

County of Santa Clara

Employee Services Agency

Employee Benefits



ESA02 092909

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DATE: September 29, 2009

TO: Board of Supervisors

FROM:

A handwritten signature in cursive script that reads "Luke Leung".

Luke Leung
Deputy County Executive

SUBJECT: Administrative Services Agreement for County's IRC 457(b) Deferred Compensation Plan and IRC 401(a) Supplemental Benefit Plan (together referred to as "Plans"); New Investment Policy Statement for the Plans; Changes to Plans' Investment Options; and Expand Oversight Responsibilities and Rename the County of Santa Clara Deferred Compensation Plan Committee as the County of Santa Clara Defined Contribution Plans Committee

RECOMMENDED ACTION

Consider recommendations from Employee Services Agency relating to the County of Santa Clara's IRC 457(b) Deferred Compensation Plan and IRC 401(a) Supplemental Benefit Plan (together referred to as "Plans").

Possible actions:

- a. Approve the Administrative Services Agreement for the IRC 457(b) Deferred Compensation Plan and IRC 401(a) Supplemental Benefit Plan with International

City/County Management Association Retirement Corporation (ICMA-RC) for the period of October 1, 2009 through September 30, 2016, with the option for up to three additional automatic one-year extensions through September 30, 2019, unless the County provides 180 days notice of intent to terminate.

- b. Approve expansion of oversight responsibility for the current County of Santa Clara Deferred Compensation Plan Committee to include both the IRC 457(b) Deferred Compensation Plan and the IRC 401(a) Supplemental Benefit Plan and rename Committee as the County of Santa Clara Defined Contribution Plans Committee.
- c. Approve new Investment Policy Statement for the Plans.
- d. Approve mapping of existing Plans participants' investments to new investment options, targeted for an effective date of December 7, 2009.

FISCAL IMPLICATIONS

There are no fiscal implications to the General Fund as a result of these actions. Plan record keeping and administrative services provided by ICMA-RC for the County's defined contributions plans are funded in its entirety by fees paid for by participants in the Plans based on their individual investment selections.

However, Plan participants will realize savings from reduced compensation paid to ICMA-RC as a result of this new agreement. Under the current agreement, ICMA-RC received an estimated net \$2.0 million equivalent to about 21 basis points (0.21%) for its plan administration and investment related services in 2008, based on an average monthly plan asset value of \$927 million during the year. Under the recommended new agreement, ICMA-RC would have only received \$0.6 million for the same plan year or 6.25 basis points (0.0625%) based on the same average monthly plan asset value, a reduction of \$1.4 million or 70% from their current level of compensation. Each dollar reduced from the compensation paid to ICMA-RC results in savings to Plan participants in the form of additional direct credits to PLUS Fund participants and revenue sharing rebates to all County employee Plan participants' accounts.

While the actual compensation to ICMA-RC will fluctuate from month to month and year to year depending on the plan asset values and the mix of investment options invested in, the annual compensation to ICMA-RC is expected to increase over the long term duration of the new agreement assuming overall plan asset values increase. Correspondingly, credits and revenue sharing rebates to Plan participants will also increase.

Plan participants will also benefit from reduced investment fees charged by investment fund providers as a result of the recommended conversion of the existing Plan participants' investments to new options. Under the existing investment options, Plan participants are charged a weighted average investment expense ratio of 0.65% against their plan assets or approximately \$6.0 million annually. With the recommended conversion, the weighted average investment expense ratio will be reduced to an approximate 0.55% or \$5.1 million. This is a reduction of \$900,000 or 15% annually.

The overall projected annual savings to participants as a result of the recommended actions are estimated as follows:

| | Existing | New | Savings |
|---|-----------------|------------|----------------|
| Fees to ICMA-RC for Admin Services Agreement | \$2.0M | \$0.6M | \$1.4M |
| Net Investment Expense Fees Charged for Investment Options | \$6.0M | \$5.1M | \$0.9M |
| Total Savings to Plan Participants | | | \$2.3M |

Under the new agreement, the County will continue to receive a portion of the overall revenue sharing available to help cover the costs of administration (including dedicated County staff time), education, financial audit, and investment advisory services for the Deferred Compensation Plan Committee in overseeing the Plans. These costs are estimated at \$180,000 to \$200,000 annually.

CONTRACT HISTORY

The original agreement with ICMA-RC was approved by the Board of Supervisors on

February 23, 1999 for the period of July 1, 1999 through June 30, 2002. The agreement was subsequently amended several times as follows:

- May 15, 2001 – First Amendment to reflect minor changes to conform to regulatory requirements.
- October 30, 2001 - Second Amendment to add a self-directed brokerage account option to provide additional investment options and flexibility to plan participants.
- November 19, 2002 - Third Amendment to extend the term of the agreement to July 1, 2009 and to implement new revenue sharing requirements in order to fund ongoing costs to the County for administration of the plan, annual audit costs, and ongoing training for Deferred Compensation Plan Committee members.
- December 23, 2008 - Fourth Amendment to add plan administration responsibilities for the 401(a) Supplemental Benefit Plan which was authorized to be established by the Board on May 20, 2008.
- June 24, 2009 – Fifth Amendment to extend term of agreement through September 30, 2009 to allow adequate time to negotiate a new contract with ICMA-RC, selected through RFP process.

