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CORRESPONDENCE / MEMORANDUM

DATE: August 14, 2014

TO: Deferred Compensation Board Investment Committee Members

FROM: Shelly Schueller, Deferred Compensation Director
David Nispel/ Dan Hayes, ETF Legal Counsel
Bob Willett, Chief Trust Financial Officer

SUBJECT: Fiduciary Duties and Allocation of Reimbursements

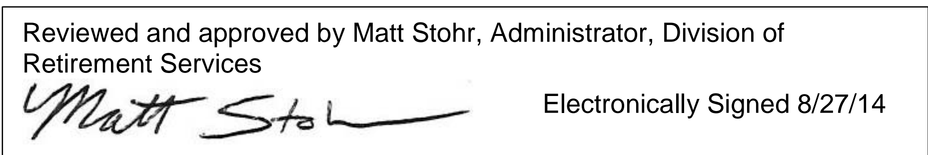
The Deferred Compensation Board (Board) has been discussing fiduciary duties as they relate to the decisions the Board may be asked to make regarding the use of reimbursements from various Wisconsin Deferred Compensation Program (WDC) investment options. Generally speaking, it is in the Board's best interest to follow sound, prudent fiduciary governance processes because these processes protect participants and shield the Board from liability. This memo provides a general refresher of fiduciary duties, discusses questions related to the Board's fiduciary duties regarding allocation of reimbursements and offers recommendations for the committee's consideration.

Fiduciary Duties

The common law of trusts defines the scope of authority and responsibilities of trustees as all powers necessary and appropriate for the carrying out of the trust's purposes, including acting to ensure that a plan receives all funds to which it is entitled so that those funds can be used on behalf of participants and beneficiaries. Fiduciaries are personally liable to make good to the plan any losses from breaching their fiduciary responsibility. Fiduciaries are held to the highest standard of conduct imposed by law.

- The 1996 Small Business Job Protection Act (SBJPA) imposed fiduciary duties including the exclusive benefit rule (loyalty) and prudence requirements on s. 457(b) plans such as the WDC.

- State laws also impose fiduciary duty through the Uniform Trust Act and Uniform Prudent Investor Act. In addition to complying with state Uniform Trust Act and the Uniform Prudent Investor Act, most governmental plans like the WDC use Employee Retirement Income Security Act of 1974 (ERISA) rules as a best practices guide.



Reviewed and approved by Matt Stohr, Administrator, Division of Retirement Services

Electronically Signed 8/27/14

Board	Mtg Date	Item #
DCIC	9.11.14	2A

Basic fiduciary principles:

- Duty of loyalty (exclusive benefit rule)
- Duty of prudence
- Duty to diversify plan assets
- Duty to monitor funds and providers and make changes when warranted
- Duty to follow terms of plan documents

The duties of loyalty and prudence are of primary importance for the Board as they consider share classes, use of reimbursements and the administrative expense account balance.

Loyalty - The duty of loyalty includes acting in the best interests of plan participants, including ensuring that plan fees and expenses are "reasonable."

Prudence - The duty of prudence focuses on the process followed when making fiduciary decisions. Prudence requires fiduciaries to act with the care, prudence, skill and diligence a knowledgeable person administering a retirement plan would use. Among other things, a sound, prudent process includes regular meetings at which careful, diligent, thorough decision-making processes are followed and documented, and periodically reviewing decisions to ensure they continue to be right for the plan.

Reimbursements Questions

As part of commitment to uphold its fiduciary responsibilities to WDC participants, there are three primary questions the Board should carefully think through:

1. ***Must the Board take the WDC's operating account balance down to zero each year?*** The answer appears to be unclear at the present time. In "Revenue Sharing Best Practices: An Excellent Time to Revisit Your Revenue Sharing Policies and Procedures" (GWRS Focus on 457 Newsletter August 31, 2011 copy attached), Question 9 on page 7 asks "Why Can't We "Hold Over" Excess Revenue for Another Year?" Great-West's answer in the newsletter indicates that because there is no provision to do so, holding revenue for a future year's expenses is not acceptable. Great-West further states that based on forfeiture account guidance, best practice is to allocate excess amounts to participant accounts annually. Finally, the Great-West newsletter points out that waiting several years to do this could be a liability for the Board because participants who close out their accounts before the allocation is completed may not receive the excess revenue which they are owed. If this were to occur, Great-West has suggested that participants could "properly allege that they did not benefit because the allocation occurred after they" closed their account.

