City and County of San Francisco
Employees' Retirement System

Deferred Compensation Division

SFERS
San Francisco Employees' Retirement System

RETIREMENT BOARD CALENDAR SHEET
Deferred Compensation Committee Meeting of March 30, 2022

To: Deferred Compensation Committee

Through: Jay Huish
Executive Director

From: Diane Chui Justen
Deferred Compensation Director

Date: March 30, 2022

Agenda Item

Plan Admin Fee Discussion

Background

The cost to administer the City and County of San Francisco Deferred Compensation 457(b) Plan (SFDCP) is borne by the participants of the Plan. Administration includes, but is not limited to, recordkeeping, tax reporting, plan management and development, education and marketing, participant interaction and outreach, legal, investment consulting, payroll processing, and trust accounting. These duties are shared between Voya and the City and County of San Francisco (CCSF) Staff. At present, Voya collects 3.75 bps annually on plan assets for recordkeeping and CCSF Staff administrative expenses are assessed at 4.8 bps annually for plan services and support. The total amount collected for SFDCP administration is 8.55 bps annually, or 2.13 bps per quarter, which is very competitive and slightly below average compared to even the largest government plans.

Plan administrative fees are charged on a per annum basis, which means the total amount collected will increase or decrease as plan assets fluctuate over time. The SFDCP experienced market highs over the last three years with an average asset growth of ~16% YOY, far besting the general 5% market forecast. As such, Staff and Callan, SFDCP Consultant, are recommending a reduction in plan administrative fees to offset some of these gains and neutralize revenue going forward.

Additional Background

At the February Retirement Board meeting, Commissioner Driscoll asked for an estimate of the revenues paid by the participants and expenses paid from the Plan for a one-year period. It should be noted that the CCSF reimbursement amount, which is paid by the SFDCP to the City for salary and other plan administrative costs, fluctuates annually. For instance, the Plan reimbursed the City for $1.425 MM for each year in FY 18/19 and FY 19/20 due to Request for Proposals and legal costs. Expenses were comparatively lower for FY 20/21 at $1.1 MM due to a decrease in salaries (personnel on leave) and limited counsel fees.

	Total Asset Based Fees	Voya Fees	CCSF Reimbursement	Net Revenue
Q3' 20	859,975.48	(375,243.60)		
Q4' 20	938,067.96	(398,670.15)		
Q1' 21	966,438.39	(405,262.67)		
Q2' 21	1,025,433.78	(447,628.00)	(1,102,039.80)	
FY 20/21 total	**3,789,915.61**	**(1,626,804.42)**	**(1,102,039.80)**	**1,061,071.39**

The SFDCP budget was approved at the February Board meeting for $1.5 MM annually. The Plan's current fee structure requires this annual flat dollar budget of $1.5 MM to be converted to an asset-based fee accrual, in order be collected. As such, when the asset base changes over time, the fee accrual also needs to be adjusted on a periodic basis. Based on 2/28/22 assets, the plan requires a 3.2 basis point fee to meet the $1.5 MM budget. However, given the net revenue received over the last year, and based on future capital market returns and participation and savings rates, the Deferred Compensation Committee should consider lowering the City and County of SF administration fee accrual to 2.5 bps.

Callan recommends reducing the CCSF Administration fee to 2.5 bps. Should the Plan move forward with this reduction, and Voya fees remaining unchanged, total participant costs decreases to 6.25 bps annually, or 1.56 bps per quarter.

There are other fee structures the Deferred Compensation Committee may want to consider in the future. For instance, instead of a per annum fee that may need to be adjusted depending on total assets, a flat fee per participant could provide more predictability. Alternatively, some plans have kept the per annum structure in light of market and cash flow uncertainty, but adopted a ceiling on the fees collected i.e., up to $150 per year, or a fee waiver for the first year of plan participation. Other plans have installed a hybrid system using per annum fees for staff costs, and a flat fee for recordkeeping costs. Should the DCC choose to pursue other fee structures, Staff and Consultant can continue the fee analysis and provide a formal recommendation on the Plan's fee structure at later date.

Recommendation

Action: Approve administrative fee reduction and forward to the Retirement Board with a recommendation for approval.

