



MEMORANDUM

To: Ralph Cetrulo, Chair of the Audit and Governance Committee
From: John Meyer, Director of Contributions and Plan Management (CPM)
Date: September 5, 2018
Re: Committee Recommendations

The Audit and Governance Committee (AGC) held a meeting on August 14, 2018 at the Office of State Treasurer (OST). The AGC received the 2015 403(b), and 2016 & 2017 457(b) and 401(a) audit reports prepared by Belfint Lyons Shuman (BLS). In addition to the audit presentations, the AGC received updates on the creation of a governance manual and discussed several expense related items. The following recommendations and action items are presented for consideration by the Plans Management Board (Board).

Recommendation Regarding Plan Financial Statements

BLS presented the audit reports and financial statements for the 2015 403(b), and 2016 & 2017 457(b) and 401(a) plans. The AGC accepted the audit reports and financial statements for the plans. Materials can be viewed [online](#) and physical copies will be available at the Buena Vista meeting location.

Action Item: Motion to accept the audit reports and financial statements for the 2015 403(b), and 2016 & 2017 457(b) and 401(a) plans.

Recommendation Regarding Governance Manual

The AGC reviewed the table of contents (TOC) for a governance manual for Board and committee members. The manual, when completed, will provide a comprehensive source of background information and laws governing the Board. The manual will include a number of policies that will govern the Board's decision making in certain critical areas. The TOC was revised to incorporate AGC's request for indemnification procedures. The TOC also was revised to provide for rules of order governing the conduct of public meetings. The TOC is attached as **Exhibit 1**.

Action Item: Motion to accept the TOC as presented and authorize and direct the development of the manual and related policies.

Recommendation Regarding Policy for Allocation and Payment of Plan Expenses

OST worked with AGC member John Macedo and counsel to develop a policy governing the use of administrative fees collected from plan participants. The policy directs OST to ensure, prior to the disbursement of fees, that expenditures are: i) borne by the appropriate plan, ii) permitted by the plans and applicable law, iii) reasonable, and iv) within budget limitations. The policy is attached as **Exhibit 2**.

Action Item: Motion to approve the policy for the allocation and payment of plan expenses.

Recommendation Regarding Deferred Compensation “Legacy Fees” Carve Out

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. In June 2018, 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 legacy fee balance is projected to cover two years of expenses and leave a budget reserve of approximately \$200,000. 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.

Challenges exist in identifying former participants that withdrew from the plan while on the Fidelity platform. It is possible to identify participants who transitioned from the Fidelity system to the Voya platform in September 2016, but subsequently withdrew from the plan. Those former participants will not receive the benefit of the fee suspension.

Preliminary research indicates that 1,116 unique participants withdrew from the 457(b) plan between September 2016 and June of 2018. Those participants would have received \$47,168 of benefit from the fee waiver over a two year period. The amount is calculated by determining a participant’s balance multiplied by the administration fee of 5 basis points and then multiplying by two for the years assessed.

Action Item: Motion to (a) approve an initial carve out of \$50,000 for participants that withdrew from the 457(b) plan between September 13, 2016 and the fee suspension date of June 30, 2018; and (b) direct OST to prepare a distribution plan for presentation at the Board meeting scheduled on December 4, 2018.

Recommendation on Auditor’s Office of Accounts Agreement

The Board is statutorily required to enter into a memo of understanding (MOU) with the Office of the Auditor of Accounts (AOA) concerning the retention of outside auditors. The draft MOU included a unique fee structure to compensate AOA for its role in the procurement process and for overseeing the engagement with the outside auditor. AGC questioned whether the proposed AOA fees could be considered “plan expenses” for budgetary purposes and paid with fees collected from plan participants. Additionally, AGC expressed concerns with the reasonableness of the proposed fees and the methodology used to calculate them. Ice Miller opined that the AOA fees qualify as plan expenses and may be paid as such to the extent they are reasonable. The current version of the MOU would require the Board to authorize payment of “reasonable” AOA fees, with the amount of the fees to be agreed upon at a later date. The MOU is attached as **Exhibit 3**.