   However, Great-West's position on this seems to be somewhat of an outlier. In response to a query posed in July 2014, to the government members of the National Association of Government Defined Contribution Administrators (NAGDCA), 19 of 21 (90%) responding plans indicated that they carryover an account balance each year. The carryover amount varied between two and eighteen months-worth of a plan's

anticipated expenses. It does not seem prudent nor a best practice to take the Board's administrative expense account to zero each year.

Staff does not recommend changing this policy, but does propose updating the Board's Administrative Expense Account Investment and Target Balance Policy to specifically declare that the Board will maintain a balance in its account in order to satisfy the plan's anticipated expenses.

2. ***Must the Board evaluate share class options with respect to cost, reimbursements, etc?*** Yes. In March 2013, the US Court of Appeals for the 9th Circuit affirmed in Tibble v. Edison International that the plan fiduciaries of Edison's s. 401(k) plan breached their fiduciary duties because they didn't examine share class alternatives, specifically whether they should offer institutional share classes where available.

   On behalf of the Board, the Department has monitored share class options available to the WDC. Institutional share classes have been offered when available. Institutional share classes typically do not provide reimbursements and frequently have lower expense ratios, which can result in savings for investors. In February 2012, the Board moved the WDC to the institutional share class of the American Funds EuroPacific Fund. In June 2014, the Board voted to move to the institutional share class for the T. Rowe Price Mid-Cap Growth Fund, which will also result in lower costs for WDC participants investing in this fund.

   In the spring of 2014 Fidelity opened ContraFund institutional share class "K" to plans such as the WDC who can meet Fidelity's minimum investment requirements. The institutional share class does not provide a reimbursement. However, staff did not recommend that the Board change ContraFund share classes. That is because the Department's analysis showed that the slightly lower cost of the new "K" share class does not translate to enough savings for WDC participants, when compared to the overall loss of the Fidelity reimbursement. Changing ContraFund share classes would negatively affect participant administrative fees, perhaps requiring an immediate increase of approximately fifty percent (50%).

   Staff does not recommend changing share classes unless it is fiscally prudent and in the best interests of WDC participants.

3. ***How should reimbursements be allocated?*** A review of best practices followed by s. 401(k) plans and a recent NAGDCA query of s. 457 plan sponsors indicates that it would be appropriate for the Board to allocate the reimbursements back to the participants in the fund that generated the revenue.

   Responses to a query posed to NAGDCA in July 2014 revealed that 16 of 21 responding plans (76%) received reimbursements. Seven operate similar to the WDC and simply use the reimbursements for general plan expenses. Many utilize the

reimbursements for overall plan expenses, and distribute any surplus revenue after expenses to their participants. A few have offered "fee holidays" which suspend participant administrative fee collection for a period of time, and at least two use the reimbursements to purchase additional shares of the option providing the reimbursement for benefit of the participants in that fund.

Unless reimbursements are returned to the participants whose balances created the reimbursement, the Board's current use of reimbursements may be viewed as inherently inequitable; some participants' investment choices (those that provide a reimbursement) are subsidizing the expenses of other participants in the plan. Returning the reimbursements to the participants whose balances created the reimbursement ensures that all participants are paying a similar proportion of the plan's administrative costs based on their account balance in each of the plan's funds. The WDC's administrator has indicated that they could rebate participants on a monthly basis, and that there would not be an additional charge to the WDC for this service.

