**MINUTES FROM MEETING OF DEFERRED COMPENSATION COUNCIL**

**OFFICE OF THE STATE TREASURER, CONFERENCE ROOM**

**July 22, 2015**

A meeting of the Deferred Compensation Council (the “Council”) was held on Wednesday, July 22, 2015 at 10:00 in the Conference Room of the Office of the State Treasurer located at

820 Silver Lake Blvd., Suite 100, Dover, Delaware.

All Board Members Represented or in Attendance:

The Honorable Ken Simpler, State Treasurer

Ms. Valerie M. Watson (on behalf of Thomas J. Cook, Secretary of Finance)

Mr. Robert Scoglietti (on behalf of Director Ann Visalli, Office of Management & Budget)

Mr. Ralph Cetrulo, Public Member At-Large (telephonically)

Mr. Charles Campbell-King, State Employee Member At-Large

Ms. Jennifer Vaughn (on behalf of Karen Stewart, Insurance Commissioner)

Others in Attendance:

Ms. AnnMarie Johnson, Deputy Attorney General & Advisor to the Deferred Compensation Council

Ms. Nora Gonzalez, Deputy State Treasurer, Office of the State Treasurer

Mr. Steve McVay, Director of Finance & Investment Services, Office of the State Treasurer

Mr. Michael Green, Financial Investment Program Manager, Office of the State Treasurer

Mr. Jeff Hoover, Investment Manager, Office of the State Treasurer

Ms. Colleen Denham, Administrative Specialist II, Office of the State Treasurer

Mr. Michael Sanders, Principal, Cammack Retirement Group

Ms. Emily Wrightson, Managing Consultant, Cammack Retirement Group

Mr. Jeffrey Snyder, Vice President, Cammack Retirement Group

**CALLED TO ORDER**

Treasurer Simpler called the meeting to order at 10:00 AM

**APPROVAL OF PRIOR MINUTES**

There was a MOTION by Mr. Campbell-King and seconded by Ms. Scoglietti to approve the May 27, 2015 meeting minutes.

MOTION ADOPTED UNANIMOUSLY

**OVERVIEW & REPORT of 403(b) & 457(b) PLANS**

Mr. Simpler asked Mr. Green to review the current portfolio. Mr. Green said there was approximately $630,000,000 in the 457(b), the 401(a) and 403(b) mutual funds through Fidelity and we have approximately $380,000,000 in the 403(b) annuity platform. Mr. McVay distributed a handout reflecting the specifics.

**OLD BUSINESS**

Mr. Simpler said he wanted to follow up on Mr. Campbell-King’s concerns regarding the status of past loans and whether those issues had been resolved to date. Mr. McVay said he had received an updated schedule from the auditor a few days prior and had reviewed the results. He reported that many accounts had been corrected, but added that Mr. Kimmel was not present to review the findings in more detail, but added the auditor was still in the process of reconciling.

Mr. McVay said Mr. Campbell-King had also requested an update on the participants that had funds withdrawn from their payroll but not deposited with the appropriate vendor and a timeline for correcting their accounts. Mr. Campbell-King added he was also seeking clarification regarding the communication to those impacted, specifically, regarding the loss of interest on their investments that were not correctly appropriated. Mr. McVay said he would like to review the report with Mr. Kimmel when he returns and would provide an update to Mr. Campbell-King at the end of August and update the Council at the November meeting.

Mr. Simpler asked the Council if there were any follow up questions, outstanding concerns or new concerns that members would like to address. Hearing none, he requested a report from the Council’s Deputy Attorney General.

**DEPUTY ATTORNEY GENERAL REPORT**

Ms. Johnson reported that the Attorney General had received acceptance of the Voluntary Compliance Program (VCP) application submitted to the IRS on behalf of the 401(a)) Plan in November 2014. Ms. Johnson described the next step to update any additional outstanding loans through the 2014 audit and the outreach to vendors to make sure there were not any new loans from January 1.

Ms. Johnson clarified what the VCP means for the Council. She stated that the obligation of the Council is to continue to be proactive with audits and update reports to reflect how the problem has been corrected.

Mr. Campbell-King asked how we hold our vendors accountable since the state employee would not know that they did anything wrong. Ms. Johnson said it was a good question, but felt the answer would require a further review of their contract because of the history and transition of legacy vendors. A legacy vendor is a 403(b) vendor that did not remain in the State Plan.

