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MINUTES FROM MEETING OF THE AUDIT & GOVERNANCE COMMITTEE OF THE PLANS MANAGEMENT BOARD MAY 15, 2018

The Audit & Governance Committee (the "Committee") of the Plans Management Board (the "Board") held a meeting on May 15, 2018, at the Office of the State Treasurer ("OST") in the Carvel State Building located at 820 N. French Street Wilmington, Delaware.

Committee Members Represented or in Attendance:
Mr. Charles Campbell-King, Committee Chair
Ms. Nora Gonzalez, Deputy State Treasurer, OST (on behalf of The Honorable Kenneth Simpler, State Treasurer)
Mr. Ralph Cetrulo, Board Member At-Large
Mr. Peter Kennedy, Committee Member
Mr. John Macedo, Committee Member
Mr. Timothy J. Snyder, Committee Member
Ms. Val Watson, Committee Member

Committee Members Not in Attendance
Mr. Gerard Gallagher, Board Member At-Large

Others in Attendance:
Mr. Jason Staib, Deputy Attorney General, Delaware Department of Justice
Mr. John Meyer, Director of Contributions and Plan Management, OST
Mr. Daniel Kimmel, Promotion and Outreach Program Manager, OST
Mr. Mike Green, Investments and Operations Program Manager, OST
Mr. Omar Masood, Policy Advisor, OST
Mr. Allen Earle, Consultant, Cammack Retirement Group ("Cammack")
Ms. Marie Villeneuve, Consultant, Cammack

CALLED TO ORDER
The meeting was called to order at 10:01 a.m.

INTRODUCTIONS
Individuals in attendance introduced themselves.

MEETING MINUTES
Mr. Campbell-King presented the minutes from the February 28, 2018, Committee meeting.

APPROVAL OF THE MINUTES
A MOTION was made by Mr. Cetrulo and seconded by Mr. Kennedy to recommend approval of the February 28, 2018, Committee meeting minutes.

MOTION ADOPTED UNANIMOUSLY

PRESENTATIONS –GOVERNANCE REVIEW

Mr. Meyer reviewed the Board structure and Resolution 2018-01 that created the Committee. Mr. Meyer indicated that the Committee has authority over plan amendments, cybersecurity issues, plan audits, and other audit or governance matters delegated by the Board.

Mr. Meyer reported that his team researched "best practices" for the Committee. The review identified a number of topics that are frequently covered at audit/governance committee meetings, such as governance documents, procurement, budgets, and education. Mr. Macedo asked if service provider oversight fits into one of these buckets. Mr. Meyer replied that it likely falls under procurement. Mr. Macedo agreed.

For next steps, Mr. Meyer suggested drafting a governance manual, updating the administrative policy manual, and scheduling fiduciary/ethics training for the Board for the fall of 2018. The Committee expressed interest in procurement and specifically a vendor management policy.

Ms. Gonzalez asked about cybersecurity. Mr. Masood indicated that cybersecurity was not one of the most common topics that came up in the review.

Mr. Meyer thanked Mr. Macedo for his efforts after the February Committee meeting in helping to identify areas of potential concern and creating a list of focus areas. Mr. Meyer reported OST looked at Mr. Macedo's list and augmented it with additional items from past Board discussions.

Mr. Meyer opened the floor for discussion on other topics that should be added to the list and discussed in future meetings. Ms. Gonzalez asked the Committee for input on prioritizing the focus areas.

The Committee discussed eligible plan expenses as a key priority.

DISCUSSIONS AND ACTION ITEMS

Mr. Meyer presented five budget-related topics for discussion and possible action: (1) administrative fee balances, (2) employee salaries and benefits, (3) Voya's performance guarantee payment, (4) audit expenses, and (5) Ice Miller's contract extension and training proposal.

Administrative Fee Balances (457(b) Plan)

The Committee discussed the unused plan expense balances for 2017. At the end of 2017, the 457(b) plan had a balance of $19,863 in unused administrative fees collected by Voya. Mr. Meyer responded to Mr. Macedo's suggestion at the last meeting to reimburse unused fee balances on a pro-rata basis on the actual fee amount collected from a participant. Mr. Meyer reported that Voya lacked the functionality to reimburse pro-rata based on the actual fee collected but could reimburse pro-rata based on a participant's assets up to $400,000 (to insure that a participant will not be reimbursed more than the amount collected).