Recommendations

Staff recommends the Investment Committee recommend the following to the Board:

1. Updating the Board's Administrative Expense Account Investment and Target Balance Policy to affirm the Board's position that maintaining a target balance in the administrative expense account to satisfy the plan's anticipated expenses is desirable (draft attached);

2. Changing share classes to offer share classes that do not provide reimbursements, when fiscally prudent and a more inexpensive (e.g., institutional) share class is available; and

3. Allocating reimbursements back to the participants in the fund that generated the revenue, as long as a minimum balance is maintained in the Board's administrative account. This proposal could be presented at the next Board meeting, along with projections on when this might be accomplished with the least disruption to the existing participant administrative fee structure.

Staff will be at the September 11, 2014, meeting, to discuss this memo and answer any questions on the contents.

Attachments:

a) Revenue Sharing Best Practices: An Excellent Time to Revisit Your Revenue Sharing Policies and Procedures" (GWRS Focus on 457 Newsletter August 31, 2011)
b) Administrative Expense Account Investment and Target Balance Policy with proposed revisions

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Revenue Sharing Best Practices:
An Excellent Time To Revisit Your Revenue Sharing Policies and Procedures

We last discussed Revenue Sharing in our Briefing Document in July, 2006. Since that time, little has changed regarding the mechanics of revenue sharing, and how such amounts should be used in public employee defined contribution plans. However, this is a good time for plan sponsors to revisit their revenue sharing policies and procedures. The increasing use of investment options with institutional pricing, and the upcoming changes in fee disclosure are just two of the reasons that all plan sponsors should review this topic.

1. What is Revenue Sharing?

"Revenue sharing" is the industry term for a return of some revenue collected by mutual fund companies or other investment providers. In general, revenue sharing comes in two forms:

- 12(b)(1) fees and;
- Shareholder service fees (sometimes called sub-transfer agent fees)

12(b)(1) fees are fees collected by the mutual fund company to cover marketing expenses. In accordance with regulatory requirements (hence the name – 12(b)(1) fees), mutual funds must disclose the amount of any such fees in the prospectus for the fund. Upcoming regulatory changes will rename these types of fees and put limits on amounts that can be collected and paid.

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Shareholder service fees are generally amounts the mutual fund company returns to the Plan in exchange for not performing certain services. For example, large Governmental Plans usually have a Third Party Administrator (TPA) or record keeper that handles record keeping services, administration, and participant services. This means that the mutual fund company does not have to perform these services, even though the expense for these services is built into the fees charged to "retail" shareholders in that fund.

Plan sponsors that are diligent in their fiduciary duties do not feel that the mutual fund company should be collecting these fees when, in fact, another entity (the TPA or record keeper) is providing these services. Therefore, many funds will "return" some of the revenue they are collecting in exchange for the TPA or record keeper handling these functions.

The total of these two items is generally referred to as "revenue sharing" because the mutual fund company is "sharing" some of the revenue they would otherwise keep. Since the source of the revenue sharing is, directly or indirectly, the fund, the Plan Participants whose accounts are invested in the fund ultimately bear the expense of the revenue sharing as well as part of the administrative costs of the plan.

- Important Note: 12(b)(1) fees and shareholder service fees are usually paid only by "retail" mutual funds. These fees are not paid by institutional funds. Institutional funds are generally funds that are designed for use by larger plan sponsors and they usually contain lower investment management fees than retail funds. In addition to lower investment management (and other) fees, many institutional funds do not pay revenue sharing, but some do. *As a general rule, it is best for a plan sponsor to consider an institutional version of a mutual fund vs. the retail version, if an institutionally-priced version is available and all other features are the same.*

  In *Tibble v. Edison International* the court found that a plan sponsor had violated its fiduciary responsibility by failing to consider the less expensive institutional share class of the same fund. Another court reached a similar conclusion in *Braden v. Wal-Mart*. Therefore, IF institutional funds, and/or share classes of various funds are available at a lower price, the plan sponsor should carefully consider them.

  In many larger Governmental Plans, retail funds have been discontinued altogether and replaced with institutional funds. If you operate a larger Governmental Plan and have not recently considered institutional funds as alternatives to your current retail funds, it may be prudent to do so.

