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Testimony to the Members of the ERISA Advisory Council

Issues and Considerations around Facilitating Lifetime Plan Participation

August 21, 2014

The City of New York, plan sponsor and administrator for the New York City Deferred Compensation Plan appreciates the opportunity to testify before the ERISA Advisory Council on the subject of "Issues and Considerations around Facilitating Lifetime Plan Participation." I am happy to talk about the City's experience with creating a low cost defined contribution program, and one that is designed to serve City employees not only during their working lives, but throughout their retirement years.

<u>The Plan and its Fees</u>

The Plan, known as NYC DCP, is the second largest public defined contribution plan in the United States. It has 165,000 participant accounts and $15 Billion in assets. The plan receives approximately $60 Million in participant contributions each month and has no employer match.

NYC DCP started in 1986 as a single 457 plan. Since that time, it has grown to be an umbrella program offering multiple plans to participants, including the 457 Plan, the Roth 457 Plan, the 401(k) Plan, the Roth 401(k) Plan, the New York City Employee (NYCE) Traditional IRA, the Roth NYCE IRA, the Spousal Traditional NYCE IRA and the Spousal Roth IRA. The eight programs offer the identical investment fund line up, and all of them are offered to participants for a single fee. The multiple programs are meant to serve as one stop shopping for City employees.

The Plan's administrative expenses are funded by a $20.00 per quarter participant fee and an annualized asset-based fee of 0.04% assessed against the Plan's investment funds. All revenues are used to pay the Plan's administrative expenses.

In 2013, the average asset-weighted expense ratio of the NYC DCP investments was 0.23% compared to 0.52% for the universe of defined contribution plans. Similarly, the annual record keeping administrative fees for NYC DCP were $51 per person as compared to $80 per person for the universe of defined contribution plans. These numbers are taken from the New England Pension Consultants' 100 DC Clients Survey.

NYC DCP has always been an unbundled program, meaning that each of the service providers is separately procured and competitively bid. These providers include the Plan's investment managers, record keeper, custodian and advisors. An unbundled program allows the Plan to see and compare explicit fees. In addition, the Plan's $15 Billion gives participants the benefit of considerable buying power.

The Plan offers participants 7 core investment options, which include both active and index management, and which cover the full range of investment asset classes. All investment funds have institutional pricing. Approximately 10 years ago, the Plan converted all of its mutual funds to lower cost separate accounts that are held in the name of the Plan by the custodial bank. The Plan also offers 12 custom target date portfolios using the Plan's own core options as the underlying investments. This allows the target date portfolios to maintain the same low cost management fee structure.

<u>The NYCE IRA, a Deemed IRA, was Created</u>

Employer sponsored plans have generally been viewed as a vehicle through which employees saved for retirement, whereas IRA's were used in retirement. These two vehicles peaceably coexisted for many years. However, of the many changes brought on by EGTRRA thirteen years ago, the one that continues to have a detrimental effect was the allowance of Governmental 457 Plans to be rolled over to an IRA. Depending on the size of the Plan, tens if not hundreds of millions of dollars leave Governmental 457 plans each year in rollovers, including the City's Plan. As a result, NYC DCP understood that it had now almost become the expectation of employees that they should roll their money over at retirement. That problem of leakage of assets was the impetus for the creation of the NYCE IRA.

Some plan sponsors have the point of view that employees come and employees go, so that plan participation balances itself out. NYC DCP recognized that was not true. While the impact on the number of participants may be minimal, plan sponsors are able to negotiate fees based on the assets they have in the plan. Large numbers and or amounts of external rollovers diminish the bargaining power of plan sponsors resulting in higher fees.

From the viewpoint of the former employee, it is even worse. They will no longer receive the institutional pricing that they were afforded while a member of their employer plan.

