The Nuts and Bolts of Public Defined Contribution Plans

Presented by:
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Director of Retirement Solutions

Putting clients first.
Today's Topics

• **Under Pressure**
  Retirement Industry Trends

• **What's Love Got To Do With It**
  Fiduciary Responsibilities

• **Who Are You?**
  Plan Partners

• **Bridge Over Troubled Water**
  Governance Best Practices

• **The Times They Are A-Changin’**
  Plan Design & Investments

• **Suspicious Minds**
  Fees & Expenses

• **What's Going On?**
  Benchmarking Fees & Conducting RFPs
UNDER PRESSURE
Industry Trends

- Continued pension reform and other political pressures
- Increased plan governance by formal plan committees
- Fee disclosure rules
- Public scrutiny and lawsuits
- Advances in recordkeeping technology
- Participant education and comprehensive retirement planning solutions
- Vendor consolidation
<table>
<thead>
<tr>
<th>Plan Types</th>
<th>401(k)</th>
<th>403(b)</th>
<th>457(b)</th>
<th>401(a)</th>
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<tbody>
<tr>
<td></td>
<td>Corporations</td>
<td>Colleges</td>
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<td>Hospitals</td>
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<td>Defined Contribution</td>
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<td>Employee money</td>
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## Shift in Risks

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<tr>
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<th>Defined Benefit</th>
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<tr>
<td>Plan Investment Selection</td>
<td>Employer</td>
<td><strong>EMPLOYER</strong></td>
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<td>Diversification / Asset Allocation</td>
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<td>Employee</td>
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<td>Determines Plan Expenses</td>
<td>Employer</td>
<td><strong>EMPLOYER</strong></td>
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<td>Pay Plan Expenses</td>
<td>Employer</td>
<td>Employee</td>
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<td>Funding (Plan Contributions)</td>
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<td>Employee</td>
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<td>Retirement Income</td>
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<td>Employee</td>
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</table>
WHAT'S LOVE GOT TO DO WITH IT
From The Headlines

Sued Over Stable Value Fund Fees

Lawsuit Challenges TDF Selection, Excessive Fees

Participants of Fiduciary

Led Breach

☑ Excessive fees
☑ Too many options
☑ Proprietary offerings
☑ Lack of oversight and ongoing due diligence

Plans Still In W
d Challenge Plan Fees

Fid's New Targets

Tairs: New Cases

EXTRA! EXTRA!
READ ALL ABOUT IT!
Accountability

- Integrity of procedures & processes
- Held to the standard of a prudent person
- Adoption of policies & procedures
- Continuous monitoring

As administrator of the City’s 457 Plan “Plan”, the City has fiduciary obligations for the oversight of the Plan. **Fiduciary obligations are not centered upon the success of the Plan, but on the integrity of the procedures and processes that are developed and implemented for the Plan.** Fiduciary status confers an expectation that the fiduciary is knowledgeable of its obligations and that it acts in the interests of the Plan participants.

The obligations for an administrator for a 457 Plan are described in the Government Code Chapter 609. The obligations include:

- Develop and implement criteria and procedures for evaluating a vendor’s qualifications and its investment products to determine whether they are acceptable.
- Create and implement requirements for vendors and their employees for disclosure, reporting, standards of conduct, solicitation, advertising, relationships with current employees, and any other matters the City deems relevant to preserve the integrity of the Plan.

Once developed, these processes should be calendared for periodic review to ensure ongoing compliance. Expertise should be obtained to assist the City in performing these duties.

Although not specifically called for in the Code, as a fiduciary the City will be held to a standard of a prudent person in the performance of its Plan duties. This includes adopting policies related to investment practices, specifically an investment policy statement; a decision making system for selecting a plan investment manager; requiring periodic reporting of Plan performance in order to have effective oversight of the investment performance that is based upon the standards set forth in the Investment Policy Statement; and, remediation methods for the management of funds whose performances represent exceptions or deviations to the stated objectives of the investment Plan.

In sum, this is not a process that runs itself; it requires a commitment to the adoption of policies and procedures that at least meet the above and effective monitoring throughout the life of the Plan. Persons who assume any of these duties on behalf of the City must be well versed in and committed to these obligations.
• **ERISA – Employee Retirement Income Security Act of 1974**
  – regulates employer-sponsored retirement plans
  – imposes specific duties on plan fiduciaries

• **DOL – Department of Labor**
  – Enforces ERISA and ensures employers are making decisions in the best interest of plan participants

• **Florida Statute 112.656 Fiduciary duties; certain officials included as fiduciaries.**
  – A fiduciary shall discharge his or her duties with respect to a plan solely in the interest of the participants and beneficiaries for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan.
Do you…

✓ Have any discretionary authority or responsibility in the administration of the plan?
✓ Exercise any authority and/or control over the management or disposition of plan assets?
✓ Render investment advice to the plan and/or its participants for a fee or other compensation, whether direct or indirect?

Or do you…

× perform certain ministerial administrative functions within a framework of the plan’s policies, practices and procedures?