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2. How is Revenue Sharing Paid?

There are two methods for your TPA or record keeper to handle Revenue Sharing paid by investment providers:

- The revenue paid by your investment providers may be taken into account when the TPA or record keeper quotes their fees. This means the TPA will retain the revenue paid (or "shared"), but use it to reduce or eliminate the fees the Plan or Plan participants would otherwise pay for the services of the TPA, or;

- The TPA will charge an explicit fee of their own, and all revenue sharing from investment providers will be paid to the Plan, rather than taken directly into account in the TPA fees. In this instance, any revenue sharing is generally first used to pay the TPA or record keeper fees. Any excess or "left over" revenue from investment providers is then retained by the Plan for other Plan-related expenses that year. After those fees are paid, any remaining balances should be allocated to Plan Participants, at least annually.

3. If Revenue Sharing is paid to the Plan, How Does That Work?

Your TPA or record keeper will collect the revenue on behalf of the Plan and deposit it into the Plan where a separate accounting is created and held within the Plan. Some of the common names for this account are "Plan Revenue Account," "Revenue Sharing Account," "Unallocated Plan Account," or "Unallocated Trust Account." The Plan Sponsor will designate an investment option for this account, often choosing the Stable Value Fund to be sure these amounts are not at risk of loss.

4. May These Amounts be paid to Another Entity Like the State Government or Municipality?

No. Revenue sharing must remain part of the Plan assets, and be held in trust for the exclusive benefit of Plan participants and beneficiaries. These amounts may not, under any circumstances, be used for any other purpose than the exclusive benefit of Plan Participants and beneficiaries. They cannot be used to pay expenses otherwise owed by the plan sponsor, only for expenses that would otherwise be borne by the Plan or Plan Participants.

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5. How is This Revenue Supposed to be Used?

IRC Section 457(b) provides that all plan assets are to be used for the "exclusive benefit of plan participants and beneficiaries". Therefore, revenue sharing must be used exclusively for Plan-specific fees and services. It may not be paid to the general fund of the employer or diverted from the Plan for other purposes.

The allocation of revenue sharing among participant accounts is becoming an increasingly important issue for plan fiduciaries. While there is no direct guidance on the allocation of revenue sharing amounts, plan fiduciaries must apply general fiduciary principles in deciding how to handle these funds. The duty to act prudently can be described as requiring procedural diligence or a prudent process. It requires the plan sponsor to engage in a process that will generally lead to informed and reasoned decisions.

It may be most prudent to follow the Internal Revenue Code (Code) and Internal Revenue Service (IRS) rulings with respect to forfeiture suspense accounts. The IRS website states: "Forfeitures must be used or allocated in the plan year incurred. The Code does not authorize forfeiture accounts to hold unallocated monies beyond the plan year in which they arise. Revenue Ruling 80-155 states that a defined contribution plan will not be qualified unless all funds are allocated to participants' accounts in accordance with a definite formula defined in the plan. This would preclude a plan from carrying over plan forfeitures to subsequent plan years, as doing so would defy the rule requiring all monies in a defined contribution plan to be allocated annually to plan participants. Revenue Ruling 84-156 states that forfeitures may be used to pay for a plan's administrative expenses and/or to reduce employer contributions. Treasury Regulations §1.401-7(a) notes that forfeitures must be used as soon as possible to reduce employer contributions.

The plan document's terms should have provisions detailing how and when a plan will exhaust plan forfeitures. A plan's failure to use forfeitures in a timely manner denies plan participants additional benefits or reduced plan expenses."

The IRS cautions plan sponsors to ensure that the terms of their plan documents are not vague in describing how forfeitures and other unallocated amounts, such as revenue sharing, are to be handled. The plan sponsor must not erroneously think that he or she has discretion over how and when such amounts can be applied and must not fail to monitor the plan's unallocated accounts to ensure that amounts deposited into such accounts in that plan year are used according to the plan's terms.