Ms. Johnson said the AG’s office originally thought that if the vendors were not compliant with the State Plan that the State would not be held accountable, however the IRS has shifted the regulatory responsibility of overseeing the vendors onto the State. She clarified, that even if a hardship is improperly processed by a legacy vendor that is no longer part of the program, the IRS will still hold the State accountable for making sure the hardships are done properly. She suggests that there would have to be some sort of approval for hardships and added that hardships are available only for select circumstances. Ms. Johnson said she is working with Mr. McVay and Mr. Kimmel to work out an administrative process.

Mr. Simpler asked Ms. Johnson to clarify if ‘legacy vendors’ referred to the pre-consolidation vendors and to confirm that the IRS views the Council to have fiduciary responsibility to the more than 100, pre-2009 vendors. Ms. Johnson confirmed and added that Ice Miller also issued the same opinion.

Mr. Campbell-King asked if we could get a list of all pre-2009 vendors along with the number and names of participants remaining with the intent of targeted outreach. Ms. Johnson agreed that would meet the “good faith effort” requirements of the IRS, but added the State has no contractual relationship with the vendors requiring them to do so.

Mr. Simpler acknowledged legacy issues were a great concern to him and thinking prospectively as the Council considers another consolidation, he asked how the Council can mitigate this problem going forward. Mr. Snyder said Cammack suggests targeted communication offering a 90-24 contract exchange to move money over. In respect to the proposed RFP, one of the goals would be a targeted communication plan that includes the option for a contract exchange. Mr. Snyder said the administrative challenges currently documented and being discussed would be mitigated by strict contracts including service guarantees.

Mr. Simpler said he is focused on mitigating current contract consolidations and the participants that would not migrate over. He said we need to gather as much information about each vendor, their participants and fund balances at the cutoff, before we make the change. Mr. Sanders encouraged the Council to maintain open communications with all current vendors if the Council consolidates.

Mr. Simpler asked what the incentive might be for current 403(b) vendors that may feel disenfranchised with the process to retain communications with the State. Mr. Snyder stated their incentive was to retain the current accounts, recognizing the State’s incentive to try to move people over, but noted the Information Sharing Agreement states they must share information about the individual contracts with the State in perpetuity. He acknowledged some vendors would be easier to collect information from than others.

Mr. Scoglietti asked if our responsibility continued after an individual was no longer a State employee. Ms. Johnson responded it was within the authority of the IRS to audit the plans, impose obligations and hold the State responsible, including fines for improper hardships.

Ms. Johnson offered that she recently attended a National Association of Public Pensions Conference and participated in a session of deferred compensation programs regarding auto-enrollment. Mr. Campbell-King asked if she was referring to an automatic opt-in, where instead the participant would have to opt-out. Ms. Johnson confirmed. Mr. Sanders agreed that auto enrollment and auto escalation are the standard, but some states have anti-garnishment rules that prevented that option. Ms. Johnson wasn’t certain if Delaware had an anti-garnishment rule.

**DEFERRED COMPENSATION CONSULTANT PRESENTATION**

Mr. Simpler said OST recently reached out to legislators to get their feedback on a single vendor solution and noted it would have been preferable to meet with them in June before the Council voted to move forward, but the end of the legislative year was not conducive to the option. OST met with Rep. Paul Baumbach, Rep. Rich Collins (also an agent for one of the 13 vendors -Horace Mann) and Jeff Taschner of DSEA. Others were invited but were unable to attend. Mr. Simpler said the goal of meeting was to have a small focus group to discuss the direction adopted by the Council. The feedback OST received was that any change would be difficult because the schools do not like to limit choices. The focus group recognized the goals of OST, but requested the possibility to maintain some broker options.

Mr. Green asked if the schools were classified as districts or agencies. Ms. Johnson said that was a complicated answer, but the short answer was that schools were classified as agencies. Mr. Green asked how schools were different from Delaware Transit Corporation and the Delaware Solid Waste Authority. Ms. Johnson said that DTC is a separately constituted corporation like DEDO, but that they were all state agencies for the purpose of state law. Mr. Green then asked if there was a preference of teachers over DTC and the DSWA. He stated they are all agencies, but DTC and DSWA use the 457(b) Plan. Mr. Simpler asked if Mr. Green was asking why we offer a 403(b) Plan. Mr. Green stated his question was regarding the structure, noting that he services state employees and also agencies resulting in the processing of three separate pay feeds. Mr. Green said that DTC and DSWA would also have their choices limited. Ms. Johnson stated she was not aware other agencies had a 403(b) or that OST serviced DTC and DSWA. Mr. Campbell-King asked if this was new, Mr. Green said it had not changed during his tenure. Mr. Green wanted to be on the record as stating the 457(b) through Fidelity also has a 403(b) feature and the 403(b) and 457(b) also have Roth features, but only mutual funds. He said there are two outside agencies in a 403(b) program offered through the state that do not have access to annuities, and questioned if there was a need to have more than one vendor to accommodate teachers when they are also an outside agency and not technically state employees.