Mr. Macedo said that while the first option would be ideal the use of participant balances would be reasonable as well. Mr. Snyder inquired as to where the money to pay for plan expenses such as auditors and Ice Miller comes from. Mr. Meyer said they currently are paid out of the plan expense account, which is funded by administrative fees collected from participants. Mr. Snyder said that under ERISA the sponsor could use these type of accounts to pay plan expenses with the remainder allocated back to plan participants. Mr. Snyder said that a participant getting $12 back in their account is not necessarily worth the effort required to execute and said that using accrued fees to pay plan expenses going forward should be explored as an alternative. Mr. Snyder asked how much is in the plan expense account. Mr. Meyer replied that there is $19,863 in the 457(b) plan expense account from 2017. Mr. Meyer also stated that the 457(b) plan has $864,775 in "legacy fees" that were deducted from the plan prior to the transfer of recordkeeping to Voya. The Committee discussed options concerning the legacy fees, including possible reimbursement of legacy fees to participants. Mr. Meyer indicated that Voya may not be able to reimburse legacy fees to past participants as some participants who paid the fee may no longer be in the plan. Voya suggested one option would be to revert back fees at a point in time, such as the transition date, based on either a pro-rata or per-capita distribution method. Mr. Staib indicated that Ice Miller had cautioned against distributing to current participants without consideration of former participants who may have contributed to the legacy balance. Mr. Macedo asked Mr. Staib about Ice Miller's general view on using legacy funds to defray future plan expenses. Mr. Staib indicated that Ice Miller was generally okay with the concept, subject to the concerns about former participants.

Mr. Campbell-King pointed out the plan is now much more transparent with respect to administrative fees and asked whether the Board should suspend the collection of administrative fees if the legacy fees are used for future plan expenses.

Mr. Cetrulo asked how many years of expenses the $864,000 would cover. Mr. Meyer indicated that the legacy fees would cover approximately two years of expenses after establishment of a budget reserve. Mr. Meyer stated that best practices include a reserve equivalent to one year's worth of expenses, and cited North Carolina as an example of a state following this practice.

Mr. Cetrulo said if Ice Miller has blessed using the legacy fees to offset future plan expenses it would be best to do so with respect to both the $19,000 and $864,000. Mr. Macedo questioned whether the Board should still assess a fee going forward because, absent continued fee collection, only current participants would benefit.

Mr. Snyder spoke about guidance from the U.S. Department of Labor on excess assets and allocating them to participants, which the DOL describes as a fiduciary function. Mr. Snyder indicated that all relevant factors need to be taken into account. One of those factors is the size of an allocation to former participants. Mr. Snyder reiterated that the reallocation expense may exceed the benefit to participants.

Mr. Campbell-King asked what the maximum and minimum potential reimbursement amounts would be. Mr. Green spoke about the administrative issues associated with attempts to track down former participants, who may have transitioned out of the plan to an IRA.

The Committee discussed concerns related to the suspension of fees going forward. Mr. Staib raised the possibility of suspending the fee, spending down the legacy fees over two years, and setting aside an amount of money to deal with former participants. Mr. Macedo commented this would show a good faith attempt to do right by former participants, even if ultimately that proves to not be feasible.

Mr. Snyder queried whether Ice Miller raised the issue of former participants being disadvantaged. Mr. Staib said that, while the analysis wasn't very detailed, he believes Ice Miller's view was that legacy fees could be used to offset future fees, which implicitly acknowledged that the former participants would not benefit. Mr. Snyder indicated that is essentially what the Department of Labor's guidance says. Mr. Kennedy stated the Committee may want to establish a policy that would cover these types of decisions going forward. Mr. Macedo discussed having a reserve and said once it reaches a certain amount the fee could be reduced going forward until the reserve reaches a target range. Mr. Snyder asked why there is a recommendation to have a one year reserve. Mr. Meyer said that recommendation is based on best practices to guard against a market downturn or funding structure changes.

The discussion returned to whether the fee should be suspended or continued. Mr. Cetrulo believed it should be suspended. Mr. Macedo reiterated his concerns.