REASONS FOR RECOMMENDATION

New Plan Administrative Services Agreement

After an extensive RFP process earlier this year whereby ICMA-RC was selected for recommendation to the Board of Supervisors by the Deferred Compensation Plan Committee, the Board on June 24, 2009 authorized staff to enter into final negotiations with ICMA-RC.

Under the current agreement, ICMA-RC provides plan record keeper/administrative services as well as investment services. Under the new agreement (Attachment A), these services are "un-bundled" and ICMA-RC will provide plan record keeper/administrative services only. The new agreement allows for an open architecture plan enabling the County to offer lower cost investment funds from other investment managers, since there are no specified minimum requirements for including proprietary funds managed by ICMA-RC.

In addition, through the RFP and negotiation process, the County was able to secure several enhancements over the current agreement with ICMA-RC. The following is a summary of these enhancements:

1. **Fee reductions** - Under the terms of the current agreement, ICMA-RC rebates to the County a fixed amount of \$250,000 annually from the total revenue share that they receive from the Plans participants' investments in the various funds in the Plan. ICMA-RC keeps the balance, which for 2008, amounts to approximately \$1.5 million. In addition, ICMA-RC retains 15 basis points (0.15% of Plan assets) or almost \$0.5 million of the revenue share available in their Stable Value PLUS Fund and rebates to PLUS Fund participants and to the County the amount in excess of the 15 basis points. As Plan asset values increase over time, ICMA-RC's revenue share increases more than the rebates to the County since a portion of the rebates are fixed.

Under the terms of the new agreement, ICMA-RC will receive only 6.25 basis points (0.0625%) of all Plan assets, which using 2008 figures would amount to less than \$0.6 million. Any amounts received in excess of the 6.25 basis points would be rebated to the Plan participants and to the County. With this new agreement, the Plan participants and the County will receive a much larger portion of the total revenue share that ICMA-RC currently receives from the mutual fund companies. The County will continue to use a small portion of the rebate to cover plan administration costs, with the bulk of the rebate distributed back to participants.

The new agreement is also structured to allow the County to offer more lower cost fund options, thus providing Plan participants additional direct savings in the form of lower investment fees up front.

2. **Annual Marketing Plan** - ICMA-RC will meet with the Committee to develop an annual marketing plan and customer service performance standards. The marketing plan will outline strategies and tactics to achieve clear performance goals, with quarterly and yearly progress reviews. Possible Year One objectives would be to increase focus on specific County departments with lower plan participation rates to encourage and promote enrollment in the Plans, and to promote the enhanced Financial Planning services being offered to all participants.

While the current agreement included certain standard customer service performance goals, there was not a clear process to track and monitor results. Under the new agreement, ICMA-RC will provide a more focused effort to jointly develop with the Committee both the marketing plan and key customer service performance goals to be tracked and reported throughout the year to the Committee.

3. **Certified Financial Planning Services** – Under the current agreement ICMA-RC offers two levels of individual financial planning services – 1) a general Financial Needs Assessment (15-20 page personalized report), free to all Plan participants; and 2) a detailed Comprehensive Financial Plan (60+ page personalized report), free to all participants with an account balance of \$200,000 or more, or for a fee of \$375 for those not meeting the minimum balance.

To expand the usage and increase the affordability of financial planning services, under the new agreement, ICMA-RC is offering an additional level of service in the form of Goal-Specific Plans. This new intermediate level of financial planning service offers Plan participants an option to focus on up to two of five potential financial areas for their financial plan, providing a 20-30 page personalized report. The normal fee for this service is \$175, but is waived for all County employee participants.

In addition, the minimum account balance requirement for waiving the fee for the Comprehensive Financial Plan service will be reduced from the current \$200,000 to \$100,000, allowing more participants to take advantage of this valuable service.

4. **Brokerage Account Fee Waiver** - Under the terms of the new agreement ICMA-RC will waive the standard \$50 annual brokerage fee for those participants who use the Self Directed Brokerage Account exclusively for the purpose of purchasing Certificates of Deposits ("CD's"). This enhancement meets the needs of those participants seeking additional options for CD investments other than the CD program offered by ICMA-RC. This is particularly important for our participants who are more risk-adverse and seeking more federally insured savings options given the uncertainty in the equity market.

Expand Oversight Responsibility for Deferred Compensation Plan Committee and Rename as County of Santa Clara Defined Contribution Plans Committee

The County of Santa Clara Deferred Compensation Plan Committee ("Committee") has had oversight responsibilities for the IRC 457(b) Deferred Compensation Plan since its inception in 1980. With the establishment of the IRC 401(a) Supplemental Benefit Plan at the end of December 2008, it is necessary to designate oversight responsibility for that plan as well.