The key to determining the fiduciary status is based on function and not simply on title.
WHO ARE YOU?
Plan Partners

• **Recordkeeper**
  • Provides recordkeeping, plan administration and participant education
  • **Best Practice:** Consolidate to single provider & require them to be open architecture with investments and transparent with fees

• **Investment Manager**
  • Manages an investment portfolio in accordance with specific objectives
  • **Best Practice:** simplified, open architecture investment lineup of 10-20 investments and a pre-diversified option (ie. Target date funds)

• **Consultant**
  • Assists with investment monitoring and fiduciary support
  • **Best Practice:** Committee should consider engaging a consultant if they feel they lack the knowledge or expertise to make sound fiduciary decisions
BRIDGE OVER TROUBLED WATER
Traditional Problem Areas

- No IPS
- No Documentation
- No Oversight
- No RFP
- Poor Value
Duties of a Fiduciary

- Duty of Loyalty
- Duty to Act Prudently
- Select & Monitor Investments
- Pay Reasonable Expenses
Fiduciary Responsibilities

**Fees**
- Ensure fee transparency
- Understand who is receiving fees
- Benchmark fees & services
- Monitor services that are provided
- Understand indirect revenue generated by the plan

**Investments**
- Construct and follow an Investment Policy Statement
- Create a simple, sensible menu
- Monitor lineup regularly
- Provide tools for participants and measure employee engagement
Create a plan committee

Hold regular committee meetings that include a review of:

- Investments
- Recordkeeper(s)
- Other professionals

Document these meetings and any relevant discussions or decisions

Implement and regularly review an Investment Policy Statement

Hire a professional to help, when appropriate

Conduct regular RFPs to benchmark fees & services
THE TIMES THEY ARE A-CHANGIN’
According to the PLANSPONSOR Defined Contribution Survey:

- # of investments offered: 23
- # of index funds offered: 6
- # of funds held by participants: 4
ERISA 404(c) Compliance

1. Broad range of investments (at least 3)
2. Participant control and ability to diversify to minimize the risk of large losses
3. Sufficient and appropriate investment information is regularly provided
• 70%+ of participants want someone else to make the investment decision

• **Solution:** Pre-diversified funds
  – Target Date Funds
  – Balanced Funds
  – Target Risk Funds
  – Managed Accounts
20% of participants have a moderate comfort level making investment decisions

**Solution:** Core lineup of 10-20 funds including active & passive options

<table>
<thead>
<tr>
<th>Very Basic</th>
<th>Basic</th>
<th>Moderate</th>
<th>Complex</th>
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<tbody>
<tr>
<td>Cash</td>
<td>Cash</td>
<td>Cash</td>
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<tr>
<td>US Aggregate Bond</td>
<td>US Aggregate Bond</td>
<td>US Short Bond</td>
<td>US Short Bond</td>
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<td></td>
<td>US Mid Cap Equity</td>
<td>US Long Bond</td>
<td>US Long Bond</td>
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<tr>
<td></td>
<td>US Small Cap Equity</td>
<td>US Large Cap Growth</td>
<td>US TIPS</td>
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<td>International Equity</td>
<td>US Large Cap Value</td>
<td>US High Yield</td>
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<td>US Mid Cap Growth</td>
<td>International Bond</td>
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<td>US Mid Cap Value</td>
<td>Emerging Mkts Bond</td>
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<td></td>
<td>US Small Cap Growth</td>
<td>US Large Cap Growth</td>
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<td>US Small Cap Value</td>
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<td>International Equity</td>
<td>US Small Cap Growth</td>
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<td>Commodity</td>
<td>Commodity</td>
<td>International Growth</td>
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<td>US REITs</td>
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<td>International Small Cap</td>
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<td></td>
<td></td>
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<td>Intl REITs</td>
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</tbody>
</table>

Source: Morningstar
• Less than 10% of participants consider themselves savvy investors
• **Solution:** Self directed brokerage

The Self Directed Brokerage Option allows participants to contribute retirement plan savings into a greatly expanded range of investment choices including, stocks, bonds, and mutual funds. Transaction fees vary and there is often an account set-up fee and an annual account fee.
SUSPICIOUS MINDS
HORRIFYING
Comparing Fees Traditionally
Types of Fees

Plan Administration
- Recordkeeping
- Participant education

Investments
- Explicit - Fund expenses
- “Hidden” - 12b-1, subTA, Proprietary fees

Other
- Investment Advisor / Consultant
- Attorney
The real cost of paying too much in fees!
What an extra 1% in fees could cost you in the long run...

