EL DORADO COUNTY
TREASURER/TAX COLLECTOR'S OFFICE
DEFERRED COMPENSATION ANALYSIS

Dated: February 15, 2006
Updated: March 21, 2006
(Updated Analysis and Recommendation section only)
Updated April 3, 2006

Background
El Dorado County retained Arnerich Massena and Associates to aid in completing a Request for Information (RFI) for the 457 Deferred Compensation Plan. The objectives of the project were to (1) lower participant and plan expenses, (2) simplify the investment menu, (3) improve the number of group seminars and individual meetings on investment and retirement planning topics, and (4) outsource plan administration functions. Information was obtained from the two existing providers, CalPERS and Nationwide.

The RFI submitted by Arnerich Massena and Associates in August 2005 consisted of information provided by both providers listed side-by side. This allowed for a comparison between the two providers.

At a meeting of the County's Deferred Compensation Committee on August 4, 2005, the consultant recommended that the County retain only one provider for its Plan. He also recommended that the County seek a further reduction in fees from Nationwide, that they add Morningstar at no cost, and offer to move participants to Table Value Fund at no cost.

The consultant returned to Nationwide for a reduction in fees and other information. The consultant submitted another RFI containing the changed information in September 2005.

Scope of this Analysis
The RFI contained primarily new information regarding proposed changes to each provider's plan without comparing this information to each provider's current plan. To determine how each provider met the objectives and to analyze their overall proposal it was necessary to look at each provider's current plan and compare it to their proposed plan.

The Request for Information (RFI)

Objective Number 1 – Lower Participant and Plan Expenses

CalPERS
Most of the information provided by CalPERS was the same as the current plan. The expense ratio remained very low at an average of .59%, with participant cost at $147 and participant revenue at $139. In addition to the .59% average expense ratio, CalPERS charges an Administration Fee of .26% so the total expense cost is .85%. They are willing to waive the Administration Fee if the County consolidates its plan to CalPERS.

Nationwide
Nationwide provided more new information with the RFI. The expense ratio with the proposed lineup is .76% versus the current expense ratio of .86%. Participant cost is $286 versus $324 currently and participant revenue is $158. In addition to the .76% average expense ratio,

Nationwide charges an Asset Based fee of .21% so the total expense cost is .97%. Currently, Nationwide does not charge an Asset Based Fee, but does charge us an Admin. Fee of 29% so the total current expense cost is 1.15%.
A significant change in the County's contract with Nationwide is the implementation of a revenue cap and reimbursement of anything above the cap back to the plan. Currently, Nationwide receives Revenue from Fund of .47%. (Revenue from Fund is derived from the weighted average assets of the fund so it changes with the assets in the fund). They charge participants an Administrative Fee (also called an Asset Based Fee) of .29%. Since there is not a cap they do not reimburse anything to the plan.

Per the RFI there would now be a Revenue Commitment Cap of .44% and no set Administrative Fee charged to participants. Nationwide expects to receive Revenue from Fund of .42%. To reach their cap of .44% they would charge an Admin Fee of .02%. (.42% + .02% = .44%). If they receive from the fund more than 44% they will not charge participants an Admin. Fee and will reimburse the plan the additional amount. This reimbursement would, in effect, lower the total expense paid by participants.

Objective Number 2 – Simplify the Investment Menu

CalPERS

CalPERS currently offers 11 funds and the proposed lineup of funds remained the same as their current lineup. Their RFI stated that a study by Columbia University suggests that plan participation declines as the number of funds in the plan increases beyond about 12 funds. Other research has shown that most plan participants invest in 1 – 4 funds regardless of how many funds the plan offers.

The following is a breakdown of the current and proposed fund lineups.

	Current and Proposed
Asset class – Asset Allocation	3
Asset class – International	1
Asset class – Small Cap	2
Asset class – Mid Cap	none
Asset class – Large Cap	2
Asset class – Balanced	none
Asset class – Bonds	1
Asset class – Fixed/Cash	2
Total number of funds	**11**

While CalPERS lineup consists of only 11 funds, they do offer participants the option of having a Self Managed (also called Self Directed) account. This option gives participants the opportunity to invest in almost any investment vehicle they choose. CalPERS charges a $50 annual maintenance fee for this option, plus there are fees for individual transactions. The Self Managed account is with State Street Global Markets, LLC. Attachment E is a Schedule of Fees for transactions done using this type of account.

Nationwide

Nationwide currently offers 33 funds. The proposed lineup retains 10 funds in the current lineup, eliminates 22 and suggests 11 new funds. The following is a breakdown of the current and proposed fund lineups.