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Governmental Plan sponsors using the Great-West Model Plan Document for their IRC Section 457 Plan,must allocate all revenue sharing amounts not otherwise used to pay expenses to participant accounts annually pursuant to the following provision:

7.08 Trustee Fees and Expenses. All reasonable costs, charges and expenses incurred by the Trustee in connection with the administration of the Trust assets (including fees for legal services rendered to the Trustee) may be paid by the Employer, but if not paid by the Employer when due, shall be paid from the Trust. Such reasonable compensation to a bank or trust company Trustee as may be agreed upon from time to time between the Employer and the Trustee may be paid by the Employer, but if not paid by the Employer when due, shall be paid by the Trust. The Trustee shall have the right to liquidate Trust assets to cover its fees. Notwithstanding the foregoing, no compensation other than reimbursement for expenses shall be paid to a Trustee who is the Employer or a full-time Employee. In the event any part of the Trust assets become subject to tax, all taxes incurred shall be paid from the Trust unless the Administrator advises the Trustee not to pay such tax. **If pursuant to 7.07(e) an account holding un-invested trust assets is in existence at anytime during the Plan Year, all amounts in the account shall be first used to offset any plan expenses and any amounts remaining shall be allocated to Participant's accounts no later than the end of the Plan Year.** (Emphasis added)

7.07 Investment Powers of the Trustee. The Trustee shall implement an investment program based on the Employer's investment objectives. If either the Employer or the Participant fails to issue investment directions as provided in Sections 8.01 and 8.02, the Trustee shall have authority to invest the Trust assets in its sole discretion. In addition to powers given by law, the Trustee may:

(e) deposit fees earned from revenue sharing, 12(b)(1) fees, any investment gains and any otherwise unallocated trust assets into an account to be invested in any employer-directed investment option available under the Plan;

6. What if the Plan Sponsor Provides Services to the Plan and Desires to be Reimbursed?

If the Plan Sponsor incurs legitimate and documented expenses that are completely attributable to services provided to the Plan, Plan assets may be used to pay such expenses. This may be done by setting Plan-level fees at a point necessary to include such expenses, and/or using the revenue sharing account to reimburse the Plan Sponsor for legitimate fees incurred on behalf of the Plan. This would include legitimate education and training activities for staff, Trustees, or Board members.

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It has always been a "best practice" to disclose to Plan Participants the fees that are used by the Plan Sponsor for such expenses, separately broken out from those paid to the TPA or record keeper. Under the new fee disclosure guidelines being implemented in 2012, the need to properly disclose these fees is even more important.

7. May the TPA or Record Keeper be paid From the Plan Revenue Account?

Yes. Some plans collect an explicit administrative fee on participant accounts (Plan assets). In addition, they collect revenue sharing from investment providers. The total is deposited into the Plan Revenue Account. Then, all Plan-related expenses are paid from the Revenue Account as authorized by the Plan Sponsor/fiduciary.

It is important to note that under this administrative platform, the Plan assumes the risk for having enough revenue to pay all Plan expenses. Explicit administrative fees and revenue sharing must be equal to or greater than the total of all fees paid to operate the Plan. The Plan Sponsor, as fiduciary, is responsible for prudent management of the "expense" and "income" elements of the Plan.

8. What if We Have "Excess" Revenue in Our Plan Revenue Account?

As indicated in question #(4) above, all excess revenue must be used for the exclusive benefit of Plan Participants and their beneficiaries. Any amounts not used to pay plan expenses should be allocated to Plan Participant accounts annually.

Excess revenue could be used for:

- Trustee and Plan Sponsor education and training
- Consulting fees for conducting an RFP process and/or annual investment analysis
- Funding to encourage participation in the Plan, or to encourage higher employee contributions
- A "Fee Holiday" to encourage enrollment
- Education and outreach programs for Plan Participants
- Funding for Investment Advice and Managed Account services.

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9. Why Can't We "Hold Over" Excess Revenue for Another Year?