Action Item: Motion to (a) approve the MOU with the Auditor’s Office, (b) authorize OST to execute the MOU on behalf of the Board, (c) authorize OST to negotiate a reasonable AOA fee (within parameters established by the Board), and (d) authorize OST to pay the negotiated AOA fee from fees collected from plan participants in accordance with the plan expense policy approved by the Board.

Exhibit 1

DELAWARE PLANS MANAGEMENT BOARD

GOVERNANCE MANUAL

Adopted on _____, 2019

DRAFT

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PLANS MANAGEMENT BOARD POLICY []

Exhibit 2

ALLOCATION AND PAYMENT OF PLAN EXPENSES

PURPOSE

This policy governs the use of State administrative fees (“Fees”) collected from participants in the plans (the “Plans”) overseen by the Plans Management Board (the “Board”). Fees shall not be disbursed except in accordance with this policy.

POLICY

Unless otherwise directed by the Board, the Office of the State Treasurer (“OST”) shall have authority to disburse Fees to pay Plan expenses in accordance with the general approval requirements and attribution and allocation rules set forth in Sections A and B below. All decisions shall be documented in writing, and such documents shall be retained, in accordance with the requirements of Section C below.

A. General Approval Requirements

Prior to the disbursement of any Fees, OST staff shall ensure that the following general requirements are satisfied:

1. *Permissible under Applicable Laws and Regulations.* No Fees shall be used to pay Plan expenses if such disbursement would be prohibited by applicable laws or regulations.
2. *Permitted by Plan.* No Fees shall be used to pay Plan expenses unless (a) expressly authorized by the applicable Plan document, or (b) the Plan document is silent regarding the payment of administrative expenses.
3. *Direct Expenses.* No Fees shall be used to pay Plan expenses unless such expenses are direct expenses of the Plan. For purposes of this requirement, an expense shall be a “direct” expense if it would not have been incurred “but for” the existence of the Plan(s). Reasonable audit-related fees payable to the Auditor of Accounts pursuant

PLANS MANAGEMENT BOARD POLICY []

to 29 *Del. C.* § 2722(e)(7) shall be direct expenses under this policy. If necessary, OST should consult outside counsel and/or relevant guidance when interpreting this requirement.

4. *Reasonable Expenses.* No Fees shall be used to pay Plan expenses unless such expenses are reasonable. No Plan expense shall be deemed “reasonable” unless it is reasonable in amount after considering all relevant facts and circumstances. In addition, except as provided in the immediately following sentence, no Plan expense shall be deemed “reasonable” if it was incurred in the performance of settlor functions, expenses for which the State, as the Plan sponsor, should reasonably be expected to bear the cost in the normal course of its business operations. For purposes of this policy, expenses incurred in connection with the marketing of the State’s college investment Plan are “reasonable” if (a) in consultation with outside counsel if deemed necessary, it is determined that such activities do not constitute settlor functions, and (b) such expenses otherwise meet the requirements of this Subsection A.5. OST should consult outside counsel and/or relevant guidance pertaining to “settlor functions” when interpreting this requirement.
5. *Adherence to Budget.* Absent Board approval, OST shall not disburse Fees in excess of the line-item amounts set forth in the annual budget approved by the Board.

B. Attribution and Allocation Rules

In addition to the foregoing approval requirements, prior to the disbursement of any Fees, OST staff shall ensure that Plan expenses are attributed and/or allocated to the appropriate Plan. In making such determinations, OST staff shall adhere to the following rules:

1. *Attribution.* Plan expenses should be attributed to the Plan that incurs the expenses. No Plan should pay for administrative expenses directly incurred by or otherwise attributable to another Plan.