Mr. Green said he interpreted the concern as one around our architecture, and that the teachers would not be receptive to the number of annuity options and he wanted to make the Council aware there were two other agencies in the 403(b) that have no annuity options, so the focus was not solely on teachers. Mr. Simpler said his interpretation was that they would be more concerned over losing the opportunity to work with people they had built relationships with rather than the investment options themselves.

Mr. Simpler described this as the most compelling argument to come out of the focus group, and asked if there was a risk of diminished participation in the plan by removing the personal contact. Mr. Simpler said Sen. Baumbach’s idea was to offer a personal broker option at a premium or fee for service, and to remain as an option for those willing to pay for it, but added it was up to the Council to make it transparent and to make it explicit.

Mr. Simpler said he expected Cammack would comment on many of the concerns discussed in their presentation and asked them for their guidance in fiduciary training.

Committee Member Fiduciary Training

Cammack distributed fiduciary guidelines to the Council. Mr. Snyder stated the State of Delaware is not subject to ERISA, but the guidelines presented are considered best practices. He noted it was recommended for the Council to review and refresh training annually.

Mr. Snyder reviewed who is a fiduciary: the fiduciaries include the Trustee, any investment advisors, any individual that exercises discretion over investments and all members of the Council. He also reviewed the responsibilities of fiduciaries: to act in the sole interest of the participants and beneficiaries, including active and inactive employees to include retirees, those no longer employed by the state, those that are divorced or alternate payees of the plan and their beneficiaries. He added, administrators and record-keepers are not fiduciaries, but rather are directed trustees.

Mr. Simpler clarified that the specific fiduciary duty and focus of the Council was on this plan and its participants and beneficiaries, not on preparing employees generally for retirement readiness. He then expressed concern as to whether shrinking the broker network in the field would diminish participation and if that was considered a breach of fiduciary responsibility. Mr. Snyder commented that it might remain a goal of OST and the Council, but not a fiduciary responsibility of the Council.

Mr. Snyder reviewed additional fiduciary responsibilities that include executing the plan document, insuring operationally that vendors are following instructions and that the plan operates under all regulatory statutes at the federal and state level, and include changes that occur on a regular basis. Mr. Simpler asked what ERISA statutes Delaware may have tried to adopt. Ms. Johnson said there were none.

Mr. Snyder said that offering diversified investments and reasonable plan expenses were also considered a fiduciary responsibility and best practices include having a proper fiduciary file that reflects all decisions made by the Council, and appropriately document the process and the intent of bringing the best value.

Mr. Green asked Mr. Snyder about the distinction between an RFI and an RFP, and the terms considered best practices. Mr. Snyder said the RFP was more comprehensive than the RFI, and that 3-5 year terms were considered best practices.

Mr. Simpler asked if there had been lawsuits around allowing too many vendors if participants could not get to the break point that would provide the best rates. Mr. Sanders said there had not been, but he thought it could be feasible in the future.

Mr. Simpler said that he had fiduciary responsibility concerns over legacy vendors that were not just marketing Delaware’s Deferred Compensation Plan, but were cross-selling other products that have nothing to do with the States retirement plans. His concerns are that the State indirectly appears to approve of those additional services. Mr. Green asked could we limit what services the brokers can sell. Mr. Campbell-King said this was a concern to him as well, and that most of the Council was not on the Council three or more years ago, and added that the legacy issues were all inherited.

Mr. Snyder acknowledged the Council’s concern over vendors and a loss of information. He discussed the fiduciary responsibility regarding audits. Ideally, there should be an administrative process that is both efficient and automated enough to eliminate human error, but also able to catch defects that might occur so that participants can be made whole.

Mr. Snyder discussed additional responsibilities including liability insurance, implementing a fiduciary due-diligence process, a review of the Investment Policy Statement and hiring prudent advisors who have a particular expertise as part of the Council’s fiduciary responsibility. He added the Council must avoid conflicts of interest, both actual and perceived conflicts.

