MEMO

To: City of San Jose Deferred Compensation Plan Staff

From: Hyas Group

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RE: Excess Revenue in Plan Administration Account

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Determining the amount charged to participant accounts requires several inputs that may change over the short term. By utilizing an asset-based fee, the amount collected in dollars is dependent on the total asset size of the plan(s). In addition, plan-related administrative budgets can change dramatically from one year to the next.

Best Practices

In our experience, plans first calculate their plan-related budget and include all expenses that the plan(s) will reasonably bear. They then look at the most appropriate way to pay for those costs:

- Have the agency (the City of San Jose) pay for the costs – some committees and their employers believe this is the most effective way to pay for a benefit that the agency provides. Although this may be the cleanest, it is very rare as most agencies simply do not have the funds to pay for these costs.
- Utilize a per-head tack-on fee – many plan providers will tell you retirement plan record keeping fees are based on the number of accounts so charging plan fees based on this metric is the most fair. Although many committees may agree in theory, the practice may be anything but fair. Many use the extreme case of very small accounts paying a relatively high per-head fee as prohibitive. In other words, if an account balance is $2,000 and the participant is contributing $25 per paycheck, their $75 annual per-head fee is 3.8%. This would be considered an exorbitant fee. On top of that, conceivably my first three contributions of $25 would go to pay this fee and not go into the participant account.
- Apply an asset-based fee – this is the form that is by far the most common. Although it charges participants with a higher balance more than participants with smaller account balances, this method reflects the other charge most typically associated with retirement plan investing: fund expense ratios. In other words, it is not the perfect solution but most likely the most appropriate of all methods.

The City uses the application of the asset-based administrative fee, and they have not only developed a budget for plan-related expenses, they have also developed a policy around excess reserves. This approach reflects best practices.

The Deferred Compensation Advisory Committee was recently informed that in the case of any future class action lawsuits, the retention for any legal defense will increase quite dramatically. There was discussion around increasing the current budget "reserve" for this hypothetical cost, which may require an increase to the current asset-based fee. We would advise against that for many reasons. First, the odds of the City and/or its plans of experiencing a legal challenge may remain low, especially given the governance structure (having a Committee that meets regularly, employing a sound governance process, utilizing prudent fiduciary best practices, engaging an outside independent consultant, etc.). Second, charging current participants a fee now for an expense that may come years or even decades from now may not be totally appropriate. The flipside to this point is that the plans can always return any excess reserves to the participants in the years any fees were not used. But this thought leads to the third point, the additional asset-based fee can always change. The plan provider takes direction from the Deferred Compensation Advisory Committee and/or City on many features of the plan(s) and the administration tack-on fee is one of those. In other words, when any unforeseen cost emerges (legal costs, insurance deductible, or any others), the Deferred Compensation Advisory Committee can slightly increase the participant fee to match the current plan-related budget in that year.

In the June meeting, the Finance Department discussed the City's fiduciary liability insurance policy and noted that the retention increased from $100,000 to $250,000. The current reserve policy includes a reserve amount of $125,000; $25,000 reserves for non-class action suit related claims, and $100, 000 related to class action suits. If the Deferred Compensation Advisory Committee wanted to increase the administrative budget by another $150,000, the following table can be a useful guide in how much the asset-based fee would have to increase given the size of the plan in future years.

Year	Assets	Cost of Retention Increase
2022	$1,120,982,023	0.013%
2023	$1,177,031,124	0.013%
2024	$1,235,882,680	0.012%
2025	$1,297,676,814	0.012%
2026	$1,362,560,655	0.011%
2027	$1,430,688,688	0.010%
2028	$1,502,223,122	0.010%
2029	$1,577,334,278	0.010%
2030	$1,656,200,992	0.009%

Combined plan assets as of June 30, 2022 (457 and PTC excluding loans). Plan growth assume 5% annual increase. Current administrative tack-on fee is 0.045%.

In Closing

Our recommendation is to maintain the budget with only bona fide plan related expenses and reserve that a reasonable person would say that will be charged in that year or in the near future. Charging now for a hypothetical cost in the future may be too burdensome for current participants.

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