Council Meeting Date: **May 23, 2011** Agenda Item: **7(d)**

CITY COUNCIL AGENDA ITEM

CITY OF SHORELINE, WASHINGTON

AGENDA TITLE:	Authorizing the City Manager to Collect Additional Fees for City Administrative Expenses of Employee Deferred Compensation Plans
DEPARTMENT:	Administrative Services, City Attorney, and Human Resources
PRESENTED BY:	Debbie Tarry, Administrative Services Director Ian Sievers, City Attorney Marci Wright, Human Resources Director

PROBLEM/ISSUE STATEMENT:

On February 28, 2011, the City Council authorized the City Manager to sign a contract with TIAA-CREF to provide administrative services for the City's 401 and 457 plans. The fees for providing this service are paid from the 401 and 457 plan assets. In the February report to Council, staff contrasted the current administrative fees for regular participant accounts (prior and current benefited employees) with ICMA ($200,000) with those proposed by TIAA-CREF ($40,000). Subsequently the staff committee working on the transition has been provided additional education on City plan fiduciary responsibilities. Plan fiduciary responsibilities include:

1. Selecting, retaining or terminating record-keepers/plan administrators.
2. Selecting, retaining, or terminating investment options.
3. Processing and submitting participant contributions
4. Negotiating fees and expenses for plan services and investment

Historically the City has passively managed plan investment options (#2). Responsibilities #1 and #4 have been completed and paid for by the City in our RFP process. Item #3 will continue to be coordinated through payroll staff. Recognizing the City's fiduciary responsibilities, as plan sponsor, the staff committee recommends that going forward a pro-active approach be taken to manage the investment results and expenses of the investment options provided for employees. Employees are responsible for making their own investment decisions from among these 28 funds.

The most common approach to meet this goal is through a "Retirement Plan Committee" composed of plan participant representatives and members with financial, human resource, and legal expertise. The staff committee also recommends that the Retirement Plan Committee hire a consultant with investment fund analysis and investment fund administration expertise to assist the committee in its responsibilities. Since this expertise is for the benefit of all plan participants the associated cost should be paid by the plan participants.

The most common method for this is through an annual fee that is assessed as a percentage of participant account balances. Based on recommendations from the consultant who assisted the City through the Request for Proposal (RFP) process for plan administration services, the estimated fee for on-going consultant services would be $20,000 annually. This fee is in addition to the TIAA-CREF administrative fees which are estimated at $40,000, and therefore must be included in the contract between the City and TIAA-CREF. This additional fee was not part of the discussion on February 28, 2011, and was not included in the estimated fee comparison. For this reason the City Attorney is recommending that the Council authorize the City Manager to direct TIAA-CREF to collect the additional fee to pay for additional City plan expenses. The total of the administrative (0.20%) and other expense fee (0.13%) is 0.33% of regular participant plan accounts. Even with this additional fee, the expected total cost to plan ($60,000) is still significantly less than the current administrative fees with ICMA.

FINANCIAL IMPACT:
There is no direct financial impact to the City budget since plan expenses are paid by plan participants.

RECOMMENDATION

Staff recommends that Council authorize the City Manager to direct TIAA-CREF to collect an additional 401(a) and 457 plan expense fee from regular deferred compensation account balances to pay for City plan expenses.

Approved By: City Manager JM City Attorney ___

INTRODUCTION

When the City incorporated a choice was made to not participate in social security, but to establish an IRS Section 401(a) plan that would be a social security replacement plan for City employees and officials. Both the City and employees contribute 6.2% of an employee's annual salary to the 401(a) plan. Participation in the 401(a) plan is mandatory.

The City also provides an IRS Section 457 plan for employees, which is similar to a private 401k plan. Employees can allocate a portion of their salary on a pre-tax basis to the Section 457 plan. The City does not make any matching contributions to the 457 plan. Also some employees allocate unused portions of their health benefit dollars to this plan. Participation in the 457 plan is voluntary, although unused pre-tax benefit dollars must be assigned to the 457 plan and may not be taken in cash.