Mr. Cetrulo said he favored suspending the fee for one year. Mr. Campbell-King asked for clarification on whether this would apply for the next 12 months or the remainder of 2018. Mr. Cetrulo said it would be best to just do it for the next four quarters.

The Committee decided to recommend that (a) legacy fees be used to offset future plan expenses and (b) state administration fees on the 457(b) plan be suspended for four calendar quarters starting in June 2018. To address potential concerns with former participants who would not benefit from the suspension of fees, the Committee recommended that a carve-out be established for the benefit of such participants. The amount of the carve-out will be established at a later date.

The Committee recommended treating the unused 2017 fees in the same manner as legacy fees.

RECOMMENDATION REGARDING ADMINISTRATIVE FEE BALANCES
A MOTION was made by Mr. Cetrulo and seconded by Mr. Snyder to recommend that the Board use administrative fee balances (2017 unused administrative fees and legacy fees) to offset future plan expenses, subject to a carve-out of legacy fees (amount to be determined later) for former plan participants, which fees would revert back to the plan expense account if it proves impossible and infeasible to identify former participants.
MOTION ADOPTED UNANIMOUSLY

RECOMMENDATION REGARDING SUSPENSION OF THE STATE FEE
A MOTION was made by Mr. Cetrulo and seconded by Mr. Kennedy to recommend suspending the fee on the 457(b) Plan for four calendar quarters.
MOTION ADOPTED UNANIMOUSLY

529 Legacy Fee Balance
The Committee discussed the $1.6 million administrative fee balance for the 529 Plan. Ms. Gonzalez noted these funds are used for salaries, marketing, legal and audit fees. Mr. Cetrulo asked what the 529 budget amount was for the year. Mr. Meyer responded that the annual budget is approximately $370,000. Mr. Campbell-King asked if Fidelity has the capability to refund participants. Mr. Meyer said this question has been posed to Fidelity but OST had not yet received an answer.

Mr. Meyer noted OST is working with Fidelity on a strategic marketing plan. Mr. Meyer said that Fidelity is responsible for marketing; however, many states allocate additional funds for local 529 marketing expenses.

Mr. Cetrulo raised the issue of reducing the administrative fee balance. Mr. Cetrulo expressed a desire to equalize the administrative fee with budgeted expenditures, to prevent the continuing increase in unused funds. Mr. Cetrulo felt that the topic of the 529 fee balance required further information prior to making a decision. Mr. Macedo agreed that it made sense to lower the fee to stop making the problem worse. Mr. Macedo expressed his view that it would be impossible to go back 20 years and reimburse past participants. Mr. Cetrulo stated the fee issue could be revisited in August. The matter was tabled for future discussion.

Salary and Employee Benefits
The Committee discussed the use of fees to pay employee salaries and benefits. Mr. Meyer indicated that the deferred compensation plans and the college investment plan are supported by four employees of OST. Pursuant to budgets approved by the Board, three of the OST positions are funded by administrative fees collected from the plans on a pro-rata basis. One OST position receives General Fund appropriations. The Committee discussed funding all four positions with administrative fees.

Mr. Campbell-King asked how salaries are allocated across the plans. Ms. Gonzalez said it is done based on assets. Mr. Macedo said he did not think asset-based was the best way to allocate for employee-related expenses and suggested it be based off of employee time. Mr. Macedo asked if the calculation includes benefits. Ms. Gonzalez said benefits are included. Mr. Macedo asked whether health costs are calculated based on actual costs or allocated accruals. Mr. Macedo said, per ERISA, his firm does not recover health care costs from the pension plan because the actual costs related to each employee are not reflected in the accounting system. In lieu of that, his firm estimates health care costs and uses an estimated monthly accrual for each person. Mr. Macedo asked for a legal opinion if the State uses estimated rather than actual costs. Ms. Gonzalez indicated that OST uses the rates set by the State per employee. If actual costs come in lower, that money remains in the fund. Mr. Snyder said that, since the State is using a proxy premium less the employee share, expense qualifies as an actual cost under ERISA. Mr. Macedo replied that it is a proxy for actual costs for the broader population but not necessarily for the four individuals in question.

