# Deferred Compensation Plan
# BOARD REPORT 17-17



Date: June 20, 2017

To: Board of Deferred Compensation Administration

From: Investments Committee

Subject: Pension Savings Plan Service Provider

**Recommendation:**
That the Board of Deferred Compensation Administration advise the General Manager Personnel Department relative to staff's recommended selection of ICMA-RC as the bundled TPA and investment management services provider for the City's Pension Savings Plan.

**Discussion:**

## A. Background

The Pension Savings Plan (PSP) is a non-qualified tax-deferred savings program for part-time, temporary, and seasonal City employees established in 1993 under Internal Revenue Code (IRC) Section 457/3121 and City of Los Angeles Administrative Code, Division 4, Chapter 16, Sec. 4.1600-4.1615. The City's PSP was established in December 1993 to provide a retirement-savings alternative to Social Security for certain City employees not eligible to participate in one of the City's three primary defined benefit retirement/pension plans. Participation in the PSP is mandatory for those employees who are not eligible to participate in one of the City's other retirement programs. Each employee contributes 4.5% of gross salary and the City makes a matching contribution of 3.0%.

The Personnel Department is the administrator of the PSP and the General Manager Personnel Department is the contracting authority. Chapter 16 provides that the Board "shall provide advice to the General Manager of the Personnel Department regarding the administration of the Plan and regarding the methods of distribution of benefits."

City employees may have a balance in the PSP if they are part-time, temporary, or seasonal employees; or if they formerly worked within one of those categories and have since transitioned to full-time status. Participants who have account balances in the PSP and become full-time employees may elect to, if they become participants in the Deferred Compensation Plan (DCP), roll over their PSP accounts to the DCP.

## B. Discussion

This report provides an analysis and staff recommendations to the General Manager relative to responses received to the Personnel Department's Request for Proposal (RFP) for Third-Party-Administrator (TPA) and investment management services for the PSP. Presently there are **43,113 participant accounts** and **$69,509,998 in assets** under management. The contractual relationship with the incumbent provider, Empower Retirement, has been in place since July 1, 2000. Empower provides TPA services bundled with investment services in the form of a separate account Stable Value Fund. The current contract with Empower was previously scheduled to expire on December 31, 2016. Per City Council action of April 28, 2017 (CF #11-0539), the contract has been extended through October 31, 2017.

The Personnel Department released its RFP on **February 9, 201**7. Responses were due by **March 23, 2017**. All five vendors were determined to be compliant.

The RFP provided the vendor community with the option of submitting proposals for either (a) bundled TPA and investment management services; (b) TPA services only; or (c) investment management services only. The City received responses from the following providers:

| Empower | National Life | ICMA-RC | Voya | Galliard |
|---|---|---|---|---|
| Bundled TPA/ Investment Management | Bundled TPA/ Investment Management | Bundled TPA/ Investment Management | Bundled TPA/ Investment Management | Investment Management |

The RFP asked vendors proposing TPA services to indicate if they would be willing to administer another provider's investment fund. Only Voya indicated it would do so; Empower, National Life and ICMA-RC all indicated their proposals were conditional upon being awarded both TPA and investment management services. However, because Voya's TPA fee in combination with Galliard's investment management fee results in a negative rate of return for Plan participants, Galliard's stand-alone investment proposal was ultimately determined to be unviable.

A rating panel consisting of Employee Benefits Division staff members Steven Montagna and Daniel Powell evaluated the vendor responses. Segal Consultants assisted with the evaluation of the investment components of the vendor proposals. A summary of the proposals and staff's associated scoring of all of the RFP's evaluation categories and key findings is provided in **Attachment A.**

Based on its evaluation, the Division is recommending that ICMA-RC be selected as the bundled provider of TPA and investment management services. This recommendation is based on a finding that ICMA-RC is able to offer effective TPA administrative services at a lower cost while providing a higher net rate of return to PSP participants, as well as providing the City with the opportunity and flexibility to address certain longstanding administrative issues related to terminated employee participant accounts.

The RFP included questions related to the full constellation of services included under the TPA duties for this program. However, the primary weighting and focus of the RFP related to participant fees and their relationship to credited rates of return, which are of most significance to the PSP and its participants.

It should be noted that participant fees can be framed as both a per-head dollar amount and as a percent of overall assets. For contractual purposes, the City may owe a per-head fee to the TPA based on the total number of participant accounts, but the fees are assessed as a percentage of overall assets. This approach is necessary because assessing fees on a per-head basis can quickly deplete small account balances.

The manner in which the percentage is applied is as a reduction in the overall credited rate of return. As an example, if the gross rate of return is 2.50%, and total fees represent 2.00% of assets, the net credited rate of return to a participant would be 0.50%.