The City, as the plan sponsor, hires a third party administrator to provide investment fund options and to perform record-keeping and administration services on its behalf. The City has a fiduciary duty to act solely in the best interest of and for the exclusive benefit of the plan participants. The City's fiduciary functions include:

- Selecting, retaining or terminating record-keepers/plan administrators
- Selecting, retaining, or terminating investment options
- Processing and submitting participant contributions
- Negotiating fees and expenses for plan services and investment.

Fees for plan administration and investment services are paid by plan participants through a fee charged against their account balances within the plan.

BACKGROUND

In 1974 the federal government issued the Employee Retirement Income Security Act (ERISA), which established a national standard for private retirement benefit plan definition and administration. Even though ERISA governs private sector retirement plans, it does provide a guide to best practices for public sector plans. Some states, such as California and Michigan, have already implemented standards that mirror ERISA for public sector retirement plans, leading some to assume that eventually, public plans will be held to a standard much like ERISA, if not ERISA itself.

Basically ERISA says that persons (employers, in this case the City) who, by either function or appointment, have authority in providing and administering retirement plans have fiduciary responsibilities to act in the best interest of the participants, as listed in the previous section of the staff report. These fiduciary responsibilities cannot be transferred to a third party administrator, such as TIAA-CREF or ICMA.

The core standards of fiduciary conduct include:

- **Duty of Loyalty**: Basically this is the exclusive benefit rule in that the City must discharge duties with respect to the Plan for the exclusive benefit of the participants and their beneficiaries.

- **Duty of Prudence**: ERISA calls for the "Prudent Expert Rule." Fiduciaries must act with "the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity" would apply. Other plan sponsors have met the duty of prudence by establishing a "Retirement Plan Committee" that has the necessary skills and expertise to monitor the plan.
- **Duty to Provide for Diversification of Plan Assets**: A fiduciary must diversify investments in order to minimize risk of loss unless it would be considered prudent to not diversify investments. The City's 401 and 457 plans are considered defined contribution plans with self-direction of investments by plan participants. Fiduciaries must balance the needs of diversification with the potential negative impacts of offering too many choices. In this case the City has a duty to provide sufficient investment options such that participants are able to construct a diversified portfolio from plan options, and has approved a diverse list of 29 investment options as part of the RFP process. Beginning with the TIAA-CREF Plan in June, employees will also have the option of investing any other stock, mutual fund or Exchange Traded Fund (ETF) shares through a broker.
- **Duty to Act in Accordance with the Plan Document:** Fiduciaries must act in accordance with plan documents, but only to the extent that the plan is consistent with ERISA requirements. There is also an implied duty to monitor plan operations and events of the world that may impact the plan.

In evaluating the City's options to meet the plan fiduciary responsibilities staff found that other organizations have established a Retirement Plan Committee (RPC).

Retirement Plan Committee

A number of other Washington organizations have chosen to establish a RPC to meet their fiduciary responsibilities related to their employer sponsored 401 and/or 457 plans. Below is a list of some of the Washington public employers who have a RPC:

Employer
City of Seattle
Municipal Employees' Benefit Trust (Consortium of the cities of Bellevue, Edmonds, Federal Way, Kirkland, Mill Creek, Redmond, Woodinville, and 911 NORCOM)
City of Spokane
City of Tacoma
City of Richland
City of Kent
City of Bellevue (457 Plan)
King County
Pierce County
Snohomish County PUD

The RPC members are usually appointed by the Chief Executive Officer of the organization. The RPC is commonly comprised of at least one "participant" representative, representative from the Executive Department (City Manager Office) and additional employees with financial, human resource, employee benefit, or legal expertise. The RPC is generally responsible for the following:

- Development of key plan documents including:
  - Statement of Investment Policy
  - Operating Policy and Procedures
- Minutes of all RPC meetings
- Fiduciary Review of Investments
  - Authorize changes in investment funds
  - Authorize changes in investment providers
- Fiduciary Review of Service Providers
- Creating or approving the design of education/counseling programs
- Monitoring of fees and expenses.

Most RPCs meet at least semi-annually with a formal review of investment fund managers annually.

