

Deferred Compensation Plan BOARD REPORT 12-35

Date: July 5, 2012
To: Board of Deferred Compensation Administration
From: Staff
Subject: Recommendation to Approve Funding for a Senior Management Analyst I Position

*Board of Deferred
Compensation Administration
Eugene K. Canzano, Chairperson
John R. Mumma, Vice-Chairperson
Cliff Cannon, First Provisional Chair
Tom Moutes, Second Provisional Chair
Sangeeta Bhatia, Third Provisional Chair
Michael Amerian
William Raggio
Robert Schoonover
Margaret M. Whelan*

Recommendation:

That the Board of Deferred Compensation Administration approve the recommendation of staff and the Plan Governance and Administrative Issues Committee to approve funding a new Senior Management Analyst I position as part of Personnel Department staffing for the City's Deferred Compensation Plan.

Discussion:

At its April 17, 2012 meeting, the Board directed the Plan Governance and Administrative Issues Committee to study the merits of and options for funding a new Senior Management Analyst I position for the City's Deferred Compensation Plan. At a meeting held July 3, 2012, the Committee reviewed the attached report from staff addressing this matter.

The Committee concurred with staff's findings as to the merits of adding the position. The Committee further concurred with staff's findings that the position can be funded with existing resources. The Committee acted to recommend approval of funding for a new Senior Management Analyst I position, but requested that staff provide additional information to the Board regarding contingency options available should the revenue assumptions utilized in staff's five-year projection not be realized. Staff has identified the following contingency options:

- (1) **Increase Plan Revenues** – As noted in the Committee report, the five-year cost of funding a Senior Management Analyst I position is approximately \$836,267. Based on a sharp increase in Plan assets over the past six months, revenue projections over a five-year period have likewise risen by over \$1 million and thus provide ample resources to fund the position. If for some reason those assumptions were not realized, there are several means by which Plan revenues could be increased.

For example, an increase of the fee cap from the current \$125 to \$140 would raise the approximate amount of the cost of the new position. This option may be the most attractive because the impact would be relatively modest for the larger account-holders that would be subject to the fee cap increase (it would only impact accounts valued at \$125,000 or higher, and the assessment would be an additional

\$3.75 per participant per quarter), and because of the limited size of the population that falls within this category (presently 8,823).

Another option for increasing Plan revenues would be a more generalized increase in the asset-based fee. For example, increasing the asset-based fee from 0.10% to 0.11% would raise the approximate amount of the cost of the new position. This would impact all accounts valued at less than \$125,000 (presently 30,992).

Other revenue-producing options include imposing service fees on certain participant transactions or processes (e.g. a \$5 service fee on distribution requests or new loan applications, or service fees for processing Qualified Domestic Relationship Orders, etc.). These options, however, would not by themselves produce sufficient revenue to cover the cost of the new position entirely, so they might be applied only to cover a smaller funding gap.

- (2) **Reduce Plan Expenses** – The other contingency option for addressing any shortfall would involve reducing Plan expenses. Virtually all Plan expenses are either (a) mandated contractually (e.g. Plan administrator fees, blended fund fees, Board elections); (b) driven by participant activity (e.g. hardships); or (c) are in amounts too small to provide meaningful expense reduction opportunities (e.g. training, office/admin, tax counsel). One exception to this is consulting, but given upcoming procurements, ongoing administrative issues and communication objectives of the Plan, it is not realistic to anticipate any meaningful reduction in consulting costs. As a result, the only viable option for reducing Plan expenses would be to lay off a position within the Plan (or not fill a vacancy if it occurred).

