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**TO: BOARD OF DIRECTORS**

**FROM: RONNY GOLDSMITH** 

**SUBJECT: PROCESS FOR TERMINATION OF INVESTMENT MANAGERS AND STATUS OF CIC ASSET MANAGEMENT CONTRACT**

**ISSUE**

At the Board of Directors meeting of February 28, 1996, the Board of Directors requested a report on (1) the process by which the LACMTA Retirement Income Plan(s) Investment Board terminates investment managers and (2) the status of the CIC Asset Management ("CIC") Contract with the LACMTA Retirement Income Plan(s) ("the Investment Plan").

**BACKGROUND**

*LACMTA Retirement Income Plan Investment Manager Termination Policy*

The LACMTA Retirement Income Plan(s) Investment Board ("the Investment Board") includes 3 union representatives and 4 management representatives. In accordance with the Retirement Income Plan(s), the non-contract members of the Investment Board hold office at the pleasure of the LACMTA Board of Directors. Contract members hold office at the pleasure of their respective unions. The 4 management Investment Board members are currently appointed by the Chief Executive Officer on authority delegated by the LACMTA Board of Directors. The 3 union representatives are appointed by their respective unions.

The Investment Board makes decisions to retain or terminate investment managers based upon:

- (1) Style: An assessment of how the manager's investment strategy fits with the strategic asset allocation strategy of the total investment portfolio;

- (2) Performance: The investment performance of the investment manager relative to an established benchmark and to the performance of other investment managers with a similar investment style; and
- (3) Manager Characteristics: Investment manager work force, resources and cost effectiveness.

*Status of CIC Asset Management Contract*

The Investment Board approved the current Strategic Asset Allocation Plan in August 1995. On February 21, 1996, CIC was notified of the Investment Boards intent to terminate their contract effective March 22, 1996. CIC's contract provides for termination on 30 days notice.

The decision to terminate CIC was based upon:

- (1) Style: As a result of a strategic asset allocation restructuring recommended by the Investment Plan's consultant, Asset Strategy Consulting, the Investment Plan favors Large Capitalization Value Managers. Asset Strategy Consulting classifies CIC as a Core Manager. A Large Capitalization Value Manager buys securities that are considered out of favor, or not efficiently priced, relative to the stock market. Core Managers reflect the portfolio characteristics of the S&P500, except they do not hold as many securities.
- (2) Performance: Since inception, CIC has under performed its benchmark, returning 12.5%, versus 15.6% for the S&P/BARRA Value Index, and 14.7% for the S&P Index. CIC has under performed the benchmark for all interim periods except the last 12 months. For the year ended December 31, 1995 CIC returned 37.2%, slightly outperforming the S&P/BARRA Value Index return of 37.0%.
- (3) Manager Characteristics: According to Asset Strategy Consulting's analysis, CIC lacks the necessary workforce, resources, and processes to provide superior performance in the future.

CIC protested the termination of their contract at the February 28, 1996 meeting of the MTA Board of Directors. Subsequently, CIC met with staff and with Asset Strategy Consulting to discuss the reasons for the termination of their contract. On March 11, 1996 CIC made a presentation to the Retirement Income Plan's Investment Board.

CIC presented the following reasons for their contract to be retained:

- (1) Style: CIC has restructured its investment portfolio and should be considered a Large Capitalization Value Investment Manager.
- (2) Performance: Their investment performance has significantly improved over the past 12 months. For the calendar year 1995, CIC outperformed the S&P/BARRA Value Index by 20 basis points.
- (3) Manager Characteristics: During their four year tenure, CIC has significantly upgraded its resources, personnel and administration.
- (4) Cost Effectiveness: CIC's fee schedule is comparable to other managers with similar size investment portfolios. Their fee of 75 basis points on the first \$15 million under management is typical of the tiered fee schedule of most investment managers.

The Investment Board voted to:

- (1) Reinststate CIC;
- (2) Evaluate CIC's investment performance as well as the investment performance of all other investment managers as of September 30, 1996;
- (3) Use the Russell 1000 Value Index as a benchmark to evaluate CIC's Investment performance (net of fees) and to include that benchmark as part of their contract. The Russell 1000 Value Index contains securities that generally have low price-to-book and low price-earnings ratios; and
- (4) Develop a written Emerging Manager Investment Policy. (Emerging managers are qualified Minority /Women Owned Business Enterprises, and Disadvantaged Business Enterprises. Currently the Investment Plan has four emerging investment managers.)

It is expected that the Investment Board will maintain the current criteria of style, performance, and cost effectiveness to decide whether an investment manager will be retained or terminated. The performance of each manager is formally evaluated every quarter and reported to the Investment Board by Asset Strategy Consulting. In addition each manager is scheduled to make at least one formal presentation annually to the Board. The Emerging Manager Investment Policy will address any special consideration in evaluating the performance of these smaller firms.