<u>Retirement Plan Investment Structure and Monitoring</u>
Historically the City has used a passive approach to managing plan investments, which has resulted in a vendor driven investment portfolio. The current portfolio with ICMA contains many of their proprietary products. Also given the number of fund options currently available to participants there are many funds that have similar investment strategies thus resulting in duplication. The various funds have a wide-variance of investment fees which participants must research individually. In the past, ICMA has terminated fund options but the City has not independently reviewed the reasons given or ascertained whether there may have been poor performing investments that have remained available to participants for years.

As a result of the change in third party administrators and the education that the transition committee has received, staff is proposing a different approach with TIAA-CREF. The staff committee requested our current consultant, Hyas Group which is independent of TIAA-CREF, to recommend a menu of investment funds to include in the City's plan based on looking for "best in class."

Specifically the committee wanted funds that met the participant's needs and the City's responsibility to provide a diversified portfolio, but also wanted to avoid unnecessary duplication. Performance, investment objective, cost, performance and management quality were primary drivers in the selection process. This resulted in the selection of 28 investment funds with only two being TIAA-CREF proprietary funds. For those Plan participants that want to make selections outside of these funds, TIAA-CREF provides a brokerage account that allows participants to make a broad range of individual choices. In this case the participant's account is charged brokerage fees based on the agreements that TIAA-CREF has with its brokerage service providers.

Beginning with the TIAFF-CREF contract in June, all employees except extra help are also provided with investment counseling and advice at no additional cost through a financial advisor retained by TIAA-CREF. The City is not responsibility for this investment advice.

Even though these funds were selected for best in class, it does not guarantee that future performance will mirror past results. As such, an important role of the RPC will be to monitor the investment fund results to determine if they are meeting their benchmark targets and performing in the top quartile of similar funds. The transition committee recommends that the RPC have a consultant assist in the on-going fiduciary responsibilities of reviewing investment options and performance as part of the fiduciary "Prudent Expert" rule. This is a very common practice for the RPCs of other organizations.

Other services commonly provided to the RPC by an expert consultant include:

- On-going education and guidance to the RPC
- Investment manager research and replacement
- Updates and guidance about legislative, regulatory and legal developments
- Assistance in evaluating new investment products, services and trends
- Assistance in thoroughly documenting Committee activities

Since the RPC is being formed to advise the City Manager as Plan Administrator as part of the transition from ICMA to TIAA-CREF, a consultant to provide these services has not been selected. Staff anticipates that a Request for Proposal process will be used this fall to make a selection for on-going services. Our current consultant has indicated that for the number of plan participants and the level of the City's plan assets (currently estimated at $20 million), that the City assume a $20,000 annual fee for on-going consultant services.

<u>Payment for Plan Services</u>
Participants pay for the expenses of the particular funds they invest in and the brokerage fees if they elect this option. Plan administration fees for record keeping are paid from participants' accounts. In the past, participants have paid .49% to ICMA for these expenses. In February the Council approved the TIAF-CREF proposal of .20% for these services for regular plan participants (current and former regular employees). The fee for extra-help participants (current and former extra-help employees) is .30% plus $25 per account.

The City may direct that TIAA-CREF assess additional fees against participants' account balances in order to generate the additional revenue necessary to pay for the anticipated consulting fees. Staff recommends a total fee of 0.33% to be assessed annually against regular participants' accounts. The current regular plan asset balance is $20 million so the proposed offset fee would generate approximately $66,000 annually. From this, the regular plan would pay the TIAA-CREF administrative fee of $40,000, leaving $26,000 for payment of any other plan expenses such as the recommended on-going consulting services. Even with raising the fee from 0.20% to 0.33% of assets, the total anticipated cost to plan participants is still significantly lower than the current fees paid to ICMA.

Setting the fee at 0.33% allows for plan market valuation changes. As we have seen the last few years, the valuation can drop dramatically and then rebound with the markets. If the market value of the plan continued to hold steady or increase, the fee could generate slightly more revenue than is needed to pay the fixed administrative fees of the Plan and anticipated consulting fees for the City. The City's agreement with TIAA-CREF provides a mechanism to either carry money over from one year to the next to pay future year expenses, or to refund the excess funds to the regular employee participants. This election will be made annually by the City Manager.

RECOMMENDATION

Staff recommends that Council authorize the City Manager direct TIAA-CREF to collect an additional 401(a) and 457 plan expense fee from regular deferred compensation account balances to pay for City plan expenses.

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