



State of Wisconsin
Department of Employee Trust Funds
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Correspondence Memorandum

Date: October 18, 2016
To: Deferred Compensation Board
From: Cindy Klimke-Armatoski, CPA
Chief Trust Financial Officer
Subject: Administrative Fee Recommendation

Staff recommends the Deferred Compensation Board (Board) approve the proposed revisions to the annual administrative fees that help fund the Wisconsin Deferred Compensation Program (WDC), effective January 1, 2017. To maintain a reserve balance close to or within target over the next five years, staff recommends an average increase in fees of 13%.

The Board maintains an administrative account to pay the administrative expenses for the WDC. These expenses consist primarily of the administrative services contract with Empower Retirement, but also include the costs for the Department of Employee Trust Funds (ETF) staff, audits and other plan expenses.

Revenues to fund administrative expenses come from participant plan administration fees and investment income on the account balance. Prior to January 1, 2016, revenues also included investment provider reimbursements. With the adoption of the Board's Investment Option Selection and Reimbursements Policy, WDC investment option reimbursements are now allocated back to participants. ETF estimated in June 2015 that the allocation of mutual fund reimbursements to participants would remove almost \$2 million a year in funding for administrative costs and that an increase in participant administrative expenses would be necessary. After reviewing the options provided by ETF, the Board chose to expand participant tiers and change administrative fees as of January 1, 2016, as shown in Table One.

Reviewed and approved by Robert J. Conlin, Secretary

Electronically Signed 10/18/16

Board	Mtg Date	Item #
DC	11.1.16	6

Table One: Pre-2016 and 2016 Fees				
Participant Account Balance	Pre-2016 Monthly Fee	Monthly Fee as of 2016	Pre-2016 Annual Fee	Annual Fee as of 2016
\$1-\$5,000	\$0	\$0	\$0	\$0
\$5,001-\$25,000	\$1	\$1	\$12	\$12
\$25,001-\$50,000	\$2	\$2.50	\$24	\$30
\$50,001-\$100,000	\$4	\$5	\$48	\$60
\$100,001-\$150,000	\$5.50	\$7	\$66	\$84
\$150,001-\$250,000	\$5.50	\$10	\$66	\$120
Over \$250,000	\$5.50	\$15	\$66	\$180
Average	\$3.35	\$5.78	\$23.50	\$69.36

Plan administrative fees are deducted from participant accounts monthly, based on the account balance. Participants also pay an internal expense charge to each fund in which they invest, but those amounts go to the investment provider, not to the plan. To encourage participation, participants pay no fees until their account balance exceeds \$5,000.

Table Two below reflects recent year activity as well as projected activity for the next three years (in thousands \$). Administrative services contract expenses increases are a direct result of the WDC contract administrator meeting the goals and objectives set by the Board in annual Plan Enhancement Programs (PEP), which became part of the administrative services contract agreement Section 7.3A¹ beginning in calendar year 2011.

¹ Section 7.3A of the Board's Administrative Service Contract states that if total WDC participant growth is greater than 1% but less than 3%, the annual administrative fee increases by 2.7%. Additionally, if the administrator meets the Board's objectives as defined in the annual PEP, the administrative fee increases by an additional 0.3% in the following year, for a total increase of 3.0%. If participant growth is greater than 3% and the administrator meets the PEP objectives, the administrative fee increases by an additional 0.7% in the following year, for a total maximum increase of 3.7%.

Table Two: Administrative Account Activity				
	2018	2017	2016	2015
January 1 Account Balance	<u>\$1,567</u>	<u>\$2,206</u>	<u>\$2,489</u>	<u>\$2,565</u>
Revenues				
Participant Fees	2,833	2,632	2,513	1,598
Investment Provider Reimbursements	-	-	388	1,483
Investment Earnings & Other	<u>42</u>	<u>53</u>	<u>66</u>	<u>64</u>
Total Revenues	<u>2,875</u>	<u>2,685</u>	<u>2,966</u>	<u>3,144</u>
Expenses				
Administrative Services Contract	3,241	3,146	3,077	3,053
DRO Fees	16	16	16	16
ETF Administration & Miscellaneous	<u>168</u>	<u>162</u>	<u>156</u>	<u>151</u>
Total Expenses	<u>3,425</u>	<u>3,325</u>	<u>3,250</u>	<u>3,220</u>
December 31 Account Balance	<u>\$1,016</u>	<u>\$1,567</u>	<u>\$2,206</u>	<u>\$2,489</u>
Account Balance as % of Projected Annual Expenses	29%	46%	66%	77%
<i>Values may not foot due to rounding.</i>				
<i>2015 figures are actual.</i>				
<i>2016 Q1 and Q2 figures are actual.</i>				
<i>2016 Q3 through 2018 figures are projected.</i>				

Participant administrative fees are closely correlated to plan assets. With equity returns as the primary driver of changes in plan assets, the Board's administrative account is very sensitive to long-term equity returns.

The Board's policy for the administrative account is to maintain an account balance equal to 50-75% of projected annual plan expenses. The accompanying charts illustrate projected administrative account balances based on an assumed investment return of 7.2% without an increase in participant administrative fees (top), and with an average 13% increase (bottom).

ETF projections show an average annual equity investment return of 7.2% will result in the reserve balance of the Board's account falling below 50% next year and being exhausted in 2022. An average annual equity investment return of 10% will result in the reserve balance falling below 50% in early 2018.

To maintain a reserve balance close to or within target over the next five years, staff recommends an average increase in fees of 13%. Table Three shows the proposed increases by participant account balance.

Table Three: Proposed Future Fees					
Participant Account Balance	Number of Participants	Current Monthly Fee	Proposed Fee		
			Goal: 50-75% Reserve Balance		
			Monthly Fee	% Increase	Basis Points
\$1 – 5,000	13,881	\$0.00	\$0.00	0%	0.0
\$5,001 – 25,000	15,444	\$1.00	\$1.00	0%	8.0
\$25,001 – 50,000	8,857	\$2.50	\$3.00	20%	9.6
\$50,001 – 100,000	8,514	\$5.00	\$6.00	20%	9.6
\$100,000 – 150,000	4,238	\$7.00	\$8.00	14%	7.7
\$150,001 – 250,000	4,036	\$10.00	\$11.00	10%	6.6
Over \$250,000	4,043	\$15.00	\$16.50	10%	6.6
Average	59,013	\$3.57	\$4.03	13%	7.0

Because the Board’s administrative account is very sensitive to long-term equity returns and ETF’s analysis is making an assumption regarding the investment return, it is possible for the balance of the administrative account to rise above 75% of annual plan expenses sometime in the future. If that were to occur we would look at a possible fee reduction.

Alternatively, the Board could chose to make no changes to administrative fees for 2017. However, as shown in the attached charts, this may result in the administrative account balance falling below the Board’s stated reserve policy amount next year, which may then lead to a larger increase in fees in the future.

Staff will be at the Board meeting to answer any questions.

Attachment A: Ending Balance as a Percent of Annual Expenses Forecast Charts

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