Mr. Macedo asked if pension contribution costs are recovered and requested a legal opinion if they are. Mr. Snyder replied the annual required contributions to a pension plan are expenses and are treated as such by accountants. Mr. Snyder believed that accounting for “normal costs” of pensions per year, which are paid by the employer along with amortization, is appropriate. Mr. Macedo replied that goes to broad costs, not costs specific to this small subset of employees and in his experience his firms have not recovered pension costs.

Ms. Gonzalez queried if there is a consensus on the need to seek legal counsel. Mr. Macedo said he would want legal counsel on recovery of employee salary and benefit costs.

Mr. Campbell-King said the Committee could make a motion to add the fourth position to be paid via administrative fees collected by the plan on a pro-rata basis, while seeking a legal opinion on benefit costs.

RECOMMENDATION REGARDING EMPLOYEE SALARIES AND BENEFITS
A MOTION was made by Mr. Campbell-King and seconded by Mr. Macedo to fund the fourth OST supporting position, effective immediately and prospectively, subject to OST’s receipt of a legal opinion on benefits and allocation methods.
MOTION ADOPTED UNANIMOUSLY

Voya Performance Guarantee
Mr. Meyer gave an overview of the agreement with Voya that contains a performance guarantee that requires Voya to increase the participation rate for the 457(b) and 403(b) plans by 2% per year. Voya did not meet the performance guarantee for 2017 and is obligated to remit $20,000 back to the plans.

Mr. Macedo said the money should go back to the plans to which it relates (referencing the 457 and 403 plans). Mr. Macedo indicated paying plan expenses would be okay, provided the $20,0000 is split appropriately across the two plans.

Mr. Cetrulo said promoting retirement readiness requires increasing participation and that would include further education efforts. Mr. Cetrulo drew a distinction between education and marketing. Mr. Staib replied that OST could go back to Ice Miller for clarification but that his initial reaction is education pertains to participants, not potential participants. Mr. Cetrulo asked if there is a fiduciary duty to increase the participation rate. Ms. Gonzalez replied that the Board consistently has expressed the idea that having more participants is a good thing and would generate lower fees. Mr. Cetrulo responded that it could then be argued that it does benefit current and future participants. Mr. Cetrulo said we can get more information but he is comfortable because he views it as education and it is good for the plan overall. Mr. Kennedy said the $20,000 should go to offset plan expenses in some fashion but the definition of marketing and education is a separate discussion.

The Committee entered into a discussion about splitting the $20,000 between the plans based on their respective assets. Mr. Cetrulo suggested using 12/31 account balances. Mr. Macedo concurred. The Committee recommended that the $20,000 payment be allocated to the two plans pro-rata and treated the same way as administrative fees.

RECOMMENDATION REGARDING THE VOYA PERFORMANCE GUARANTEE
A MOTION was made by Mr. Cetrulo and seconded by Mr. Kennedy to recommend putting the $20,000 back in the expense account on a pro-rata basis as of December 31, 2017.
MOTION ADOPTED UNANIMOUSLY

Audit Expenses
Mr. Meyer discussed the audit process for the plans and reminded the Committee of the presentation by the Auditor's Office of Accounts ("AOA") at the last meeting. Mr. Meyer outlined the proposed memo of understanding ("MOU") that says OST would pay AOA a "reasonable fee" for AOA's administrative and oversight role in respect of plan audits. Mr. Meyer discussed the fee schedule and how it is calculated each year. Mr. Macedo asked if the State pays AOA fees, which involves a State agency paying another State agency. Mr. Meyer replied that currently the plans pay the fees. Mr. Macedo said that under ERISA overhead could not be charged to the plans because it is an expense that would be incurred absent the plans. Mr. Macedo said the federal Department of Labor frowns upon retirement plans paying for overhead.

There was a discussion of how AOA calculates rates. Ms. Gonzalez explained how the rate is set by the Office of Management and Budget and indicated that all State agencies are mandated to adhere to it. Mr. Cetrulo noted the great variance on a year-to-year basis in the historical fee schedule. Mr. Macedo responded that he did not consider such work a plan expense.

