

Deferred Compensation Market Consolidation

Presented by:

Valentine J. Link, RPA
Managing Director
PFM Asset Management LLC
Two Logan Square, Suite 1600
Philadelphia, PA 19103
(215) 567-6100
www.pfm.com



Governmental and Not-for-Profit Deferred Compensation Plans

- 457(b) plans – exclusively for governmental employees including school district employees
- 403(b) plans – exclusively for education and not-for-profit healthcare
- 401(a) – pension substitute used in governmental and not-for-profit markets



Common Confusion in 457 Plans

- Two broad types of 457 plans
 - Governmental deferred compensation plans, that look and act like a 401(k) plans [(b) – plans]
 - Non-qualified deferred compensation plans, that are used primarily by corporations for highly compensated individuals [(f) – plans]



Common Confusion in 457 Plans

- Governmental plans are funded plans owned by individuals through a trust
- Non-qualified deferred compensation plans are typically general liabilities of a corporations
- Many non-qualified plans are unfunded and may be forfeited in a bankruptcy



457(b) Plans

- 457(b) plans
 - Not an ERISA qualified plan type
 - “Plan Committee” may be a common law fiduciary
 - Historically, the domain of insurance companies
 - State plans tend to be single vendor
 - “Local” plans, have tended to utilize multiple vendors



403(b) Plans

- 403(b)
 - Public school plans are not ERISA plans
 - Other 403(b) plans may be ERISA plans
 - Fiduciary status of “Plan Committee” less certain
 - School districts almost exclusively multi-vendor with many having open door policies driven by insurers and brokers
 - Not-for-profits have fewer multi-vendor plans



What is happening in the marketplace

- Congress, the SEC and the DoL have been focused on fee transparency of deferred compensation plans
- Many plan sponsors are looking to:
 - Reduce fees
 - Improve the structure of these plans for participants
 - Ease the administrative burden on internal staff
- New 403(b) regulations are increasing plan sponsor responsibilities for compliance
- More plan sponsors are replacing pensions with 401(a) plans



Plan Sponsor Reaction

- Conducting more vendor search activity
- Demanding fully transparent administrative fees from generally lower cost administrators
- Creating open architecture investment menus
- Consolidating into single vendor plans to ease compliance and improve participant communications



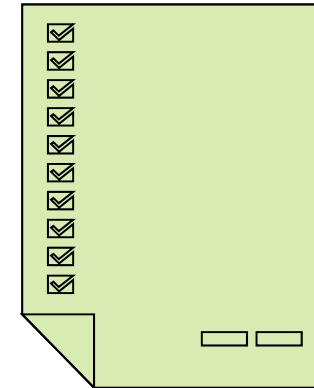
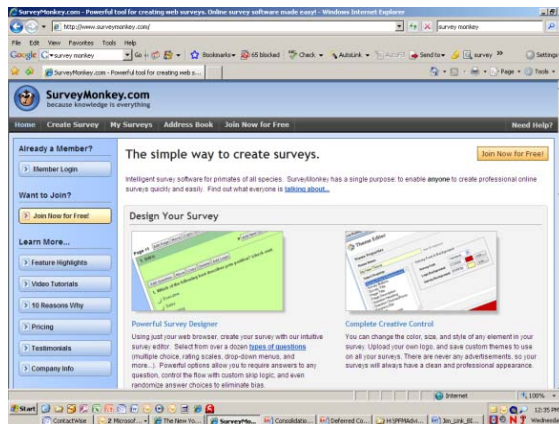
RFP Search Activity

- Many local government plans have never done an RFP for DC plan vendor
- Good fiduciary due diligence process means conducting an RFP approximately every 5 years



Conducting a Vendor Search

- Set plan goals
- Solicit participant feedback
- Create a comprehensive questionnaire
- Interview (site visit) finalists



Fee Transparency

- Old-style annuity programs versus new annuity programs and mutual fund platforms:
 - Generally higher in fees
 - More restrictive regarding fund transfers
 - Generally less transparent in terms of fees
- Administrative services were “free”
- Unbundling to better understand investment versus administrative costs
- Administrative revenue sharing is becoming less difficult to understand



