth Equity	14	October 23, 2021	November 6, 2021		3Q21
16	DCP Small Cap Stock Fund Finalist Report	7	November 6, 2021	November 13, 2021	November 22, 2021	3Q21

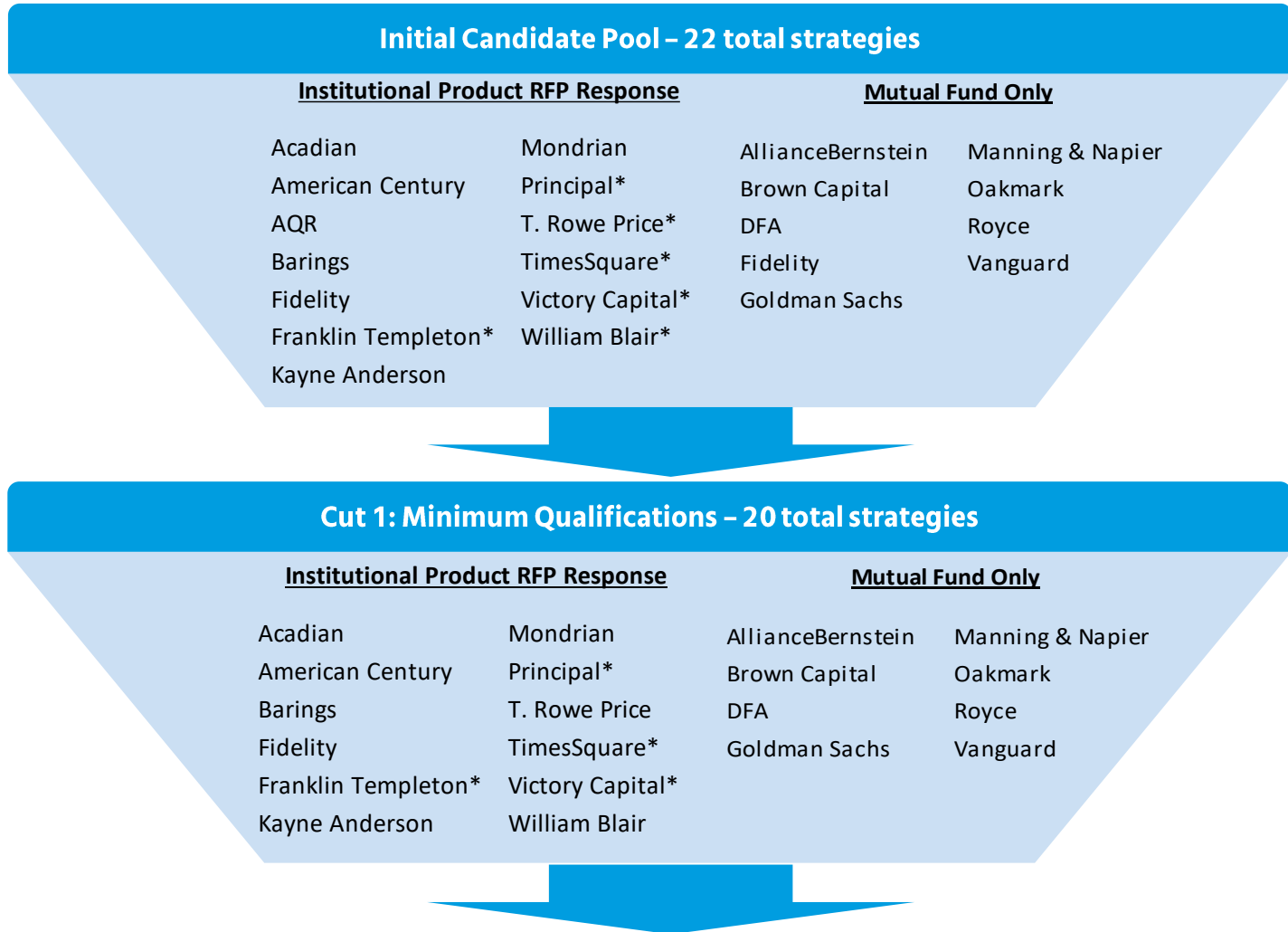


Appendix



Stage 1 Evaluation Process

Active International Small Cap Equity



AQR was removed for not meeting the minimum qualification of strategy assets greater than \$1Bn. Fidelity MF (this strategy is different from the one proposed on the Institutional Product RFP), T. Rowe Price MF and William Blair MF were excluded from further consideration due to being closed to new investors per recordkeeper.