PLANS MANAGEMENT BOARD POLICY []

2. *Allocation, Generally.* Where Plan expenses are attributable to more than one Plan, the expenses should be allocated across appropriate Plans using the methodologies listed below, if applicable, or another reasonable allocation method approved by outside counsel.
3. *Sub-Allocation of 403(b) Expenses.* Expenses properly attributed to the 403(b) Plan should not be paid with Fees collected from participants in a group contract by the current Plan provider, Voya Institutional Trust Company, or its affiliates, from and after September 2016 if such expenses were incurred in connection with services that were not for the general benefit of 403(b) participants, but rather exclusively benefitted either (a) participants with individual contracts issued by a vendor authorized under the 403(b) Plan between January 2009 and September 2016 (often referred to as the “legacy” accounts), or (b) individuals with individual contracts issued by a vendor prior to January 2009 (often referred to as the “orphan” accounts).
4. *Allocation of OST Staff Expenses.* Expenses for salaries and benefits for OST staff who support the Plans (other than the ABLE plan) full time may be allocated pro rata across such Plans based on asset values and consistent with the recommendations of outside counsel. OST shall on an annual basis, or whenever circumstances indicate that a reasonableness assessment would be appropriate (e.g., a change in job responsibilities), test the reasonableness of the asset-based allocation method and determine whether a different methodology (e.g., allocation based on employee time) should be utilized.
5. *Rules for Attorneys Fees and Expenses.* Outside counsel who support the Plans must bill each Plan separately. Where attorney time is spent or expenses are incurred across multiple Plans, outside counsel should allocate time

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and expenses equally among such Plans to the fullest extent possible unless doing so would be unreasonable.

C. Documentation and Retention

In addition to the foregoing approval requirements, prior to the disbursement of any Fees, OST staff shall ensure that all decisions relating to Fees required under this policy, including outside counsel advice, are documented in writing. All such documents shall be maintained by OST in accordance with a retention schedule approved by the Board.

Exhibit 3

**MEMORANDUM OF UNDERSTANDING
BETWEEN AND AMONG
THE OFFICE OF AUDITOR OF ACCOUNTS
AND
THE PLANS MANAGEMENT BOARD
AND
THE OFFICE OF THE STATE TREASURER**

WHEREAS, pursuant to 29 *Del. C.* § 2722, the Plans Management Board (the “Board”) is the State of Delaware (the “State”) agency responsible for the oversight and administration of the State’s deferred compensation programs under 26 U.S.C. §§ 457(b), 401(a), and 403(b), and the State’s qualified tuition program under 26 U.S.C. § 529 (collectively, the “Plans”);

WHEREAS, pursuant to 29 *Del. C.* § 2722(e)(7), the Board is required to (a) arrange for an annual financial audit of each Plan; (b) enter into a memorandum of understanding with the Office of the State Auditor of Accounts (“AOA”) regarding each such audit; and (c) approve payment for such audit.

WHEREAS, pursuant to 29 *Del. C.* § 2722, the Office of the State Treasurer (“OST”) is required to and does provide administrative support for the Board;

WHEREAS, AOA, the Board and OST are referred to collectively herein as the “Parties”;

WHEREAS, the AOA, pursuant to 29 *Del. C.* § 2906(c), has sole responsibility for the arrangements under which the postaudits of State agencies are conducted, and for the selection of certified public accounting firms who shall perform the postaudits;

WHEREAS, AOA has, through a professional services procurement process in accordance with 29 *Del. C.* ch. 69, selected a certified public accounting firm (the “Contractor”) to perform the annual postaudits for each Plan (the “Engagement”);

WHEREAS, AOA has entered into a professional services agreement, Contract 18-CPA-02 (the “Contract”), with the Contractor regarding the Engagement;

WHEREAS, the Contract was awarded for a two-year term and may be extended by AOA as provided in the Contract and this Memorandum of Understanding (the “MOU”); and

WHEREAS, AOA, the Board and OST agree that the MOU is intended to document their mutual understanding and agreement regarding payment of all Contract-related fees and other matters related to the Engagement, as specified herein, and is entered into as of the date executed by the Parties.