The sharp increase in forecasts for Plan revenues appears sufficient to fully fund the cost of the new Senior Management Analyst I position over five years. Staff continuously reviews the status of Plan budget accounts and updates five-year forecasts with the Board during quarterly budget reviews. As a result, should a sustained and material change in staff's projections occur, there will be ample opportunity to address it. Staff therefore concurs with the Committee's recommendation to approve funding for a new Senior Management Analyst I position as part of Personnel Department staffing for the City's Deferred Compensation Plan

Submitted by: _____
Steven Montagna

Approved by: _____
Alejandrina Basquez

Deferred Compensation Plan PLAN GOVERNANCE COMMITTEE REPORT 12-01

Date: June 25, 2012

To: Plan Governance & Administrative Issues Committee

From: Staff

Subject: Proposal to Approve Funding for a Senior Management Analyst I Position

Board of Deferred Compensation Administration
 Eugene K. Canzano, Chairperson
 John R. Mumma, Vice-Chairperson
 Cliff Cannon, First Provisional Chair
 Tom Moutes, Second Provisional Chair
 Sangeeta Bhatia, Third Provisional Chair
 Michael Amerian
 William Raggio
 Robert Schoonover
 Margaret M. Whelan

Recommendation:

That the Plan Governance and Administrative Issues Committee recommend that the Board of Deferred Compensation Administration approve funding a new Senior Management Analyst I position as part of Personnel Department staffing for the City's Deferred Compensation Plan.

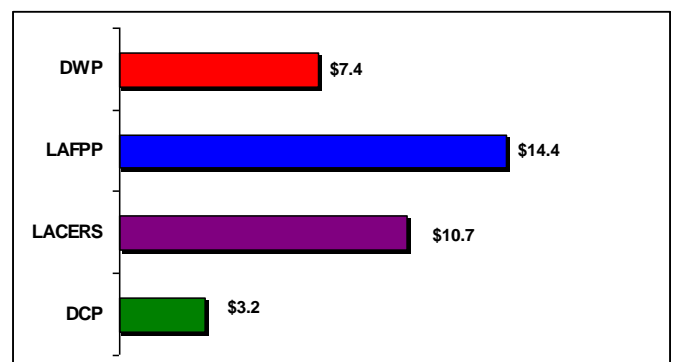
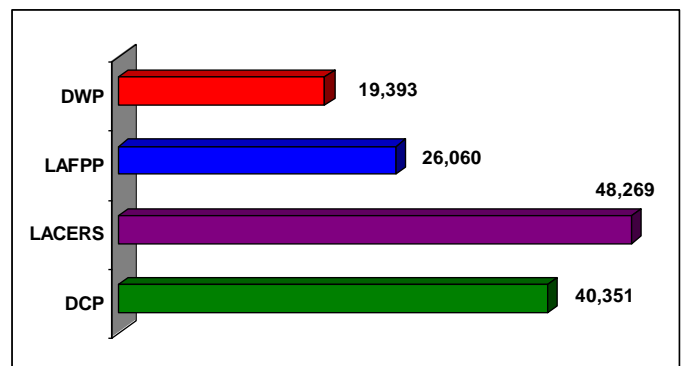
Discussion:

At its April 17, 2012 meeting, the Board directed the Plan Governance and Administrative Issues Committee to study the merits of and options for funding a new Senior Management Analyst I position for the City's Deferred Compensation Plan. At the meeting, staff presented a report indicating that the Personnel Department had included within its budget request for Fiscal Year 12/13 the addition of a new Senior Management Analyst I position to the Plan. This position was subsequently included in the adopted budget.

Adding this position has not been previously considered by the Board because the opportunity for the Personnel Department to request it as part of this year's budget request occurred with little advance notice. The Committee was directed by the Board to review the merits for adding and funding the position and return with a recommendation.