*Mutual fund vehicle also available and passed initial screening

Stage 1 Evaluation Process

Active International Small Cap Equity



Barings, Manning & Napier, and Royce were removed due to City of LA mandate representing more than 10% of strategy assets, making concentration risk higher than desired.

*Mutual fund vehicle also available and passed initial screening

Stage 1 Evaluation Process

Active International Small Cap Equity

Cut 4: Investment Approach & Process – 17 total strategies

Institutional Product RFP Response

Acadian
 American Century
 Fidelity
 Franklin Templeton*
 Kayne Anderson
 Mondrian
 Principal*
 T. Rowe Price
 TimesSquare*
 Victory Capital*
 William Blair

Mutual Fund Only

AllianceBernstein
 Brown Capital
 DFA
 Goldman Sachs
 Oakmark
 Vanguard

No managers removed

Cut 5: Performance – 11 total strategies

Institutional Product RFP Response

Acadian
 American Century
 Fidelity
 Kayne Anderson
 Mondrian
 T. Rowe Price
 TimesSquare*
 Victory Capital*
 William Blair

Mutual Fund Only

AllianceBernstein
 Brown Capital

DFA, Goldman Sachs, Franklin Templeton, Principal, Oakmark and Vanguard were removed due to 5- year Information Ratio and Sharpe Ratio below median.

*Mutual fund vehicle also available and passed initial screening

Stage 1 Evaluation Process

Active International Small Cap Equity

Cut 6: Administration & Reporting and Transition – 10 total strategies

Institutional Product RFP Response

Acadian
 American Century
 Fidelity
 Kayne Anderson
 T. Rowe Price
 TimesSquare*
 Victory Capital*
 William Blair

Mutual Fund Only

AllianceBernstein Brown Capital

Mondrian was removed due to only having a separate account option which would require additional administrative, custody and trading fees, and added complexities. Given the number of qualified strategies, we don't believe it necessary to incur this complexity.

Cut 7: Fees – 9 total strategies

Institutional Product RFP Response

Acadian
 American Century
 Fidelity
 Kayne Anderson
 T. Rowe Price
 TimesSquare*
 Victory Capital*
 William Blair

Mutual Fund Only

AllianceBernstein

Brown Capital* was removed due to having net effective costs over 1.00%.

* Brown Capital did not respond to revenue sharing information requests from Voya/Mercer.

Stage 1 Evaluation Process

Active International Small Cap Equity



- As noted, 13 RFP responses were received for this mandate, 12 of which met minimum requirements. In addition, 15 mutual funds passed the initial screening process, 9 of which an institutional product was not proposed.
- Implementing the proposed Stage 1 Evaluation Process would result in a total of 9 active international small cap equity candidates (noted above) for further consideration in Stage 2.

*Mutual fund vehicle also available and passed initial screening

Stage 1 Evaluation Process

Active International Small Cap Equity

	Organizational Strength And Continuity				
	Business Strength And Resiliency	Number of Investment Professionals	Firmwide Assets (\$B)	Year Firm Founded	History Of Legal And Regulatory Proceedings*
Acadian		217	107.2	1986	
American Century		196	212.5	1958	
Barings		773	345.2	1940	
Fidelity		634	257.6	1946	
Franklin Templeton		727	1,497.6	1947	
Kayne Anderson		62	51.7	1984	
Mondrian		69	54.9	1990	
Principal		561	545.0	1998	
T. Rowe Price		2449	1,470.2	1937	
TimesSquare		46	16.2	2000	
Victory Capital		224	147.2	1894	
William Blair		143	69.7	1935	
AB		582	685.9	1971	N/A*
Brown		20	18.5	1983	N/A*
DFA		571	600.8	1981	N/A*
Goldman Sachs		706	1,953.8	1988	N/A*
Manning & Napier		153	20.1	1970	N/A*
Oakmark		48	103.6	1976	N/A*
Royce		59	14.5	1972	N/A*
Vanguard		277	6,742.2	1975	N/A*
		>50	>25B	>10 years	
		26-50	10B-25B	5-10 years	
		11-25	5B-<10B	3-<5 years	
		<10	<5B	<3 years	

*All RFP respondents indicated that there were no material proceedings affecting the services they would provide. Mercer is unable to evaluate the veracity of this assertion, though we viewed these responses to be satisfactory. Legal and Regulatory histories have not been assessed for the mutual fund candidates.