Mr. Snyder asked if this audit is mandatory. Ms. Gonzalez replied that an annual audit managed by AOA is mandated under the Board's enabling legislation. Ms. Gonzalez said the MOU cannot be signed absent Board approval.

The Committee discussed whether AOA fees can be paid with administrative fees collected from participants. Mr. Macedo said that under ERISA the answer would be no.

Mr. Kennedy proposed a solution and asked if there is a way AOA could charge on an hourly basis. Mr. Macedo replied that he would still think there is an issue under the "but for" test and gave an example that people would be paid a salary with or without the plan audit. Mr. Campbell-King said a legal opinion would be needed, as well as additional information concerning the year-to-year variance in AOA fees. The matter was tabled for a future meeting.

Belfint, Lyons, & Shuman ("BLS") 529 Audit Fees
Mr. Meyer provided an overview of the issue with vendor BLS and the 529 audit. Mr. Meyer explained that BLS incurred additional fees to order to meet a deadline for the 529 audit.

Mr. Meyer reported that BLS is seeking an additional $55,000 payment for completion of the audit. Mr. Meyer noted the previous auditor charged $150,000 for the audit, while the BLS had proposed charging approximately $75,000 for the same work. Mr. Meyer requested that the Committee recommend approval of the additional fees.

The Committee discussed the timing of the audit and the reason for the additional fees.

RECOMMENDATION REGARDING AUDIT EXPENSE
A MOTION was made by Mr. Kennedy and seconded by Mr. Macedo to recommend that the budget for the 529 audit be increased by $55,000.
MOTION ADOPTED UNANIMOUSLY

Ice Miller Contract and Training Proposal
Mr. Meyer discussed OST's recommendation to extend Ice Miller's contract, which expired in April 2018, for one year, which would extent the engagement to April 2019. Ice Miller also is asking for an update to its billing schedule, which originally was created in 2013. Ms. Watson asked if the updated schedule would generate greater costs for OST. Mr. Meyer indicated that there could be increased fees. Mr. Campbell-King asked for clarification on whether the rate has remained the same since 2013. Mr. Meyer confirmed that the rates had not changed since the inception of the engagement.

Ms. Watson asked for clarification on whether OST intends to issue a request for proposal. Mr. Meyer confirmed that the business would be put out to bid prior to the end of the extended term.

Mr. Snyder asked about the rate increases. Mr. Macedo expressed concern about the cost of paralegals. Mr. Staib said he would discuss a reduction of the paralegal fees and confirm applicability of the original $500 fee cap.

Mr. Meyer discussed the upcoming Board training and Ice Miller's proposal. Ice Miller's portion on fiduciary issues will run about 1.5 hours and will cost $10,000. Mr. Meyer explained that Mr. Staib would handle ethics and FOIA training.

Mr. Macedo commented on Ice Miller's sample slides. Mr. Macedo felt the materials were good but focused almost exclusively on investment options, rather than service provider oversight. Mr. Macedo requested that Ice Miller draft the presentation well ahead of the meeting so input could be provided by the Committee and Board.

RECOMMENDATION TO EXTEND ICE MILLER CONTRACT
A MOTION was made by Mr. Campbell-King and seconded by Mr. Macedo to recommend that the Board approve a one-year extension of the Ice Miller contract, through April, 2019, with OST to complete a request for proposal prior to the expiration of the extended term.
MOTION ADOPTED UNANIMOUSLY

RECOMMENDATION REGARDING FIDUCIARY TRAINING
A MOTION was made by Mr. Campbell-King and seconded by Mr. Kennedy to recommend that the Board hold fiduciary training in or around October 2018 at a cost of no more than $10,000, with Ice Miller to provide a slide deck for the Committee's review prior to the August Committee meeting.
MOTION ADOPTED UNANIMOUSLY

PUBLIC COMMENTS
No members of the public were present.

NEXT MEETING
The next meeting is scheduled for August 14, 2018.

ADJOURNMENT
APPROVAL TO ADJOURN
A MOTION was made by Mr. Kennedy and seconded by Mr. Macedo to adjourn the meeting of the Committee at 12:44 p.m.
MOTION ADOPTED UNANIMOUSLY

Respectfully submitted,

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Charles Campbell-King,
Chair, Audit & Governance Committee