Administrative Fee Example

- Old Style generally depicts an annuity or proprietary fund type example
- New Style generally depicts an open architecture type example

	Expense Ratio	Fund Revenue Sharing	Administrative Cost	Net Cost	Last Year Return/Rate
Old Style					
Fund A - Class A	1.50%	0.00%	0.00%	1.50%	4.25%
Fund B - Class A	2.25%	0.00%	0.00%	2.25%	7.50%
General Fund	N/a	N/a	0.00%	N/a	5.15%
New Style					
Fund A - Class R	1.00%	0.25%	0.23%	0.98%	4.77%
Fund B - Class R	1.20%	0.25%	0.23%	1.18%	8.57%
Stable Value	0.30%	0.00%	0.23%	0.53%	4.65%

- Old Style General Fund cost was impossible to discern and may have heavy restrictions on plan level disbursements
- New Style Stable Value Fund is easier to calculate costs and may have less restrictive plan level distribution terms

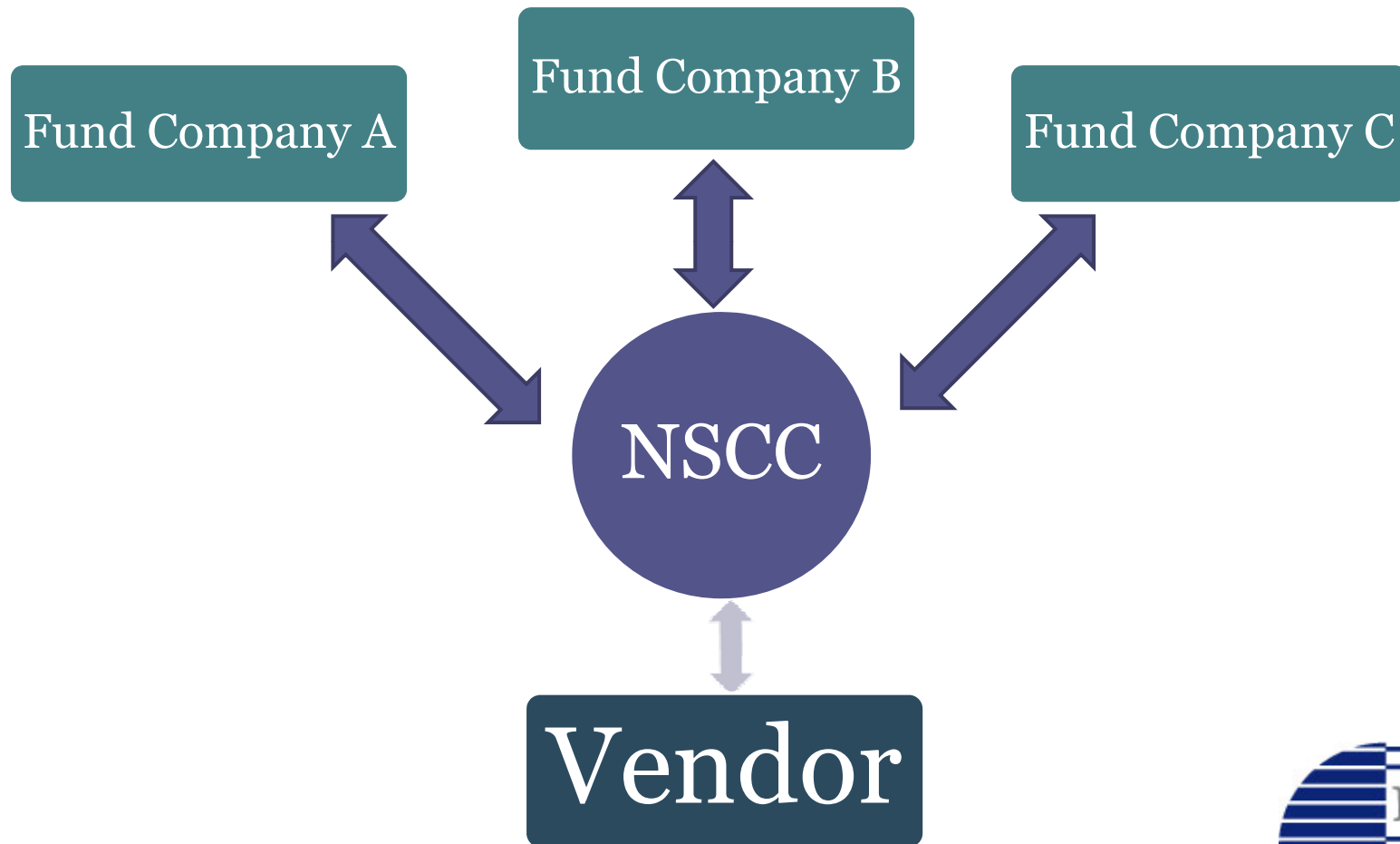


Investment Menu

- Historically, investment menus were constructed of proprietary fund options
- In the early 1990s, the NSCC created a real electronic fund trading process
- No more need for individualized trading schemes with different fund families
- Thus, any administrator could effectively monitor and trade any fund



NSCC Trading



Fund Open Architecture

- Best-in-class funds is now available in every asset class
- No more proprietary dominance of investment menus by vendor funds
- Lower share cost share classes could be developed for retirement plan only investing



Fixed Accounts

- Many styles of fixed accounts
 - General accounts
 - Annuities
 - Pooled stable value funds
 - Separate accounts
- Several major differences
 - Crediting rates
 - Market Value Adjustments (“MVA”)
 - Plan level disbursement restrictions



Account Style Differences

- General accounts
 - Invest along side the insurer
 - Receive a stated rate of return (reset periodically)
 - No ability to see cost
 - Exposed to insurers risk of default
- Annuities and pooled stable value funds
 - Invested in a specific pool of assets separate from insurers assets
 - Typically earn a variable rate of return, but can be stated rate
 - Cost of investment is explicit and transparent



Account Style Differences (cont'd)

- Separate accounts
 - Invested in a segregated pool of assets for a specific entity
 - Rate of return can be variable or set
 - Costs are explicit and transparent
 - Own specific assets