There is no question that the IRA can play an important role in an individual's retirement. The ability to consolidate all assets in one place, to make contributions of earned income post retirement and the flexibility of tax withholding (no mandatory 20% withholding rule) are just some of the benefits. The NYCE IRA can meet all of those needs. In accordance with Section 408(q) of the Internal Revenue Code, a deemed IRA is an IRA program that is part of a previously established eligible retirement plan such as a 401(k). The NYCE IRA owner utilizes the Plan's investment options, taking advantage of the Plan's size and institutional investment pricing. Plus, by attracting and retaining the NYCE IRA accounts, those assets build the overall retirement pool which lowers the costs for the assets still further.

The establishment of the NYCE IRA was a lengthy process, more than a difficult one. The Plan needed to work in partnership with its legal consultants, custodian and record keeper. Therefore, for any plan sponsor, the first step in establishing a Deemed IRA is to determine whether their record keeper and custodian are willing to go down this road.

The first step to establishing the NYCE IRA was to incorporate the appropriate deemed IRA language into the NYC DCP 401(k) plan document. The second step was to revise the custodial agreement to create a group trust. Both the NYC DCP 401(k) plan document and custodial agreement required IRS approval. As the NYCE IRA is part of the 401(k) plan, the Deferred Compensation Board is the fiduciary.

It is important to note that a plan sponsor also needs to be able to separate the assets, as it is critical that the assets of a defined contribution plan and a deemed IRA be kept separate for record keeping purposes, even though they are allowed to be commingled for investment purposes. That is where the group trust comes into play. The plan sponsor also needs a record keeper who can support these multiple account types, as well as ideally combine them into a single statement for the participants.

Within its first six years, both the Traditional NYCE IRA and the Roth NYCE IRA have accumulated assets to over $100 million each, the definition of a large plan in the defined contribution industry.

Plan Communications

Since NYC DCP was implemented in 1986, communication had focused almost exclusively on asset accumulation and education to assist participants with saving and investing.

That changed once the Plan became a mature one where participants had substantial account balances. First, the glide path of the target date portfolios was developed to go through retirement, rather than only up until the date of retirement. New participants choosing their investment options were immediately introduced, both in words and graphs, to the concept of remaining in NYC DCP throughout their lives, with the roll down of the portfolios going through age 85.

Then when the NYCE IRA was established, the Financial Planning Center was added as a new service to Plan participants. The Center provides in-person group retirement and distribution seminars for participants. There are 12 different seminars ranging from the Basics of Diversified Investing or Money and Credit to Eldercare or Estate Planning. The Retirement Planning Seminar specifically addresses all options available to participants, including the NYCE IRA. Seminars are provided by on-site, non-commissioned Certified Financial Planners (CFPs). Participants may also choose to take advantage of the Personal Financial Needs Assessment for a fee of $179. There are approximately 125 seminars per month, with an average of 20 participants attending each seminar.

The purpose of the Center is to help participants plan with the de-cumulation phase of their accounts. It is tailored to those participants who have been in NYC DCP the longest, have the largest account balances, and have paid the most accumulated fees over their years of participation. Through group seminars and individual financial needs assessments, the Center helps participants integrate the various sources of and vehicles providing their retirement income. It encourages participants to use the NYC DCP benefits to their maximum advantage, including educating them on the advantages of the NYCE IRA. And finally, it encourages participants to retain their assets in the NYC DCP during both their working and retirement years.

The Role of the Plan Sponsor

The City of New York is well aware that while employed, the Plan population is a captive audience. However, at the point of their severance from service, the NYCE IRA becomes a competing product in a world of retail IRAs. The relationship that the Plan has built with its employees over their working lives by offering the best competitively selected investment products at the lowest possible cost becomes the basis on which participants make their decision to stay in the Plan. Not only to stay, but to roll their other retirement assets into the NYCE IRA. And to have their spouses open a Spousal NYCE IRA and roll their retirement assets into that.

In a word, NYC DCP is adhering to a good-faith contract that says 'I am offering you a plan and I will do my best to offer you the best plan and to give you the best information about how to create the best outcome.'

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