Position Justification

As the Board is aware from data provided in the January 2012 Plan Demographics Training, the City's Deferred Compensation Plan is comparable in size and scope to the City's other three retirement/pension plans. The Plan has over \$3 billion in assets and over 40,000 participant accounts. It has recently achieved a 70% participation rate, which is



significantly higher than the governmental defined contribution plan average of 22%. Presently the City devotes only a fraction of the staffing resources to its Plan compared to the staffing resources devoted to the City's three retirement plans relative to the populations they serve:

Plan	Staffing	Plan Participants	Ration of Staff to Participant Population
Pensions	100	26,090	1 : 261
DWP	58	19,393	1 : 334
LACERS	127	48,269	1 : 380
DCP	3.8	40,336	1 : 10,615

Although this staffing differential is partially explained by the fact that the retirement systems perform their recordkeeping functions in-house, rather than using a contracted Third-Party-Administrator (TPA), it is also true that staffing for the program has changed very little from a period of time when the Plan was smaller and considerably less complex, as illustrated by the following table comparing size/activity from 1995 vs. the present:

Metrics	1995	2012	Growth Rate
Plan Assets	\$ 702,213,742	\$ 3,245,911,916	362%
Participant Accounts	23,886	40,351	69%
Contracts	2	15 ¹	650%
Distributions	749	15,868	2019%
Loans	0	7,200	-
Staff Positions	3	3.8	27%

The administrative complexity of Section 457 plans has grown immensely in the past 15 years, with Federal rules allowing new features such as unlimited distributions, expanded rollovers, loans, and a Roth 457 savings option. At the same time, the Plan's oversight burden is expanding rapidly with a growing number of procurements, contracts, regulatory requirements, administrative challenges and communications objectives.

It should further be noted that staff are responsible for conducting procurements and negotiating contracts involving fees of tens of millions of dollars. As an example, over the

¹ Estimated number of total contracts following implementation of redesigned investment menu, which is likely to add approximately eight investment management services contracts to the current total of seven contracts for administration, consulting, and investment management.

next two years staff will be initiating procurements which may result in as many as 15 total Plan contracts. This includes not only investment services procurements, but a custodial procurement and possibly Plan audit procurement as well.

In staff's view, the staffing resource base should be commensurate with the size, scope, responsibilities, and complexity of the Plan. Critical new endeavors in communications, participant services, asset retention, contract monitoring, and retiree income protection (to name just a few) will need appropriate professional level resources in order to be executed in a timely, effective and competent manner.

In addition, staff believes it is crucial to begin developing deeper staffing resources to assure organizational continuity over time. Defined contribution plan administration is a highly specialized field. The knowledge and experience base cannot be easily replicated. Over-reliance on too small a staffing contingent leaves the Plan vulnerable to the loss of key individuals.

A Senior Management Analyst I position would add needed depth to the Plan at a critical level and for important responsibilities such as policy development, procurement/contracting, and regulatory compliance. Staff views addition of this position as an important step forward in ensuring that the Plan has the appropriate resources to meet its mandate in future years.

Position Funding

The Board oversees reserve funds in two accounts: a fund maintained with Great-West Retirement Services (which holds the bulk of reserve assets) and a small fund maintained by the City Controller (which primarily functions as a pass-through vehicle for reimbursements and minor expenses). Pursuant to the Board's Governance Policies/Bylaws Section 5, these funds function as repositories for participant fees used "to meet the Plan's contractual fee obligations to the third-party-administrator" and "pay for all administrative and operating costs generated by the Plan, as approved by the Board."

Section 5.2 of the Bylaws state that the Board will prepare annual budgets and "in structuring this budget, will maintain a long-term balance between revenues and expenditures that is consistent with avoiding volatility in the collection of participant fees. In furtherance of that objective, the Board shall maintain a prudent reserve in the Trust Fund to protect against fluctuations in Plan assets."

In budgetary matters staff and the Board have used a five-year projection to smooth out the volatility that can result from shorter-term projections. The key number is the **estimated reserve amount at the end of the five-year period**. The target reserve is 50% of annual Plan operating expenses. Based on current data, this target is approximately \$1.4 million.

As part of developing a Five-Year Strategic Plan, in September 2011 staff reviewed and updated the assumptions, variables and projections for the Plan's budget accounts for the five-year period of 2012-2016. The key variable affecting Plan revenues is the **rate of increase in Plan assets**. Staff's projections at the time indicated that the estimated

reserve was consistent with the targeted reserve amount. Since that time, sharp market gains in the quarters ending 12/31/11 and 03/31/12 have resulted in rising revenue projections going forward.