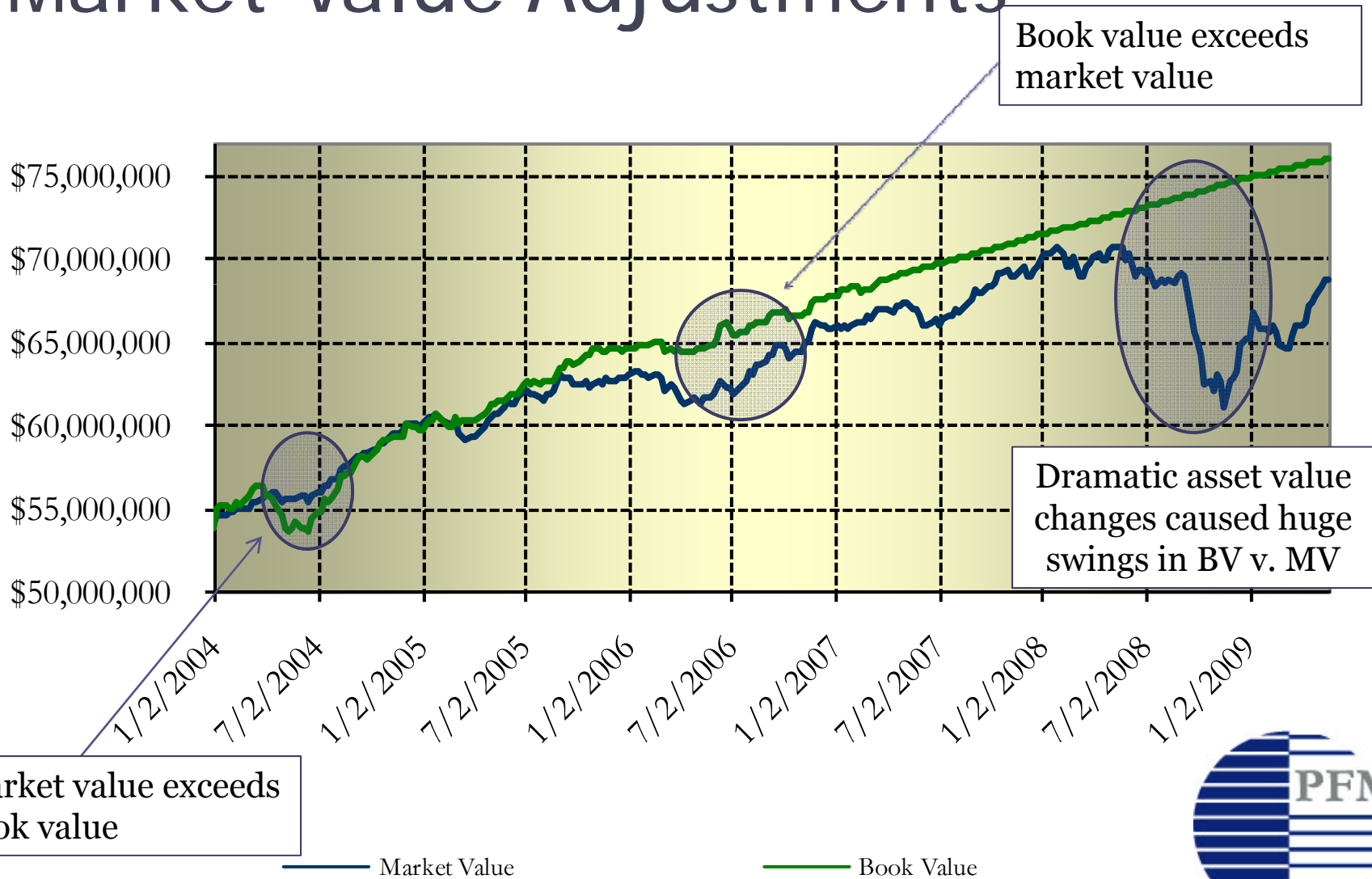


Fixed Account Contract Terms

- Plan level disbursement restrictions
 - 12-month Put
 - Term payout
- Potential charges at disbursement
 - MVA (where market value is less than book value)
 - Surrender Charges



Market Value Adjustments



Fixed Account: What to look for

- Ratings of insurer
- Structure of asset pool backing the account
- Fees associated with account
- Plan transfer terms
 - Restrictions on asset movement
 - Cost (MVA and/or surrender charges)
- Impact of state insurance funds on accounts



Plan Administration

- Historically, multiple vendor plans
 - Less focus on compliance
 - Administrative cost was characterized as “free”
 - Focus was on fixed interest product rate
 - Provided diversification of investment products
- Move to single vendor is facilitated by
 - Due diligence process
 - Need for better compliance
 - Focus on costs
 - Advent of open architecture



Experience in Conversion

- Plan sponsors take more control in process
- Cost is generally lower for participants (in some cases dramatically lower)
- Less restriction on asset movement
- Better accountability for compliance from vendor staff rather than internal staff
- Access to wide array of fund offerings



Questions



Biography and Contact Information

Valentine J. Link, Jr., RPA (Jim), Managing Director
(215) 567-6100
linkj@pfm.com

- Mr. Link is a Managing Director of PFM Group LLC. He has more than 20 years of experience in the institutional retirement plan, asset management, and institutional trust and custody markets. Mr. Link consults with governmental retirement plans and leads the Other Post Employment Benefits (“OPEB”) and deferred compensation consulting businesses at PFM. Within these areas, he works with clients and public organizations around the country to provide education and to design programs that meet clients’ needs. Apart from his work experience, Mr. Link is a regular instructor at various state GFOA and management conferences, industry conferences and at training events. He has lectured on retirement related issues at the Fels Institute of Government at the University of Pennsylvania to students in the Master of Public Administration program. Mr. Link is a graduate of Texas A&M University in College Station, Texas where he earned his Bachelor of Science Degree in Economics with a minor in Management.

