PENSION REVIEW COMMITTEE
RECOMMENDATION
FUND SHARE CHANGES TO REDUCE EXCESS ADMINISTRATIVE REVENUE
August 29, 2019

DISCUSSION

The traditional model for paying the administrative costs associated with defined contribution pension plans is through revenue sharing. Also known as 12b-1 fees, a revenue sharing fee is imbedded in the expense ratio of a mutual fund. The money raised by 12b-1 fees is paid by a mutual fund to brokers and service providers for marketing, record keeping and other services related to the mutual fund. Presently the Lancaster County investment lineup generates 13.7 bps of revenue sharing for plan administrative expenses. This revenue is used to pay Prudential, with the remainder available for County administrative expense.

In October of 2018 Lancaster County and Prudential negotiated a two-year extension of Prudential's contract to provide record keeping and administrative services for the County's 401(a) Retirement Plan and 457(b) Deferred Compensation Program. As part of the extension Prudential agreed to lower its annual fee from 10 basis points (bps) to 7.5 bps. The reduction of Prudential's fee means a greater percentage of revenue sharing is going to the County for administrative purposes. The County needs approximately $30,000 per year (2 bps) for administrative expenses. However, the County now receives approximately $102,700 per year. Presently the balance of the County's expense account is $116,000.

With the implementation of Prudential's new contract rate the Pension Review Committee began discussions on how the excess amount of revenue sharing coming to the County could be reduced. In this regard Frank Picarelli of Segal Marco Advisors recommended fee leveling. The Committee met June 26, 2019 to discuss the concept of fee leveling. A conference call was conducted with the following people: Robb Craddock, Prudential Vice President of Investment Strategy; and Frank Picarelli, Segal Marco Advisors Vice President. Julie Klassen, Prudential Vice President of Key Accounts, was present at the meeting. The following documents were received by the Committee: a two-page document from Prudential entitled Fee Levelization; a Prudential estimate of revenue available for record keeping purposes for Lancaster County's defined contribution plans; and a list Produced by Prudential of zero revenue share classes for funds in the County's investment lineup.

The Committee was presented with two approaches to fee leveling. Under the first approach the County would offer funds with zero revenue sharing and then charge each participant either an asset-based fee or a flat fee for administrative expenses. Another approach is to keep funds as they are, pay the applicable revenue sharing back to participants who paid it in the first place, and then apply a levelized fee. Either approach can be implemented without changing any funds in the County's existing investment lineup. However, there are numerous equitable and procedural issues related to fee leveling which require further review by the Committee.

After discussing the information received at the June 26th meeting, the Committee scheduled another meeting for the specific purpose of determining if participant fees could be lowered immediately by selecting share classes for existing funds which pay less revenue sharing as part of the expense ratio. This meeting was held August 14, 2019. A conference call was again conducted with Robb Craddock and Frank Picarelli, along with Julie Klassen. The Committee also reviewed documents provided by Picarelli and Craddock showing how to reduce administrative revenue with share class changes to various funds in the County's investment lineup.

Specifically, Craddock and Picarelli identified share class changes in four mutual funds which would reduce the annual amount of revenue sharing paid to the County from approximately $102,700 to approximately $23,678 (1.6 bps). Additionally, Picarelli identified two more changes which would lower the County's annual administrative revenue to $13,000 (.86 bps).

The Committee determined that all six of the changes should be implemented by the County. In making this determination the Committee relied on the following rationale. These changes can be implemented immediately while the Committee continues to examine whether fee leveling should be adopted. If for some reason additional administrative revenue is needed in the future, necessary share class adjustments can be easily made by Prudential. However, with an expense account balance of $116,000, and assuming the historical rate of plan expenditures, it would take almost eight years for the County to deplete the account balance. Finally, the Committee recognizes there is no equitable way to return the excess administrative revenue to plan participants. It is better to spend down the existing expense account balance by keeping revenue sharing as low as possible.

RECOMMENDATION

Based on the foregoing information and discussion, the Pension Review Committee hereby tenders the following recommendation to the Lancaster County Board of Commissioners:

The amount of revenue collected for Lancaster County's administrative expenses related to the 401(a) Lancaster Employee Retirement Plan and 457(b) Deferred Compensation Program should be reduced through the following changes to existing funds within the County's investment lineup:

1. **American Funds Fundamental Investors Class R-4 - move to R5E share class;**
2. **American Funds Capital World Growth and Income Fund Class R-4 - move to R5E share class;**
3. **American Funds EuroPacific Growth Fund Class R-4 - move to R5E share class;**
4. **Oakmark Equity and Income Fund Investor Class - move to Advisor share class.**
5. **Eaton Vance Atlanta Capital SMID Fund Class 1 - move to R6 share class; and**
6. **Mid Growth Westfield Capital (separate account) - move from an expense ratio of 85 bps with 10 bps of revenue sharing to an expense ratio of 75 bps and 0 bps revenue sharing.**

Respectfully submitted the 29th day of August, 2018.

Kerry P. Eagan
Chief Administrative Officer

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