	Current	Proposed
Asset class – Asset Allocation	5	3
Asset class – International	3	3
Asset class – Small Cap	3	4
Asset class – Mid Cap	3	3
Asset class – Large Cap	12	4
Asset class – Balanced	1	1
Asset class – Bonds	3	1
Asset class – Fixed/Cash	3	2
Total number of funds	**33**	**21**
Number of funds in current lineup to keep		10
Number of new funds proposed		11

Like CalPERS, Nationwide also offers a Self Managed account through their affiliate, Charles Schwab. There is a $50.00 initial fee, a $50 annual fee and fees for individual transactions. Attachment F is a Schedule of Fees for transactions done using this type of account.

Objective Number 3 – Improve the number of group seminars and individual meetings on investment and retirement planning topics.

CalPERS

CalPERS responses regarding services indicate that they are a “no frills” provider; most of the services they offer are standard for all companies and they do not really offer any customization. The services they do provide are comprehensive.

CalPERS does not provide investment advice, either in-person or online. They do have an affiliate, CitiStreet Advisors LLC that does provide advice via online, telephone and paper but the County would need to contract separately with this company. Should the County decide to offer the CitiStreet Advisor Service there would be a one-time set-up charge of $5,000. The guidance component would be provided free of charge to all participants. If a participant wanted specific investment recommendations they would be charged an advisory fee of 6.25 basis points per month which is equivalent to $6.25 for a $10,000 account balance.

CalPERS is willing to commit to more than doubling the number of enrollment/education services they provide.

	Current	Proposed
Number of 1 hour group meetings	0	14
Number of ½ hour Individual meetings	225	450
Proposed total number of on-site service hours	112	256
Proposed total number of days	14	32

Nationwide
Nationwide's response regarding services indicate that they are willing to offer the County some customized services, IF the County contracts with Nationwide as the sole provider. (This is stated in Nationwide RFI response but is not included in the consultant's report, Pg 10, item B-12).

Nationwide does provide investment advice online thorough their affiliate, Morningstar. There is no separate contract required and no setup fee. Investment guidance tools are provided free of charge. If a participant wants specific investment recommendations they will be charged an advisory fee of $65.00 per month.

Nationwide is willing to commit to more enrollment/education services.

	Current	Proposed (if exclusive only)
Number of 1 hour group meetings	8	140
Number of ½ hour Individual meetings	440	450
Proposed total number of on-site service hours	250	365
Proposed total number of days	44	70

Objective Number 4 – Outsource Plan Administrative Functions

CalPERS
Through its affiliate CitiStreet, CalPERS offers a comprehensive listing of administrative services.

Nationwide
Nationwide offers a comprehensive listing of administrative services.

Other Notes

Incorrect information in the consultant's report states on Page 28 that CalPERS has a .54% Revenue Commitment Requirement and that they are not willing to rebate money. The information provided by CalPERS states that they do not have any Revenue Commitment Requirement. It also states that they are willing to rebate money and are willing to "share upside asset growth above their assumptions and the resultant revenue after the conclusion of a 5 year contract."

Some of the information in the RFI that was used for comparison was incorrect. Pages 15 through 20 of the August 2005 RFI list comparisons of a CalPERS fund and a Nationwide fund in a particular asset class. It contained the performance and expense ratio of each fund and the performance of a benchmark and universal median. An analysis of the components of these expense ratios revealed that the CalPERS ratio includes the asset-based fee and the Nationwide expense ratio does not. When the asset-based fee is added to Nationwide's expense ratios they clearly are much higher than CalPERS.

Page 29 of the August 2005 RFI states that Nationwide expects to receive .26% revenue based on the fund lineup, however page 16 of the September 2005 RFI states that this amount is .42%

This incorrect information affects the appearance of the comparison between CalPERS and Nationwide but has no effect on the results of this analysis.

Additional Factors for Analysis

There are several factors that need to be taken into account when deciding to make any changes to the deferred compensation plan.

Factors

The percentage of current participation in a given fund – this is a strong indication of what participants have historically viewed as a desirable fund to invest in.

The percentage of contributions going into a given fund – this is a strong indication of what participants currently view as a desirable fund to invest in.

Performance – how is the performance of the proposed lineup versus the current lineup.

Expenses – is the performance of a fund justifying a high expense ratio?

Watch list – are there any current funds on the 2nd or 3rd Quarter 2005 Plan Review to watch or deselect due to poor performance.

Availability – are there any funds that are currently closed to new deferrals.

Participant perception – the impact large changes may have on the confidence level participants have in the County's and the Committee's ability to oversee the plan.

Recommendation

CalPERS

My recommendation for CalPERS is that we keep the fund lineup as it now stands. Although CalPERS did not make any changes to their funds to meet the objectives of lowering plan and participant expenses or simplifying the investment menu, this is probably due the fact that the current plan is already inexpensive and relatively simplified. It is clear from the RFI that CalPERS is providing the County with the same rates and funds that it provides to all its customers.