The chronic low interest rate environment which has been in place since the 2008/2009 recession has created persistent downward pressure on the rate of return to investors in fixed income assets such as the interest-bearing investment offering in the PSP. Although there have been recent trends suggesting higher interest rates over the near-term, those trends could quickly evaporate upon the next economic contraction.

Contractions are an inherent feature of the economic cycle. The average post-World War II U.S. business cycle expansion has lasted 56 months, or 4.7 years. The current expansion is 95 months, or 7.9 years – the third-longest in U.S. history. An economic decline that occurs prior to a more meaningful improvement in interest rates could drop those rates, and rates of return in fixed-income assets, to new lows. Under the incumbent provider's present offering, the rate of return is at high risk of going negative, which would create serious challenges for the City and PSP participants. Accordingly, the RFP analysis focused particularly on provider fees, investment offerings, and net rates of return. The performance examination provided to all three vendors was devoted exclusively to this topic.

Key findings of staff's analysis are summarized as follows:

- <u>TPA Fees</u> - ICMA-RC's TPA fee of 1.40% was the lowest of those firms (ICMA-RC, Empower, and Voya) that disclosed their administrative fees/costs. National Life proposed bundled TPA services and an annuity product that quoted zero administrative costs, but this means that those administrative costs are not transparent within the structure of the offering (because administrative costs are an inherent and necessary component of plan administration). Galliard did not propose administrative services.

| Provider | TPA Fee as Percent of Assets Under Management |
|---|---|
| ICMA-RC | 1.40% |
| Empower | 1.79% |
| Voya | 2.11% |

- <u>Investment Fees</u> – Empower had the lowest investment management fee at 0.25%; National Life does not provide a discrete investment management fee as it nets its (undisclosed) investment costs out of its credited rate of return.

| Provider | TPA Fee as Percent of Assets Under Management |
|---|---|
| Empower | 0.25% |
| Voya | 0.415% |
| ICMA-RC | 0.46% |
| Galliard | 0.47% |

- Net Rate of Return – Based on current investment portfolio rates of return and after integrating both TPA and investment management fees, ICMA-RC has the highest credited rate of return for PSP participants:

  | Provider | Credited Annual Rate of Return |
  | --- | --- |
  | ICMA-RC | 0.83% |
  | Voya | 0.49% |
  | Empower | 0.13% |

  National Life offers a 1% guaranteed minimum rate of return but its associated Contingent Deferred Sales Charges[1], which apply to the entire asset pool, render this guaranteed rate unreliable, particularly over a 3-year contract term, and create an unacceptable risk for the City and PSP participants.

- Impact of Reduction in Participant Accounts/Assets – At over 43,000 participant accounts, the PSP has a long-standing challenge with total account accumulation, including those participant accounts where the City has lost contact with the account-holder. Several options exist for addressing the accumulation of Plan accounts. An assessment of those options is not the focus of this report, but they could result in a meaningful future reduction in participant accounts and assets. Such a reduction could create additional pricing risks for the PSP, since the provider proposals included certain assumptions/conditions for their pricing. Of all the vendors, only ICMA-RC demonstrated an ability, in both its written proposal and performance examination, to work flexibly with the City in securing proposed TPA pricing (and by extension participant net rates of return) over the full contract term in the event the City elects to substantially reduce the number of accounts.

- Organizational Strength and Recordkeeping Services – ICMA-RC is a major player within the governmental defined contribution market. ICMA-RC's niche has been in the small-plan market, and the City's PSP would fit within that category. ICMA-RC services approximately 9,700 plans with over 1.2 million participant accounts and $49.4 billion in assets under management.

- Participant Services - Unlike the City's supplemental Deferred Compensation Plan, PSP participant service features are limited. Under the incumbent provider, participants don't have access to a website to obtain account information – the only information they receive about their account comes from a semi-annual account statement mailed to their homes. Under ICMA-RC, a website will be added as an information tool. The PSP does not include DCP design features such as the ability to change deferral amounts (contributions are mandatory), trade investments (since there is only one investment offering), take out loans or hardships, and other assorted

[1] Contingent Deferred Sales Charges are special surrender fees charged in certain insurance company annuity products which are applied if the investor removes its assets from the insurance company within a certain term. In the case of National Life's proposal, their charges would be in force for seven years, beginning at 7% of contract value in year one, declining by 1% each year thereafter.

services associated with supplemental plans. ICMA-RC will be able to administer and somewhat expand the minimal participant services requirements of the PSP.

Based on staff's scoring and analysis, staff's recommendation to the General Manager Personnel Department is to select ICMA-RC as the TPA and investment services provider for the PSP. The information in this report and attachments is provided to the Board for the purpose of the Board providing further advice to the General Manager relative to this decision.

Submitted by ______________________________

Steven Montagna