First and foremost are the requirements outlined in Question #(4) above. There is no provision which indicates that "holding over" excess funds from year to year is acceptable. To the contrary, where guidance on this issue exists (for forfeiture accounts), it requires that excess amounts be allocated to participant accounts annually.

As a secondary consideration, but of equal importance, is that Plan Participants who generated the revenue should have an equal opportunity to share in the allocation. If a Plan has not distributed excess revenue for several years, and a participant retires or terminates, then he or she will never have received the excess revenue they are entitled to. Assuming several years' worth of excess revenue is allocated after a participant separates service, they could properly allege that they did not benefit because the allocation occurred after they terminated. Therefore, holding over excess revenue from year to year is not a "best practice" and is not specifically provided for in any legal or regulatory guidance.

10. Should Our Policy on the Use of Revenue Sharing be Documented?

Absolutely. The plan document should clearly state how revenue sharing amounts are to be used. The policy could provide for the payment of plan expenses, and describe the method to be used in allocating any remaining amounts to Plan Participants.

11. What if Our Plan Uses Both Retail Funds and Institutional Funds?

If that is the case, then you will want to seriously consider how your Revenue Sharing Account assets are used. If the plan document does not specify a method (or is ambiguous), the plan sponsor must select the proper method to apply. Although governmental plans are not subject to the Employee Retirement Income Security Act (ERISA), most plans use those rules as a "best practice." The principles described by the Department of Labor (DOL) in Field Assistance Bulletin 2003-03 are essentially as follows:

1. Plan sponsors must follow deliberative, prudent process in deciding on the allocation methodology.
2. Plan sponsors must take the interests of different classes of Plan Participants into account and the effect the allocation method will have on each class.
3. The allocation method must have a reasonable relationship to the services being provided to Plan Participants.
4. Plan sponsors must avoid conflicts of interest.

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The DOL has also provided guidance on the allocation of settlement proceeds from securities class action litigation regarding late trading and market timing. In Field Assistance Bulletin 2006-01, the DOL concluded that similar to allocating expenses, a plan fiduciary must be prudent in the selection of an allocation method. The DOL indicated that prudence requires the plan sponsor to choose a methodology where the amounts would be allocated, where possible and cost effective, to the affected Plan Participants.

This would entail allocating the revenue sharing to participants who use the retail funds, and not to participants in the institutional funds. As an example, each fund would have a revenue sharing allocation once per year, and it would be deposited into that particular fund under your Plan on a certain date. That is the best way to ensure that participants who earned the excess revenue share in it.

It would also be wise not to use assets in the Plan Revenue Account for consulting or other fees if in fact many participants are using institutional funds, or funds that do not pay revenue sharing. Having one class of participants fund items like consulting fees through higher expenses, while another class of participants pays nothing could be viewed as unfair or inappropriate. In this case, a uniform fee assessed against all participants accounts should fund such expenses (including the TPA or record keeping) fee. Revenue sharing would be used solely to be returned to participant accounts who earned it.

For plans where the asset distribution shows a fairly equal use of retail and institutional funds, then the Plan Sponsor may conclude that use of funds in the Plan Revenue Account can be used for plan-wide services like consulting fees and/or staff expenses, etc.

12. Are Revenue Sharing Funds Subject to Fee Disclosure?

It has long been a “best practice” to disclose the use and purpose of funds in the Plan Revenue Account, including payments to service providers, staff expenses, and ultimately, how excess amounts will be allocated to Plan Participant accounts. Not all Governmental plan sponsors have or follow such a policy however.

Beginning in 2012, Governmental Plan Sponsors will want to consider making a more detailed disclosure of revenue sharing amounts to Plan Participants. While only ERISA plans are required to comply with the new fee disclosure rules, most governmental plans use ERISA as a “best practice.” Therefore, beginning next year, we expect most Governmental Plans will enhance their disclosure with respect to how revenue sharing amounts are used to pay plan expenses and the method used to allocate remaining revenue sharing amounts to Plan Participant accounts.

