

Date: April 25, 2007Committee Meeting Date: May 17, 2007Board Meeting Date: June 7, 2007**BOARD MEMORANDUM**ACTION  DISCUSSION  INFO 

**TO:** Administration and Finance Committee  
Santa Clara Valley Transportation Authority  
Board of Directors

**THROUGH:** Michael T. Burns  
General Manager

**FROM:** Jerry G. Mikolajczyk  
Chief Financial Officer

**SUBJECT:** Authorize the General Manager to Terminate and Execute Agreements with the Professional Investment Management Firms.

**RECOMMENDATION:****Policy-Related Action: No****Government Code Section 84308 Applies: Yes**

Authorize the General Manager to execute an agreement with MFS Investment Management (MFS) and terminate the agreement with Pyramis Global Advisors (Pyramis) for the management of the International Growth Equity Index Fund portfolio of the VTA/ATU Pension Plan assets.

**BACKGROUND:**

Pyramis currently manages fifteen percent (15%) of the VTA/ATU Pension Plan portfolio, which is invested in an International Growth Equity Index Fund (commingled account) and valued at \$55 million as of March 31, 2007.

In December 2006, the manager of the European equity portfolio (based in Europe), which represents more than 65% of the total International Equity portfolio managed by Pyramis, left the firm. Pyramis appointed two managers (based in Boston) to replace him. While the new managers have portfolio management experience, Mercer Investment Consulting (Mercer), VTA's professional investment consultant, expressed concern that their experience is not at the same level as the previous manager and is likely to result in a significantly different product.

**DISCUSSION:**

VTA has retained Mercer to monitor our money managers' performance. Money managers whose investment performance falls below expectations are typically notified that they have been put on a "watch list" and given an opportunity to improve. If a money manager's performance continues to deteriorate, Mercer recommends termination.

In the Pyramis case, the sudden departure of the key International Equity manager, which negatively impacted the idea-generation capabilities of the European Equity team, was enough that Mercer downgraded Pyramis' rating from A to B. Mercer also recommended skipping the standard "watch list" procedure, terminating Pyramis, and searching for a new International Equity money manager. On December 12, 2006, the VTA/ATU Board of Pension (ATU Board) approved the motions to terminate Pyramis and search for its replacement and the following process took place:

- VTA engaged Mercer to search for an International Equity manager
- On February 13, 2007, Mercer presented the credentials of five Investment Management Firms to the ATU Board (Alliance, Artisan, Blair, MFS, and MSIM)
- The ATU Board selected the top three candidates (Blair, MFS, and MSIM) for interviews
- Finalists were interviewed using the following criteria:

**Organization**

- Firms that have been managing assets for at least five years, preferably longer.
- Firms with sufficient assets under management, such that our assets would not represent a significant percentage of total assets.
- Firms with a competitive and preferably negotiable fee schedule.

**Performance**

- Verifiable track record that demonstrates consistent adherence to the stated investment approach.
- Risk and return characteristics of historical data that are consistent with the prescribed benchmark.
- Performance that is generally competitive over time when compared to other managers with the same index.

On March 19, 2007 the interview panel composed of VTA Investment Manager Manny Bagnas, ATU representative Loretta Springer, and Mercer's Tom Lightvoet unanimously selected MFS for the following reasons:

- Well-diversified stock mix in the portfolio with a 25% maximum allocation to emerging markets
- Global research capabilities
- Highest (among the finalists) investment performance return of 17.3% for 5 years ending December 31, 2007
- Lowest management fees (among the finalists)

On April 16, 2007, the VTA/ATU Board of Pension approved the motion to hire MFS.

**ALTERNATIVES:**

There are no practical alternatives.

**FISCAL IMPACT:**

Based on the February 2007 balance of \$53 million International Growth Equity Index Fund (commingled) portfolio, the \$402,500 MFS management fee will be lower by \$127,500 per year compared to Morgan Stanley Investment Management's \$530,000 per year and by \$180,500 compared to William Blair Company's \$583,000 per year. Of the 3 Investment Management Firms reviewed, MFS proposed the lowest management fee of \$402,500, with Morgan Stanley Investment Management's fee at \$530,00 and William Blair Company's fee of \$583,00 per year respectively. However, the MFS management fee is higher by \$93,500 per year compared to the Pyramis Global Advisors fee of \$309,000 per year.

**Contractor Information:**

MFS Investment Management  
500 Boylston Street  
Boston, MA 02116-3741

Ownership:

Sun Life Financial Inc.	78%
Employees	22%

Prepared by: Manny Bagnas, Investment Program Manager