Mr. Snyder stated fee disclosures do not apply to state governments but Cammack considers them to be best practice. He said there are two sets of fee disclosures; a 408(b)(2) notice being a detailed fiduciary/employer letter, and a 404(a)(5) notice being a participant disclosure that is more generic and generally expressed participant fees per $1,000. Mr. Snyder said that most participants aren’t aware that there is a fee for administrative services. Mr. Sanders added that the fee disclosure is reported on a plan level, not a vendor level disclosure and becomes the responsibility of the plan administrator to compile the vendor disclosures into one for the entire plan.

Mr. Snyder continued reviewing fiduciary responsibilities to include managed risk, careful review of the meeting minutes, understanding that third parties are fiduciaries and that there are different levels of fiduciary status (i.e. 3(21) versus 3(38)). He said best practices included increasing participation to lower fees, a carefully crafted plan document, and spending time benchmarking plan performance.

Mr. Snyder reviewed current developments in the arena of defined contributions. Cammack has seen an increased demand for annuitizations, including target date funds, incorporation of insurance products within the plans and other lifetime income options.

Mr. Simpler said that one concern brought to his attention by Rep. Collins should there be a consolidation toward one record-keeper, was that there were employees that have bought annuity products and have a rate lock that is significantly higher than they would have if they had to start over with a new vendor. Mr. Simpler felt that was not an insubstantial amount to these participants. Mr. Campbell-King added it would be difficult to count how many participants would be impacted.

Mr. Snyder continued with current developments noting the continuation of explosive growth in target date funds as a result of the Pension Protection Act of 2006. The equitable distribution of fees is a critical fiduciary concern and is an important reason to consider a single record-keeper. Competition for record-keepers is fierce. With only 50 states, many record-keepers have been consolidating.

Mr. Snyder stated Stable Value represents 40-50% of plan assets and added that as the Federal Reserve begins to raise rates for the first time in 30 years, data and advice would be important to the Council as fiduciaries of the plan. Mr. Simpler clarified that the Council was responsible for basic market knowledge. Mr. Sanders agreed.

Initial Needs Assessment

Ms. Wrightson stated that the investment reports in the back of the report focused on the three vendors that had group contracts: Lincoln, Horace Mann and Fidelity. She referred to the highlights of the reports and stated the 403(b) Plan is expensive, and it was likely participants were unaware of what fees they are paying. The same funds are offered with different vendors at different costs. Ms. Sanders stated there are differences among services that are being offered, but as fiduciaries the Council should understand the difference.

Ms. Wrightson said Fidelity was the largest in total investments. She noted that Fidelity’s expenses reflect a weighted average of 65bps and is considered in line with the mutual fund based platforms.

Ms. Wrightson reviewed the fee table that reflects the highest fund expense and the lowest fund expense available for that vendor’s platform. In addition there are surrender charges and administration fees. She added that fees add up and can restrict participants from moving funds around to other investments. Mr. Campbell-King asked if it was possible to use plan funds to help cover the cost of these expenses to participants. Ms. Johnson did not think the State could. Mr. Sanders added this was extremely difficult to implement with multiple vendors.

Ms. Wrightson said that of $371 million dollars, there is $37 million that is moveable at the direction of the Council, and that was something the Council would discuss through the RFP process.

Mr. Simpler asked Ms. Wrightson what Cammack’s experience was regarding the portion of legacy assets that actually move over to a new record-keeper. Ms. Wrightson replied, about 15%.

**REVENUE CREDIT SHARE**

Mr. Simpler asked the Council to discuss the capacity to use plan assets to make payments for plan expenses, specifically related to the payment currently due to Cammack. He said historically, under the initial arrangement with Fidelity $450,000 (now $550,000) a year was renegotiated into a revenue share and that funds were available, either received or to be received, to defray plan expenses related to 457(b) and 403(b). Mr. Simpler said there were sufficient funds available to satisfy the engagement with Cammack for this initial implementation phase, assuming that Cammack would be invoicing the plans based on plan assets pro rata for their fees on a quarterly basis. Since the Council does not have a clear Investment Policy Statement that states what types of expenses the Council has agreed upon, Mr. Simpler said he would like to make a motion for the Council to agree to use the money accumulated in the revenue share and to direct the payment from Fidelity directly to Cammack. He asked Ms. Wrightson to elaborate on OST’s conversations with Cammack that this was considered a best practice.