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The next issue of Focus on 457 (September, 2011) will discuss fee disclosure for Governmental Plans in more detail. If you would like more background on this subject before next month's issue, please refer to the Focus on 457 dated October 28, 2010 : DOL Issues Final Participant Fee Disclosure Regulation.

Conclusion: Plan sponsors must act prudently, in the best interests of Plan Participants and without conflicts of interests when allocating plan expenses and revenue sharing amounts. It is particularly important to carefully deliberate when choosing an allocation method given the increased concerns and litigation surrounding plan fees and revenue sharing. Prudence would appear to favor the selection of the actual allocation method of returning revenue sharing to affected Plan Participant accounts when that can be accomplished in a cost-effective manner.

If you have any questions or require additional information, please contact your Great-West plan relationship associate:

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Administrative Expense Account
Investment and Target Balance Policy

Adopted: May 1996

Last Revised: ~~November 1999~~draft for consideration at Nov. 2014 Board mtg

The Deferred Compensation Board's Administrative Expense Account will be invested in the Stable Value Fund. The Board's Target Balance Policy is that the administrative account from which Wisconsin Deferred Compensation Program (WDC) expenses are paid will attempt to maintain a prudent level of financial resources, which is an account reserve balance that equals approximately 45% to 50% of annual plan expenses. This amount may be adjusted as needed.

Excess Administrative Account Reserve Balance *(adopted xxx):* The balance in this account will be monitored and a report presented to the Board no less than annually. In the event that the Board's administrative expense reserve exceeds (2x or % or $) of the target balance, participants investing in options generating reimbursements may be partially rebated.

Investment of Board's Administrative Expense Account *(adopted May 1999)*: The Board's administrative expense account shall be invested in the WDC's Stable Value Fund. This move was authorized after the Board recognized that higher returns could be achieved through the Stable Value Fund while still safeguarding the principal. Prior to 1999, the administrative account was invested in the WDC's FDIC option.

Target Balance Policy Background: The Board's goal is to continue to minimize individual participants' annual fee levels while taking into consideration the potential for market downturns that negatively impact asset-based participant fee revenues. Forty-five to fifty percent of annual plan expenses was selected as the appropriate expense account target balance because analysis showed that this would help stabilize participant administrative fees while maintaining enough in the Board's administrative expense account to pay for WDC-associated expenses.

The target balance is intended to provide financial stability and flexibility to:

- Maintain services and achieve goals during unanticipated or extended economic downturns resulting in revenue shortfalls
- Avoid unplanned increases in participant administrative fees
- Fund new initiatives and services
- Respond to unexpected opportunities

The WDC is a self-funded program; no state tax revenues may be used to support it. All revenues used to pay plan expenses are generated from participant administrative fees, some investment option reimbursements (for recordkeeping and marketing) and any gains on the Board's administrative expense account.

From 1992 through 1995, the Board used a combination of an annual $10 administrative service fee plus an asset-based participant fee to pay for all WDC-related expenses. From 1995 through 1999, the WDC imposed a straight asset-based administrative fee on participants. This asset-based fee fluctuated, depending on what was required to pay WDC expenses. It also required a very conservative approach by ETF staff when making revenue and expense projections in order to protect against raising participant administrative fees should there be a long or short-term market downturn. As a result, for several years the revenues generated by

the participant administrative fee exceeded annual estimated expenses and the balance in the Board's administrative expense account grew significantly beyond the Board's established rate stabilization reserve level.

In 1998-99, the Board began examining the idea of moving the participant administrative fee from an asset-based fee to a flat fee. This proposal was made because it was becoming obvious to staff that using an asset-based participant fee posed potential problems. With many WDC participants investing in equity mutual funds, a potential market down-turn (short or long) could greatly decrease total WDC assets and thus monthly revenues. The volatility associated with the asset-based fee also made it difficult to project revenues: as the markets and WDC assets fluctuate, so would the amount of revenue generated. At their meeting in November of 1999, the Board approved moving to a flat participant administrative fee beginning in February 2000, which significantly reduced this volatility.