The Plan's fee structure applies an asset-based fee of 0.10% on the first \$125,000 of a participant's account. The fee is capped at \$125, such that any participant with a balance larger than \$125,000 will pay no more than \$125.

Total Plan assets rose from \$2.9 billion as of 09/30/11 to \$3.4 billion as of 03/31/12, a 15% increase. In addition, the number of participants being charged the maximum fee of \$125 rose from 7,645 to 8,823 over this same time period, also a 15% increase. Projected fee revenues have risen by 7.6%.

Based on this and current assumptions regarding Plan revenue and expenses (including staffing), the projected target reserve amount over a five-year period has risen as follows:

Projected Five-Year Ending Surplus Amount 09/30/11:	\$1,170,764
Projected Five-Year Ending Surplus Amount 03/31/12:	<u>\$2,257,551</u>
Difference:	\$1,086,787

The higher projected ending five-year balance is attributable to the following three components:

Additional Projected Fee Revenue:	\$825,773
Additional Projected Interest Earnings:	\$79,276
Additional Higher Projected Beginning Balance:	<u>\$178,691</u>
Total Increase:	\$1,083,740

Adding a Senior Management Analyst I position represents an additional expense to the Plan of approximately \$836,267 over a five-year period. This includes full direct and indirect costs, and assumed cost-of-living adjustments.

Based on this information, it appears funding for the new position is available within existing Plan resources and consistent with maintaining a prudent reserve over a five-year period, as illustrated in the following table:

	3/31/2013	3/31/2014	3/31/2015	3/31/2016	3/31/2017
Starting Balance	\$ 2,870,093	\$ 2,554,992	\$ 2,253,109	\$ 1,934,441	\$ 1,631,127
Estimated Interest Earnings	\$ 86,103	\$ 76,650	\$ 67,593	\$ 58,033	\$ 48,934
Estimated Participant Fee Revenue	\$ 2,311,113	\$ 2,379,416	\$ 2,450,661	\$ 2,524,991	\$ 2,602,556
Estimated Total Revenue	\$ 2,397,216	\$ 2,456,065	\$ 2,518,254	\$ 2,583,025	\$ 2,651,490
Estimated Expenses	\$ (2,712,316)	\$ (2,757,949)	\$ (2,836,923)	\$ (2,886,339)	\$ (2,910,791)
Difference	\$ (315,101)	\$ (301,883)	\$ (318,668)	\$ (303,314)	\$ (259,301)
Estimated Surplus Balance	\$ 2,554,992	\$ 2,253,109	\$ 1,934,441	\$ 1,631,127	\$ 1,371,826
Reserve Target	\$ 1,356,158	\$ 1,378,974	\$ 1,418,461	\$ 1,443,169	\$ 1,455,395

However, it is also clear that the Plan asset amounts that underlie these projections can be volatile. Current assumptions are that Plan assets will grow by 5% annually over the five-year period. However, this projection might not be realized if investment returns and participant contributions are weaker than anticipated.

Should revenues rise less than anticipated, the Board would have a number of options for raising revenues. These options include increasing the asset-based fee and/or raising the fee ceiling cap, as well as instituting transactional fees, such as for QDRO processing or processing distribution requests. However, based on current data staff does not see a need for contemplating any of these at the present time.

Having said that, if the Committee and Board approve adding the new Senior Management Analyst position Plan assets will need to be monitored closely in coming quarters. This is particularly true at the present time given the historically unusual and in some ways unprecedented risks facing the world's developed economies and financial markets. A sharp and sustained depression in asset values would impact not only existing Plan assets but could also reduce new employee contributions.

Conclusion

Staff's review indicates that both the justification and funding exist for adding a Senior Management Analyst I position to the Plan. As a result, staff recommends that the Committee recommend to the Board approval for funding the position.

Submitted by: _____
Steven Montagna

Approved by: _____
Alex Basquez