Attachments

Callan's Fee Analysis

Callan

March 30, 2022

City and County of San Francisco Deferred Compensation

Plan Admin Fee Discussion

Greg Ungerman, CFA
Defined Contribution Consulting

Ben Taylor
Defined Contribution Consulting

Agenda

Discussion Outline

- Education on Types of Plan Fees
  - Focus on Administrative Fees
- Review Current Methodology
  - Voya's Recordkeeping Fee
  - SF City and County Admin Fee
- Recommendation to Change City and County Admin Fee Accrual
  - Review supporting assumptions
  - Revenue share method change
- Consider other Administrative Fee Methodologies
  - Flat dollar fee vs. asset based fee

The Four Types of Plan Fees

Plan-Level Administration Fees

Administration fees reflect the services required to administer the plan on an ongoing basis. Typically there is a flat per participant fee or an asset based fee that is set by the administrator.

These fees can be collected directly from the plan sponsor, the participant, forfeiture accounts, or revenue sharing, or some combination of any of the above.

Additionally, separate fees may apply for non-discrimination testing, government forms support, communications and education, etc.

Participant-Level Transaction Fees

Participant transaction fees are assessed based on an individual's action: taking a loan, requesting a distribution, submitting a QDRO, investing in self-directed brokerage.

These transaction fees may generate considerable revenue for the recordkeeper ("RK") and should be considered in any review of plan fees.

These fees can generally be negotiated in the context of the overall recordkeeping relationship.

Investment Management Fees

Investment management fees are set at the fund level and assessed pro-rata based on the assets invested in the fund.

In a mutual fund environment, the operating expense ratio and revenue shared are set between the investment manager and the RK; opportunities to move to a lower fee may be available when plan assets in the fund reach certain levels. Additional share classes or vehicles are continually being made available and must be carefully monitored for eligibility.

Other Revenue

In addition to the sources of revenue outlined, the vendor may also receive additional compensation from other sources: advice providers, rollover partners, self-directed brokerage relationships or trading fees, general account-backed fixed annuities or "spread" products, etc.

It is important to inventory and assess all fees as a component of ongoing due diligence.

The focus of this discussion is on Plan Level Administration Fees

Current SFDCP Plan-Level Administration Fee Policy

Two Key Administrative Fees

1. Voya's Recordkeeping Fee
   - An annualized 3.75 basis points on plan assets
   - Plan assets exclude loans and brokerage window assets
   - Fees charged to participant accounts
   - Plan participants see a line item on their statement and the cost is deducted from their balance.
2. SF City and County Administrative Fee
   - The 2022 budget is $1.5 million
   - The plan uses an annual 4.8 basis point fee accrual on plan assets
   - Plan assets exclude brokerage window assets
   - Fees charged to participant accounts
   - Given the significant growth of the plan, this fee accrual can be lowered

<u>Callan Observations:</u>

- The annual Voya Recordkeeping fee by contract is 3.75 basis points and is passed directly on to participants.
- The SF City and County Administrative fee is an annual flat dollar budget fee of $1.5 million that is collected by converting to an asset based fee accrual. When the asset base changes over time, the fee accrual also needs to be adjusted on a periodic basis.

Focus on SF City and County Administration Fee Policy

Current Calculation Inputs

Background Details:

- The 2/28/22 Plan Assets less the SDBW totaled $4,660,530,627
  - Plan assets grew by $606 million in 2021 and $1.8 billion over past three years
  - Asset growth largely due to exceptional investment returns
  - Future asset growth is very difficult to predict and not expected to grow as quickly
  - Plan assets have fallen by roughly $300 million during 2022, for example

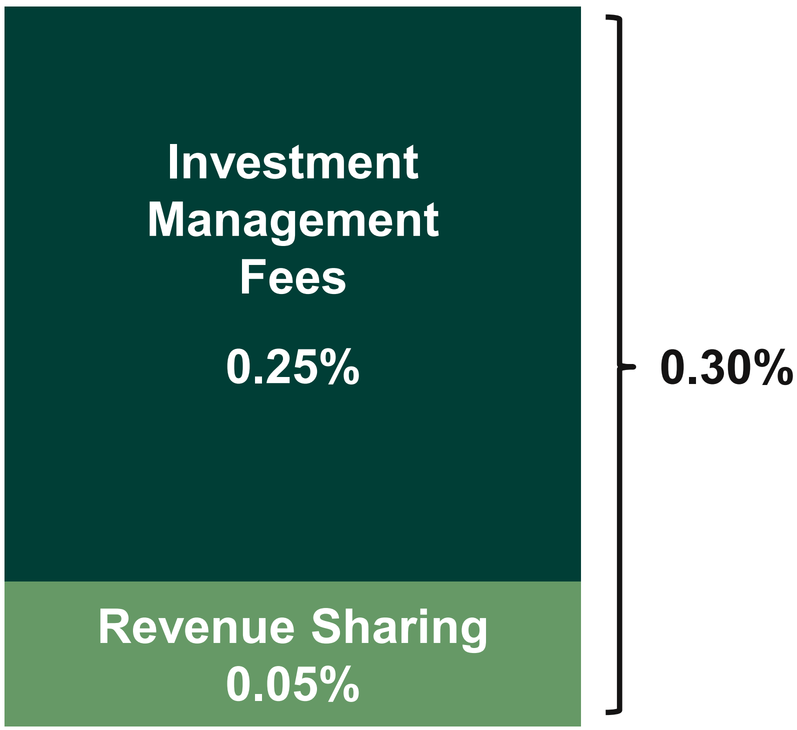
- The budgeted annual fee of $1.5 million equates to a 3.2 basis point fee accrual based on 2/28/22 assets