Ms. Wrightson said in an ideal situation the plan would have the required revenue put into place by each provider that services the plan, but in the case of the current plan it is only set up with Fidelity. She clarified, Fidelity indicates how much revenue is needed to run the plan, and anything Fidelity gets from investments above and beyond that gets funneled into a revenue credit account that DOL says can be used to pay for permitted plan expenses: consultant fees, certain legal fees, compliance monitoring service fees, education or other fees that benefit the participants directly.

Ms. Watson asked how current advisors were being funded. Mr. Simpler said historically Fidelity funds have been used to pay for out of pocket third party expenses related to the 457(b) Plan. He said there have also been expenses related to the 403(b) Plan, but that the State issued appropriations to cover those.

Mr. Simpler stated, as State Treasurer he questions why the people of Delaware were paying for a voluntary benefit that only accrues for state employees and that because of the scale the plans have now reached, that the plans should be bearing their full costs.

Mr. Simpler said in the case of the 403(b) assets that carry over, that there would be time until those accounts could reasonably support the expenses. He added that he wanted to bring to the attention of the Council, that when he went back to look at the code, the code allows that all expenses can be paid by the plan to include personnel expenses for pension, 529 and 529(a) expenses. He said, however that the statutory language around deferred compensation says all expenses can be paid excluding personnel. He stated he didn’t know why the plan would be excluded from paying personnel expenses relating to the plan from the plan itself, but that it was a discussion the Council should have going forward.

Mr. Green said one benefit of having the record-keeper pay all plan expenses would be to have a detailed audit report. Ms. Gonzalez added that the money doesn’t leave the plan, all expenses are tracked and we do not lose transparency because we can disclose the report on our website.

Ms. Johnson said that the State Auditor is authorized to out-source the audit through the RFP process. She said the Pension audit is paid through the administrator. Ms. Watson said that she had concerns about the accounting structure and she would like to put in writing the path being proposed to the Auditor’s office and the Accounting office for the proposed expense. Ms. Johnson said the audit was separate from the expenses the Council was considering and added that Ice Miller had already issued a legal determination that the permitted expenses incurred for the plan could be paid for by the plan. Mr. Simpler summarized that the Council’s consultants, lawyers and the Auditor’s office all agree but Ms. Watson’s concerns were that she felt there was not a known consensus from other state offices. Ms. Watson agreed and said she would assure a prompt review from her office, but requested to see it in writing.

Mr. Campbell-King said he wanted to clarify that what the Council was being asked to consider was to pay the plan expenses for all plan participants from the Fidelity Revenue Sharing Credit Account, even though Fidelity only held about 60% of the portfolio, and he felt that some participants were being subsidized. Mr. Sanders said that all 457(b) accounts were with Fidelity. Mr. Campbell-King said he understood the need to make a motion to approve this expense, but the Council should make the necessary corrections to avoid this scenario in the future. Mr. Sanders said the only way was to go to a single record-keeper.

Mr. Simpler asked Ms. Johnson if it was within the rules to make a motion to approve the use of the funds, pending the consensus of the specified state agencies requested by Ms. Watson. Ms. Johnson indicated it was permissible.

Mr. Simpler said he would like the members of the Council to receive the ICE Miller opinion, documentation from the plan’s auditor and the requested affirmation from OMB and the Division of Accounting that they are satisfied with this practice and that it is permissible and considered best practices to use the funds for permitted expenses of the plan.

A MOTION was made by Mr. Simpler and seconded by Ms. Watson that the Council vote to approve, subject to receipt by the Council of the above mentioned documentation to pay Cammack aggregate initial needs assessment fee in four equal quarterly payments, from the Fidelity Credit Revenue Sharing Program.

MOTION ADOPTED UNANIMOUSLY

Ms. Watson inquired on the dates for a continuation of the fiduciary training. All agreed dates would be circulated and set for the near future.

Mr. Campbell-King suggested more frequent meetings of the Council. Mr. Simpler added he would like Cammack to help with the suggested schedule. Mr. Campbell-King requested the Council receive specific written guidelines on their fiduciary duty and liability. Ms. Johnson said she would provide the Council with examples of case law.

**PUBLIC COMMENTS**

There was no public present for comment.

**ADJOURNMENT**

Mr. Simpler adjourned the meeting at approximately 12:30 PM

Respectfully submitted,

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The Honorable Ken Simpler, State Treasurer

Co-Chair for the Deferred Compensation Council

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The Honorable Thomas J. Cook, Secretary of Finance

Co-Chair for the Deferred Compensation Council