Stage 1 Evaluation Process

Active International Small Cap Equity

	Investment Experience			
	History Of Managing Intl SC Equity	Scale Of Intl SC Equity Assets Under Management (\$B)	City of LA % of Strategy Assets	Number of Portfolio Managers
Acadian	1993	9.3	1.3%	18
American Century	2001	2.0	6.1%	3
Barings	2009	1.1	10.9%	4
Fidelity	1995	2.6	4.7%	2
Franklin Templeton	1991	3.7	3.3%	21
Kayne Anderson	2012	3.0	4.0%	2
Mondrian	1998	6.0	2.0%	4
Principal	1995	4.8	2.5%	2
T. Rowe Price	1988	12.3	1.0%	3
TimesSquare	2012	2.9	4.2%	1
Victory Capital	2007	4.5	2.7%	4
William Blair	2004	3.1	3.8%	2
AB	2014	3.6	3.3%	2
Brown	2013	2.5	4.9%	4
DFA	1996	14.4	0.8%	42
Goldman Sachs	2005	3.6	3.3%	21
Manning & Napier	2012	1.1	10.8%	1
Oakmark	1995	2.1	5.7%	3
Royce	2010	1.1	10.5%	1
Vanguard	1996	2.8	4.4%	6

	Investment Approach And Process		
	Investment Approach	Typical Number of Holdings*	Expected Annual Turnover (per manager in Mercer Insight DB)
Quantitative	1,488	60%	0.0%
Fundamental	126	150%	17.9%
Fundamental	104	Not provided	1.5%
Fundamental	200	45%	3.9%
Fundamental	109	Not provided	22.4%
Fundamental	42	30%	20.2%
Blend	85	30%	0.0%
Fundamental	205	75%	0.0%
Fundamental	218	60%	21.5%
Fundamental	75	40%	8.7%
Fundamental	216	75%	4.9%
Fundamental	105	100%	25.0%
Fundamental	100	45%	10.5%
Fundamental	41	Not provided	0.8%
Quantitative	4,227	13%	2.2%
Quantitative	353	Not provided	0.0%
Fundamental	80-105	85%	14.0%
Fundamental	59	40%	14.1%
Fundamental	61	21%	3.4%
Blend	533	29%	9.4%

>10 years	>2-12	<3%	2-10 & fundamental
>7 Years	>12-18	3%-5%	
>5 Years	1-2, >18-20	>5%-10%	1 or >10 & Fundamental
<5 Years	<1, >20	>10%	