Both plans are currently administered by ICMA-RC and offer the same investment options to its participants and will continue to do so under the terms of the new agreement. For ease and efficiency of administration, it makes sense for the same Committee to have oversight for both plans. At its July 30, 2009 meeting, the Committee voted to accept oversight for both plans, subject to the approval of the Board of Supervisors. Upon approval by the Board of Supervisors, the Committee will be known as the County of Santa Clara Defined Contribution Plans Committee to

recognize its broader oversight responsibility. Plan Documents will be updated at a later date to reflect that change accordingly.

New Investment Policy Statement

An existing Investment Policy was established in March 2004 by the Committee with the assistance of a consultant. While the Policy was never brought forward for formal approval by the Board of Supervisors, the Policy has served as an important guide to the Committee over the past several years whenever changes to investment options were considered and recommended to the Board for approval.

As part of the Committee's due diligence and in anticipation of changes to the current investment line-up, the Committee retained consultants Arnerich, Massena & Associates, Inc. to review the existing policy and suggest changes or updates. Upon consultation with the committee, a new policy (Attachment B) was drafted that better reflects and documents the purpose of the Investment Policy Statement, and the processes and policies to be used to manage the investments offered by the plan. In addition, the new Investment Policy Statement spells out the roles and responsibilities of the Committee and other key parties involved with the oversight and administration of the Plans.

Since changes to Plan investment options have historically been brought to the Board of Supervisors for final approval after vetting at the Committee level, it makes sense that an Investment Policy Statement should also require Board approval. All investment options offered by the Plans and the process for evaluation and selection of these options would need to be consistent with the Investment Policy Statement.

Mapping of Existing Investments to New Investment Options

With the new administrative services agreement structured to allow for an open architecture design for the Plans, the Committee as part of its fiduciary responsibility engaged the services of Arnerich Massena & Associates to perform a comprehensive financial performance review of the current line-up of investment options offered in the Plans.

The purpose of the review was to: 1) determine whether the current investment funds are performing consistent with the benchmark and criteria established under both the current and proposed Investment Policy Statement; 2) recommend whether or not current investment funds should be retained or replaced and mapped to better performing and/or lower cost funds; 3) where possible, recommend whether certain fund categories should be consolidated to fewer options within each category in order to eliminate redundancy and to help simplify the decision making process for Plan participants; and 4) provide recommendations for replacement fund options for the Committee to consider.

Attachment C provides a summary of the recommended changes and the proposed mapping to other investment options, consistent with the purpose of the review stated above. The recommended changes include a consolidation from 49 down to 42 investment funds, 14 fund changes including several to Vanguard funds which are among the lowest costs

funds in the market, 8 changes to lower cost institutional share classes within the fund group due to the large size of the County's plan investments, and 6 changes to very low cost institutional money market or index funds all of which are to Vanguard products. As noted earlier in the Fiscal Implications, these changes will result in direct reductions of investment expense fees charged to Plan participants estimated at approximately \$900,000 annually based on the proposed mapping.

Upon approval by the Board of Supervisors, the Committee will coordinate with ICMA-RC and Arnerich Massena & Associates with the implementation of the conversion targeted for a December 7, 2009 effective date. Plan participants will be notified in writing of the upcoming fund changes. Those with assets in funds that are going to be replaced will have the option of allowing the affected fund to map to the proposed fund by default or if they so choose, they can elect to map to an alternative fund or funds of their choice within the available new options.

BACKGROUND

The County of Santa Clara Deferred Compensation Plan ("Plan") was established in 1980, pursuant to Sections 53212 to 53214 of the Government Code of the State of California, and Section 457 of the U.S. Internal Revenue Code. It provides County employees the opportunity to defer receiving a portion of their current compensation until retirement, termination of employment, death, or other events as provided in the Plan Document.

The Plan is overseen by a seven-person committee appointed by the Board of Supervisors to perform the duties designated in the Plan Document. The committee's duties and authority are described in the Plan Document, specifically in Article V, below:

5.01 Authority of the Committee: The Committee shall have the sole power and authority to adopt, alter, amend, revoke or interpret any rules and policies, necessary for the administration of the Plan, provided they are not inconsistent with the provisions of the Plan of Section 457 of the Code and any rules or regulations issued there under.

In addition, an IRC 401(a) Supplemental Benefit Plan (defined contribution plan) was authorized by the Board on May 20, 2008 to be established in order to address Internal Revenue Code Section 401(a)(17) limitations that affect a limited number of employees.

CONSEQUENCES OF NEGATIVE ACTION

The County's current agreement with ICMA-RC will expire on September 30, 2009 with no new agreement in place for the record keeping and administrative services for the IRC 457(b) Deferred Compensation Plan and the IRC 401(a) Supplemental Benefit Plan.

STEPS FOLLOWING APPROVAL

The Clerk of the Board will forward two signed copies of the original agreement and related attachments to Kathleen Barber, Employee Services Agency.

ATTACHMENTS

- ATTACHMENT A - Administrative Services Agreement

- ATTACHMENT B - Investment Policy Statement
- ATTACHMENT C - Fund Mapping