Extra savings: $500,000

Extra spending: 10+ years
WHAT’S GOING ON?
A County Considers Consolidation

Current

- Total Plan Assets:
  - $30M

- Total Plan Providers:
  - Vendor A
  - Vendor B
  - Vendor C

- Total Investment Options:
  - Vendor A (37 + TDF + Risk)
  - Vendor B (36 + TDF + Risk)
  - Vendor C (16 + TDF)

Purposes of Consolidation

- Leverage economies of scale to reduce recordkeeping fees
- Utilize best practices for fee transparency and equalization
- Simplify investment lineup using open architecture approach and lowest net expense share classes
- Offer unified, comprehensive education and communication program across the County
- Streamlining plan administration for Staff
Current Recordkeeping Fee Summary

Current

- Plan Assets:
  - $30M

- Est. Recordkeeping Fees ($):
  - $230,000

- Est. Recordkeeping Fees (%):
  - 0.76%

<table>
<thead>
<tr>
<th>Constitutional</th>
<th>Vendor A</th>
<th>Vendor B</th>
<th>Vendor C</th>
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<tbody>
<tr>
<td>Group A</td>
<td>$14.2M</td>
<td>$8.3M</td>
<td>$2.8M</td>
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<tr>
<td>Group B</td>
<td>$0.4M</td>
<td>$1.1M</td>
<td>$0.5M</td>
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<td>Group C</td>
<td>$0.3M</td>
<td>$1.4M</td>
<td>-</td>
</tr>
<tr>
<td>Group D</td>
<td>$0.6M</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Group E</td>
<td>-</td>
<td>$0.2M</td>
<td>-</td>
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<tr>
<td><strong>Total Assets</strong></td>
<td><strong>$15.5M</strong></td>
<td><strong>$11.0M</strong></td>
<td><strong>$3.3M</strong></td>
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## Simplified Fund Lineup

### S&P 500 Index Example

<table>
<thead>
<tr>
<th>Funds</th>
<th>Participant Balance</th>
<th>Fund Expense</th>
<th>R/ K Fee (%)</th>
<th>R/ K Fee (per head)</th>
<th>Inv Advisory</th>
<th>Total Annual Fees ($)</th>
<th>Total Annual Fees (%)</th>
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</thead>
<tbody>
<tr>
<td>S&amp; P 500 Index #1</td>
<td>$10,000</td>
<td>0.17% $17</td>
<td>0.95% $95</td>
<td></td>
<td></td>
<td>$112</td>
<td>1.12%</td>
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<tr>
<td>S&amp; P 500 Index #2</td>
<td>$10,000</td>
<td>0.20% $20</td>
<td>0.95% $95</td>
<td></td>
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<td>$115</td>
<td>1.15%</td>
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<tr>
<td>S&amp; P 500 Index #3</td>
<td>$10,000</td>
<td>0.06% $6</td>
<td>0.34% $34</td>
<td>0.10% $10</td>
<td></td>
<td>$ 50</td>
<td>0.50%</td>
</tr>
<tr>
<td>S&amp; P 500 Index #4</td>
<td>$10,000</td>
<td>0.04% $4</td>
<td>0.40% $40</td>
<td>$16</td>
<td></td>
<td>$ 60</td>
<td>0.60%</td>
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<tr>
<td>S&amp; P 500 Index</td>
<td>$10,000</td>
<td>0.04% $4</td>
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<td></td>
<td>$ 4</td>
<td>0.04%</td>
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<tr>
<td>Recordkeeping Fee</td>
<td>$10,000</td>
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<td>0.12% $12</td>
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<td>$ 12</td>
<td>0.12%</td>
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<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td><strong>$ 16</strong></td>
<td><strong>0.16%</strong></td>
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S& P 500 Index 10,000 $ 0.25% $25 $ 25 $ 0.25%
Anticipated Savings

Consolidated

- **Plan Assets:**
  - $30M

- **Single Plan Provider:**
  - Vendor A

- **Investment Options:**
  - 10-20 core investments
  - Target Date funds (TDFs)

- **Recordkeeping Fees ($):**
  - $36,000 - $75,000

- **Recordkeeping Fees (%):**
  - 0.12% - 0.25%

- **Annual Fee Savings:**
  - $150,000 - $200,000

<table>
<thead>
<tr>
<th>Constitutional</th>
<th>Single Provider</th>
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<tr>
<td>Group A</td>
<td>$25.3M</td>
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<tr>
<td>Group B</td>
<td>$1.94M</td>
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<td>Group C</td>
<td>$1.7M</td>
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<tr>
<td><strong>Total Assets</strong></td>
<td><strong>$29.7M</strong></td>
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</table>
Impact of Fee Savings Over 30 Years

Calculation based on $10k starting balance, $40k annual salary, 7% contribution rate, 6% rate of return, & 2.5% annual salary increase
Things to Consider when Evaluating Plans

• When were the plan(s) fees and services last benchmarked?
• Determine if consolidation is possible
• Identify if any restrictions in current plans might adversely impact process
• Ensure all parties understand fiduciary responsibilities and agree with primary objective to improve participant value
• Outline goals and objectives for project
• Notify employees in advance of issuing the RFP
• Invite representation from employee unions to be part of the review process
• Recognize the politics but remember there is still a fiduciary duty
• Understand that the typical RFP process will take 4-6 months based on schedules and complexity
Prudence is a process…
but only if you can prove it!

- Have a process
- Follow that process
- Document, document, document
Putting clients first.