	51-125	<50	0-10
	126-200	51-100	11-20
	<50, >200	101-200	21-25
			>25

*Legend applies to Fundamental strategies

Stage 1 Evaluation Process

Active International Small Cap Equity

	Investment Performance						Benchmark
	Overall 5-Year Performance Relative to Universe	5-Year Std Dev	5-Year IR	5-Year Sharpe Ratio	Correlation vs MSCI EAFE Small Cap Index	Overall Performance Metrics (1-20)	
Acadian	11.3	16.9	0.5	0.6	0.99	17	MSCI EAFE Small Cap
American Century	13.8	18.7	0.7	0.7	0.96	17	MSCI ACWI ex-US Small Cap
Barings	10.0	16.5	0.1	0.5	0.99	17	MSCI EAFE Small Cap
Fidelity	10.7	17.5	0.3	0.5	0.99	16	S&P Developed ex-US SmallCap
Franklin Templeton	8.8	18.0	-0.3	0.4	0.99	10	MSCI ACWI ex-US Small Cap
Kayne Anderson	19.8	17.4	1.6	1.1	0.96	19	MSCI ACWI ex-US Small Cap
Mondrian	10.1	17.7	0.1	0.5	0.99	16	MSCI World ex-US Small Cap
Principal	8.9	18.3	-0.3	0.4	0.99	10	MSCI World ex-US Small Cap
T. Rowe Price	16.0	17.0	1.3	0.9	0.96	20	S&P Global ex-US SmallCap
TimesSquare	10.3	19.4	0.1	0.5	0.98	14	MSCI EAFE Small Cap
Victory Capital	10.5	18.2	0.2	0.5	0.99	15	S&P Developed ex-US SmallCap
William Blair	12.2	18.3	0.5	0.6	0.97	15	MSCI ACWI ex-US Small Cap
AB	11.0	18.0	0.3	0.5	0.99	16	MSCI ACWI ex-US Small Cap
Brown	22.5	17.9	1.5	1.2	0.89	17	MSCI ACWI ex-US Small Cap
DFA	9.1	18.2	-0.3	0.4	1.00	10	MSCI ACWI ex-US Small Cap
Goldman Sachs	8.7	17.3	-0.5	0.4	0.99	12	MSCI EAFE Small Cap
Manning & Napier	15.2	17.2	0.8	0.8	0.94	19	MSCI ACWI ex-US Small Cap
Oakmark	8.8	23.3	-0.1	0.3	0.97	9	MSCI World ex-US Small Cap
Royce	15.1	16.3	1.0	0.9	0.95	19	MSCI ACWI ex-US Small Cap
Vanguard	8.0	18.6	-0.5	0.4	0.99	9	S&P EPAC SmallCap

1st Quartile (>12.3)	1st Quartile (<17.4)	1st Quartile (>0.5)	1st Quartile (>0.6)	0.96-1	18-20
2nd Quartile (10.0-12.3)	2nd Quartile (18.0-17.4)	2nd Quartile (0.1-0.5)	2nd Quartile (0.5-0.6)	0.91-0.95	15-17
3rd Quartile (7.9-10.0)	3rd Quartile (18.0-18.4)	<0.1 (Median)	<0.5 (Median)	0.85-0.90	13-14
4th Quartile (<7.9)	4th Quartile (>18.4)			<0.85	<13

Stage 1 Evaluation Process

Active International Small Cap Equity

	Portfolio Transition	Administrative and Reporting		Fees			
		Able to provide a daily NAV?	Additional Sep. Acct Costs/Reporting	Separate Account	CIT	Mutual Fund (Rev. Share)	Most Cost Effective and/or Viable Vehicle
Acadian			Sep. Acct	0.67%	0.85%		0.85%
American Century			Sep. Acct	0.87%	0.95%		0.95%
Barings					0.78%		0.78%
Fidelity					0.75%		0.75%
Franklin Templeton	Sep. Acct	Sep. Acct	Sep. Acct	0.80%		1.03%	1.03%
Kayne Anderson			Sep. Acct	0.80%	0.80%		0.80%
Mondrian	Sep. Acct	Sep. Acct	Sep. Acct	0.75%			0.75%
Principal					0.70%	1.08%	0.70%
T. Rowe Price			Sep. Acct	0.90%	1.00%		1.00%
TimesSquare					0.95%	0.98%	0.95%
Victory Capital					0.75%	0.96% (0.10%)	0.75%
William Blair					0.89%		0.89%
AB						1.09% (0.25%)	1.09% (0.25%)
Brown						1.15%	1.15%
DFA						0.44%	0.44%
Goldman Sachs						0.99% (0.30%)	0.99% (0.30%)
Manning & Napier						1.01%	1.01%
Oakmark						1.37% (0.35%)	1.37% (0.35%)
Royce						1.19% (0.20%)	1.19% (0.20%)
Vanguard						0.39%	0.39%
	Simple Transition	Yes		0.75% or less	0.75% or less	0.75% or less	0.75% or less
	Moderate Transition			0.76%-0.90%	0.76%-0.90%	0.76%-0.90%	0.76%-0.90%
	Complex Transition		Sep. Acct.	0.91%-1.00%	0.91%-1.00%	0.91%-1.00%	0.91%-1.00%
			Addtl Costs	>1.00%	>1.00%	>1.00%	>1.00%

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Returns for periods greater than one year are annualized. Returns are calculated gross of investment management fees, unless noted as net of fees.

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