NOW THEREFORE, pursuant to the foregoing, the Parties hereto agree to the following:

1. All information, data, reports, and records, as are necessary for carrying out the Engagement, shall be furnished to the Contractor without charge by OST, and OST shall cooperate with the Contractor during the course of the Engagement.
2. During the course of the Engagement, and prior to the completion thereof, AOA shall notify in writing and consult with OST concerning any proposed extension of or addendum or revision to the Contract, including but not limited to the exercise of any optional term or changes in the scope of the Engagement that may affect Contract-related fees or other material terms.
3. Within 10 business days of such notice, OST may provide written comments to AOA regarding the proposed extension, addendum or revision. AOA will consider OST’s comments and notify OST in writing of any extension of the Contract, or any changes made to the Contract that may affect Contract-related fees or other material terms.

4. OST and the Board acknowledge AOA's statutory authority under 29 *Del. C.* § 2906(c) and agree that neither OST nor the Board will not enter into any side agreement or arrangement with the Contractor that would create a conflict of interest.
5. AOA acknowledges the Board's statutory authority under 29 *Del. C.* § 2722(e)(7) to arrange and approve the payment for an annual financial audit of the Plan.
6. AOA shall be solely responsible for finalizing and publicly issuing a report relating to the annual financial audit.
7. In the first quarter of each calendar year during the term of this MOU, the Board shall approve an annual budget for the Plan that includes a line item for the payment of all annual audit-related fees and expenses, including reasonable estimates for all AOA and Contractor fees and expenses incurred or expected to be incurred each calendar year. OST shall pay the Contractor any fees and expenses due and owing under the Contract, subject to OST's right to review and approve such fees and expenses in accordance with this MOU.
8. AOA shall promptly review and tentatively approve all invoices submitted by the Contractor. AOA shall promptly send all tentatively approved fees to OST for review and approval. OST will approve and promptly pay all undisputed charges in accordance with the budget. OST may directly address with the Contractor any disputed fees or expenses. OST and the Contractor may resolve any such disputes, and OST may pay all agreed-upon fees or expenses in accordance with the budget. Absent Board approval, OST shall not pay any fees or expenses that exceed the amount provided in the annual budget.

9. If the Contractor informs AOA of a potential cost overrun, AOA will immediately notify OST.
10. In the event a subpoena, other legal process, or a Freedom of Information Act request seeking access to or copies of work papers or any other documents related to the Engagement is received by AOA, AOA shall respond in accordance with law following consultation with its assigned Deputy Attorney General. Unless prohibited by law, AOA shall immediately notify OST of its receipt of any such request for access to confidential or potentially confidential documents relating to the Engagement.
11. OST and the Board agree to allow OST's employees to respond to audit inquiries and inform AOA and the Contractor of any significant facts regarding matters of internal controls, fraud, waste, abuse, or illegal acts. Any information obtained as a part of this Engagement will be processed in accordance with applicable audit and investigative standards.
12. All notices and communications between the parties regarding any aspect of this MOU should be directed to the following individuals in writing:

To OST or the Board:

Name: John Meyer
 Title: Director, Contributions and Plan Management
 Agency: Office of the State Treasurer
 Address: 820 Silver Lake Blvd, Suite 100
 Dover, DE 19904
 Email: john.meyer@state.de.us
 Telephone: 302-672-6705

To AOA:

R. Thomas Wagner, Jr.
 State Auditor
 Office of Auditor of Accounts
 401 Federal Street, Suite 1
 Dover, DE 19901
R.Thomas.Wagner@state.de.us
 302-739-5055

13. This MOU may be amended only by written agreement of the Parties.

14. Subject to the budget or as otherwise approved by the Board, OST shall pay to AOA a reasonable fee for AOA's administrative and oversight role related to the Contract and the Engagement.

OFFICE OF THE STATE TREASURER

OFFICE OF AUDITOR OF ACCOUNTS

Name: John Meyer
Title: Director, Contributions and Plan
Management
Date: _____

Name: R. Thomas Wagner, Jr.
Title: State Auditor
Date: _____

PLANS MANAGEMENT BOARD

Name: Stephen Saville
Title: Chair
Date: _____