Recommendation:

- While difficult to predict, based on future capital market returns and participation and savings rates, the DCC should consider lowering the SF City and County Administration fee accrual to 2.5 basis points from the current 4.8 basis points.
  - This assumes a 5% asset growth from the 12/31/21 plan balance
  - This provides a conservative expectation to reflect a smooth fee reduction
  - This analysis will need to be adjusted over time based on actual plan asset changes

Potential Change to Revenue Sharing Funds

What is Revenue Sharing?



- Revenue sharing is the portion of the expense ratio that goes to pay for administrative expenses.
- In this example:
  - The investment manager (Baird Core Plus) retains 0.25% of the total expense ratio of 0.30%.
  - The recordkeeper that offers the fund on its platform receives 0.05% of the total expense ratio to pay for services such as administration, participant and plan sponsor websites, call center services, compliance functions, participant communications, postage/printing, participant meetings, reporting, etc.
- Revenue sharing varies by fund and by recordkeeper.
- This revenue sharing amount can be reallocated to the investment fund that generated it.

- The SFDCP has four funds that generate revenue sharing: Baird Core Plus, MFS Emerging Market Debt, Nuveen Global Infrastructure, and Allspring short duration fund.
- Voya has developed a way to allow the revenue share amounts of these funds to go back to the participants that generated the income.
- Recommendation: Work with Voya to attribute these revenue share amounts to go back to the funds rather than to be used to pay general plan expenses.

Future considerations on City & County Administration Fees

Direct Fee Payment Methods (Hard Dollar vs. Asset-Based)

- Hard dollar fee structure (e.g., $46 per participant):
  - **Pros**: Plan fees are transparent and consistent over time, and easily predictable year to year. It is not necessary to change fees based upon market movements or participant contributions. Based on the rationale that administrative costs are largely driven by head count, not fluctuations in the market. The number of participants has been much more consistent than plan asset totals. May be more equitable for participants and easier to explain.
  - **Cons**: Fees can seem high for new participants or participants with low balances.
- Asset-based fee structure (e.g., 0.025% on assets):
  - **Pros**: Fees paid are typically lower initially but may grow dramatically over time if there is no cap. However, if plan assets decline, the fee accrual may need to increase.
  - **Cons**: As plan assets increase through contributions and investment returns, the amount of the total dollars will exceed the budgeted amount of $1.5 million. Participants pay different fees while receiving substantially the same services.

Additional Considerations

- New hires / low balance participants (e.g., administrative fees do not apply until a certain balance threshold or certain timeframe is met)

SFDCP as of December 31, 2021	
Total Plan Assets	$5,011,048,554
Total Plan Participants	32,906
Required Fees to Pay Admin Costs	2.5 basis points ($45.58/participant)

DOL's Perspective on Appropriate Payment of Plan Fees

Department of Labor Field Assistance Bulletin 2003-3

- While SFDCP is not governed by ERISA, the Plan's investment policy refers to ERISA as an aspirational best practice, making existing ERISA guidance relevant.
- ERISA contains no provisions specifically addressing how plan expenses may be allocated among participants and beneficiaries.
- A fiduciary must be prudent in the selection of the method of allocation.
- The fiduciary weighs the competing interests of various classes of the plan's participants and the effects of various allocation methods on those interests.
- A fiduciary's decision must satisfy the "solely in the interest of participants" standard. However, a method of allocating expenses would not fail to be "solely in the interest of participants" merely because the selected method disfavors one class of participants, provided that a rational basis exists for the selected method.

Disclosures