CalPERS did make changes to meet the objectives of improving the number of group seminars and individual meetings on investment and retirement planning topics and outsourcing plan administration functions.

One of the questions in the RFI asked if the company provides any investment advice. CalPERS responded that they didn't but they have an affiliate that does, for an additional cost to the County and with a separate contract. I do not recommend that the County pursue this contract. Nationwide has a service that provides this at a relatively low cost so if participants want to receive investment advice they can use the Nationwide service.

I recommend signing a contract with CalPERS (if applicable). If a contract is not signed I suggest the County prepare a Memorandum of Understanding that clearly states their changed responsibilities as outlined in the RFI.

Nationwide
As stated in the "Background" the consultant Jayson Davidson recommended adopting the proposed fund lineup from Nationwide. After review of the information in the RFI and taking into consideration of the additional factors, I recommend that we not implement their proposed fund lineup. The lineup meets the objectives of lowering plan and participant expenses and simplifying the investment menu, but when taking the additional factors mentioned above into account I do not agree with the extensive changes they are suggesting.

Several of the funds they are recommending for elimination have a large percentage of participation, in both current contributions and historically. If participants are happy with these funds and the performance is good there is no reason to eliminate them.
The performance of most of the funds in the proposed lineup was very similar to the performance of most of the current funds. If the expense ratio of the current fund was the same or less than the proposed fund there is no reason to change.

Four funds in the current lineup were listed on the 2nd and 3rd Quarterly Plan Reviews for de-selection due to poor performance. Nationwide recommends eliminating all of these funds. I agree with this recommendation. The funds are: Templeton Foreign Fund, Brown Capital Management Small Company Fund, AIM Mid Cap Core Equity Fund, and American Funds Washington Mutual Investors Fund.

One fund in the current lineup is listed on the 2nd and 3rd Quarterly Plan Review as being closed for new deferrals. Nationwide recommends eliminating this fund. I agree with this recommendation. The fund is Vanguard 500 Index Fund.

Lastly, the issue of participant perception played a role in my recommendation as well. The County has not received any comments from participants that they are unhappy with the funds or performance of the current lineup of funds. I think Nationwide's suggestion that 22 of the 33 be eliminated or changed is too severe and will not be well received by participants.

Updated Analysis and Recommendation

I submitted my proposed fund lineup to Jayson for his comments and for input into the correct formatted spreadsheet. Jayson thought my fund lineup was fine but he had a few comments.
(1) The RFI asked each provider to suggest a fund within a list of asset classes. Jayson's proposal included one for each class but mine did not. I patterned mine after the classes Nationwide is currently providing so there are some classes that will not be covered. They are High Yield Bond, Mid Cap Value, Small Cap Growth, Small Cap index, and International Small.
(2) One of the funds I recommended keeping (Federated Kaufman) has a very high expense ratio. It has good performance and participation. Jayson thinks this fund's performance is not justifying the high expense ratio. He expressed that this is a fund we should reconsider.

I prepared the following Attachments for information and comparison. They appear in full at the end of this document.

A. Arnerich's proposed lineup from the September 2005 RFI (asset and expense information updated 12/31/05)
B. My proposed lineup (asset and expense information updated 12/31/05)
C. Nationwide's current fund lineup (asset and expense information updated 12/31/05)

The following is a breakdown of the current Nationwide lineup, Arnerich's proposed fund lineup, and my proposed fund lineup by asset class.

	Current	Arnerich's Proposal	My Proposal
Asset class – Asset Allocation/Lifestyle	5	3	3
Asset class – International	3	3	2
Asset class – Small Cap	3	4	2
Asset class – Mid Cap	3	3	2
Asset class – Large Cap	12	4	5
Asset class – Balanced	1	0	1
Asset class – Bonds	3	2	2
Asset class – Fixed/Cash	3	2	2
Total number of funds	**33**	**21**	**19**
Number of funds in current lineup to keep		9	16
Number of funds in current lineup to eliminate		24	17
Number of new funds proposed		12	3

Here is a summary of the costs and revenue:

12/31/05 information

	Current	Arnerich proposal	My proposal
Average cost per participant	$369	303	322
Total cost per participant	.95%	.78%	.83%
Revenue commitment	unlimited	.44%	.44%
Revenue based on fund lineup	.44+%	.42%	.40%
Average revenue per participant	$184	$162	154
Total reduction in plan costs to all participants	n/a	$30,977	22,036

With my fund lineup performance will be relatively the same as current (nothing is assured of course); the funds where participation is high will remain, as will the diversity in the asset allocation. The funds being eliminated are those where participation is low and/or expenses are high.

Lastly, Attachment D shows how many people will be affected by the changes.