CITY OF SANTA CLARA

REVIEW OF FOREIGN SECURITIES IN THE SELF-DIRECTED BROKERAGE ACCOUNT

457(b) DEFERRED COMPENSATION PLAN

SUMMARY

The Committee recently approved the addition of options within the self-directed brokerage account (SDBA) and has requested a brief document considering the pros and cons of allowing the use of foreign securities in order to support informed decision making. This document explores the potential advantages and disadvantages of adding these securities to the SDBA, along with another consideration of participant education, before ultimately providing a recommendation from the Fiduciary Consulting Group.

FOREIGN SECURITIES

Foreign securities are accessible to participants in several ways; American Depositary Receipts (ADRs) or through direct investment. ADRs are a simplified route for US investors to hold foreign securities as they trade on US stock exchanges, like the NYSE or NASDAQ. Crucially, ADRs are denominated in US dollars, trade during US market hours, and pay any dividends in US dollars. Direct investment involves participants purchasing individual stocks or bonds through the SDBA provider on foreign stock exchanges. By allowing participants to access domestic equity markets, they currently have access to ADRs. The below table outlines the pros and cons specifically in relation to allowing participants access to direct investing.

Description	Pro (+) or Con (-)	Primary Advantage/Disadvantage for Participants
Diversification	+	Reduces portfolio dependance on the US economy alone; provides access to different industries/sectors; potentially lowers overall portfolio volatility due to imperfect correlation with US assets.
Access to Global Growth	+	Opportunity to invest in economies potentially growing faster than the US; broadens the investment universe beyond US-only companies.
Potential Currency Benefit	+	Possibility of enhanced returns if the US dollar weakens relative to the foreign currency of the investment.
Currency Risk	-	Fluctuations in exchange rates negatively impacting the USD value of investments and returns. Complexity in understanding and predicting currency movements.
Political/Economic	-	Instability, policy changes, nationalization, capital controls, economic downturns, or sovereign debt in the host country harming investment value. Higher risk in emerging markets.
Regulatory/Legal	-	Differing accounting/disclosure standards hindering analysis. Unexpected regulatory changes. Difficulty in seeking legal remedies against foreign entities.
Market/Liquidity	-	Lower trading volumes making it difficult to buy or sell without impacting price. Different market operating hours and procedures adding complexity.

PARTICIPANT EDUCATION

If the committee approves foreign securities, a robust and targeted educational program is essential. Participants would need clear, accessible information covering: the nature of foreign securities; a detailed explanation of specific risks (regulatory, liquidity, etc.); examples of how exchange rates can impact returns, reinforcement of key investment principles like diversification, asset allocation, and understanding one's own risk tolerance. As part of their fiduciary duty, the Committee should also consider the overall financial literacy, investment experience, and retirement planning needs of the participant base when weighing whether to add foreign securities to the SDBA.

RECOMMENDATION

The Fiduciary Consulting Group recommends allowing participants access to invest in foreign securities within the brokerage account. By allowing participants access to these securities, the committee increases the plan’s overall competitiveness by offering additional flexibility to sophisticated participants who may otherwise look to transition their retirement assets away from the plan after they are separated from service. Furthermore, the risk profile of foreign securities does not materially expand the risk profile of the overall SDBA.

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