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MEMORANDUM

To: Ralph Cetrulo, Chair of the Audit & Governance Committee
From: John Meyer, Director of Contributions and Plan Management (CPM)
Date: August 14, 2018
Re: May Meeting Follow Up Items

The Audit & Governance Committee ("AGC") held a meeting on May 15, 2018. The AGC discussed several matters, some of which were tabled for discussion at a future AGC meeting. The following items are the matters that required further research after the May AGC meeting.

529 Administrative Fee Balance

Background: *529 Administrative Fee Balance* – The 529 plan has approximately $1.6 million in administrative fee balances. The balances are a result of the state administration fee (currently 5 basis points) accruing over time. The 529 plan currently generates approximately $25,000 a month in revenue by assessing a state administration fee. The fee revenue covers an annual budget of $350,000 in expenses.

The Trust document states:

> *"The Trust is authorized to pay all expenses, fees, charges, taxes and liabilities incurred or arising in connection with the Trust or in connection with the management thereof, including, but not limited to, Trustees' reasonable travel reimbursement, salary, marketing and other Trust-related administrative expenses of the Trust or the Board's administrative agency, the Office of the State Treasurer ("OST"), and expenses and charges for the services of the Trust's investment adviser, administrator, distributor, auditor, counsel, depository, custodian, accounting and servicing agent and such other agents, consultants and independent contractors, and such other expenses and charges as the Trustees may deem necessary or proper to incur. A portion of such fees and expenses may be designated as an initial application fee. Except as otherwise provided for in the Trust or applicable law, OST shall pay all expenses arising from the operation and administration of the Trust from the Administrative Fund."*

Research Questions:

1. *Are we assessing a fee when our costs do not exceed the fee revenue collected?* No. The annual budget accounts for roughly $350,000 in expenses. In the current market environment, the revenue generated is approximately $25,000 a month or $300,000 per annum.

2. Can Fidelity stop charging the fee? No. Fidelity's 529 agreements with other states include provisions that require each plan to have the same program fee (program manager fee + state fee). Additionally, the 529 Management and Administrative Services Agreement for one of Fidelity's plans also includes a provision that requires the underlying investment option fees and expenses offered through that 529 Plan to be the same as those available in Fidelity's other 529 plans. Due to contractual requirements, Fidelity is not able to offer a lower program fee on the Delaware 529 Plan.

3. Can Fidelity revert back the administrative fund balance back to participants that were charged the fee? Yes. Fidelity indicated that if the Board has legislative authority to disburse the funds, Fidelity does not have an issue from a legal perspective in reverting back the administrative fund balance to participants that were charged the fee. If the Board selected the option of reverting back fees to participants, Fidelity would engage to discuss further details and logistics. For example, Fidelity would need direction on how far back the Board would like analyzed and Fidelity would then determine what data would be available.

In addition to the questions raised at the May AGC meeting, Fidelity also indicated that if the Board selected to disburse the funds, Fidelity could either rebate fees to all active participants at the end of a calendar year (i.e. $100 to each participant) or could facilitate an incentive for new accounts (i.e. $100 to each new participant that contributed to an account). Refunding a fee or creating an incentive would be classified as a contribution on behalf of the account owner.

New Hampshire and Arizona (two other Fidelity managed plans) use administrative fund balances to fund scholarships (NH) and conduct marketing campaigns (AZ). The Arizona marketing budget is approximately $200,000 per year. The CPM team held an initial meeting with a strategic marketing firm on July 20, 2018. The strategic marketing firm will be delivering a proposal with several options for Board consideration at the September meeting. The marketing firm will be presenting three pricing tiers ranging from $50,000 to $150,000.

Action Item: Motion to recommend that the Board increase the marketing budget for the 529 Plan by $150,000 to implement the strategic marketing firm's proposal if approved by the Board.

529 Audit Timeframe

Background: Audit firm Belfint, Lyons & Shuman ("BLS") incurred additional costs in completing the pooled investment vehicle audit for the 529 Plan. The AGC recommended and the Board approved a budget increase for BLS. The AGC inquired regarding the origins of 120 day timeframe.

Research:
As a follow up, the time frame is required by the Securities and Exchange Commission (SEC). The SEC requires that program managers present annual audited financial statements to the state agency within 120 days of the end of the 529 Plan's fiscal year. The program manager also has 150 days after the 529 Plan's fiscal year to comply with the rule of the Municipal Securities Rulemaking Board (MSRB). The Trust is responsible for the audit of the financial statements.

Action Item: No action item needed at this time.

Audit Expenses

Background: As part of the audit process for the plans, the Board enters into a memo of understanding ("MOU") with the Auditor's Office of Accounts (AOA). The MOU states that Board through the Office of State Treasurer, would pay a "reasonable fee" for AOA's administrative and oversight role in respect to the plan audits. At the May meeting, the AGC discussed whether AOA fees can be paid with administrative fees collected from participants

Research:
Based on Ice Miller's advice, the AOA fee would be viewed as payment for plan administration services. The Department of Labor ("DOL") although not binding on a governmental plan, has stated that payment for plan services necessary to administer the plan are considered plan expenses. Ice Miller suggests it would be prudent for OST to further investigate how the AOA fee is determined and to discussed the reasonableness of the fee.

Action Item: Motion to recommend that the Board approve the MOU with the Auditor's Office and authorize OST further negotiate the reasonableness of the fee prior to the Board meeting.

Deferred Compensation "Legacy Fees" Carve Out

Background: *457(b) Legacy Fees* – The 457(b) plan has $864,775 in "legacy fees" that were deducted from the plan prior to the transfer of recordkeeping to Voya Financial. The AGC recommended and the Board approved a motion to use legacy fees to offset future plan expenses and suspend state administration fees through June 2019, subject to a carve-out (amount to be determined later) for former participants. The AGC recommended that if it proves either impossible or infeasible to identify former participants, the carve-out amount would revert back to the plan expense account.

Research:
Challenges exist in identifying former participants that withdrew from the plan while on the Fidelity platform. The AGC discussed researching participants that transitioned to the Voya platform in September 2016, but subsequently withdrew from the plan prior to receiving the benefit of the fee suspension in June 2018. In suspending the state administration fee for the 457(b) plan and using the legacy fees to offset future expenses, the legacy fee balance will cover two years of expenses and leave a budget reserve of approximately $200,000.

The following data reflects participants that withdrew from the plan between September 2016 and June 2018.

457 (b) Plan Full Withdrawals

Year	Participants	Assets	Annual Fee Revenue at 5 bps*	2 Year Fee Revenue*
2016	188	$9,639,534	$4,756	$9,512
2017	615	$25,195,818	$12,141	$24,282
2018	313	$14,318,407	$6,687	$13,374
Total	**1,116**			**$47,168**

*5bps and Includes the $200 maximum fee cap

Approximately 52% of the withdrawals were direct to the participants and 48% to a financial institution. The estimated carve out would consist of 2 years of fees and some additional cost for postage, mail production, labor costs.

Action Item: Motion to recommend that the Board (i) approve an initial carve out of $50,000 for participants that withdrew from the plan between September 2016 until the 457 (b) fee suspension in June 2018 and (ii) direct OST to present a distribution plan at an upcoming meeting.

Fiduciary Training Proposal

Background: In June, the Plans Management Board approved a motion to accept Ice Miller's proposal for fiduciary training, requested Ice Miller to prepare presentation material for review at AGC's August Meeting and schedule training session in or around October 2018.

Research:
Ice Miller has prepared the attached presentation material for the AGC's review.

Action Step: Motion to recommend that the Board accept the fiduciary training slides for the 2018 training session.