NC Supplemental Retirement Plans

Cost Allocation Plan

March 7, 2012

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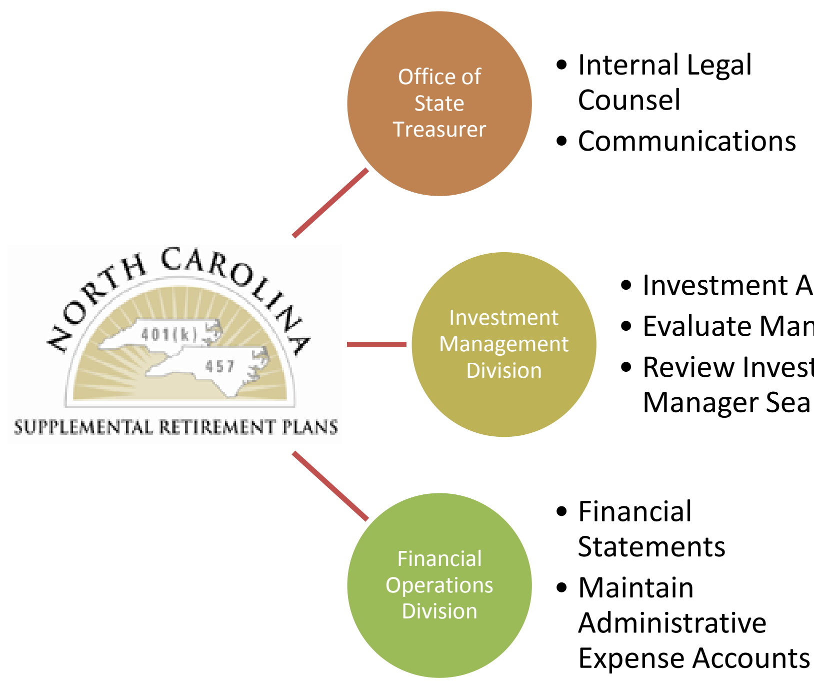
Background

The administration of the Supplemental Retirement Plans ("Plans") relies on the support from multiple staff members of the Department of State Treasurer ("DST"). Currently, compensation from only two staff members, the Plans' Coordinator and the Retirement Systems Director, are being allocated to the Plans (a Deputy Director was approved at the September 7, 2011 meeting of the Board of Trustees and will be added to this list upon employment).

The Plans often receive internal support from staff on communication, financial statement preparation, legal review, and investment advice. Currently these staff members supporting the Plans are compensated only from the receipts provided by the defined benefit pension plans. Therefore, the Plans are in effect receiving a subsidy from members of the pension plan.

It is important to continue to monitor all related activity to ensure we maintain allocations, which are reflective of support and appear appropriate. The level of support needed for the Plans varies throughout the year, therefore estimates must be made to appropriately invoice the Plans for internal services.



The cost allocation proposals following this document display the estimated time spent by staff serving the Plans and the associated cost, which would be applied to the Administrative Reimbursement Accounts for the Plans. If approved, the positions identified serving the Plans will not receive any pay increase. The portion of their time spent serving the Plans will be paid for by the Plans' Administrative Reimbursement Accounts rather than administration accounts supported by receipts from the various defined benefit pension plans. A summary of the positions serving the Plans, their estimated time spent working on the Plans, and the estimated cost to the Plans is provided in Table 1.

Table 1

Position	**% of Time Spent on Plans**	**Estimated Annual Cost to the Plans**
RSD Director	25%	$40,000
Chief Investment Officer	5%	$19,000
Global Equity Director	10%	$26,400
Portfolio Manager	10%	$11,800
Deputy Director, Communications	10%	$6,800
Assistant General Counsel	15%	$15,300
Chief Financial Officer	5%	$7,500
Deputy Director, Accounting	10%	$9,400
Accounting Supervisor	15%	$9,500
Total Estimated Cost		**$145,700**

How would this change affect the current budget?

The revenue generated from the 2.5 basis points charged to participants for the State's expenses attributable to the Plans does not change. The estimates provided in Table 2 are based on a combined 401(k)/457 asset valuation of $6.3 Billion. The 12b-1/sub-transfer agency fees will no longer be received due to the discontinuance of the mutual funds.

Table 2

Revenue	**Current Budget**	**FY '12 Recurring**
2.5 bps on Plan Assets (401k)	$1,350,000	$1,350,000
2.5 bps on Plan Assets (457)	$205,000	$205,000
Interest	$260,000	$260,000
12b-1/Sub-transfer agency Fees	$200,000	$0
Total Annual Revenue	**$2,015,000**	**$1,815,000**

If expenditures for both Plans following the implementation of the cost allocation plan are aggregated, then Table 3 would reflect the changes to the expenditures of the Plans.

Table 3

Expenditures	**Current Budget**	**FY '12 Recurring**
Salaries	$41,360	$242,175
Benefits*	$13,518	$65,040
Contractual Services	$779,600	$746,675
Office	$2,296	$5,659
Other	$24,000	$24,000
Total Annual Expenditures	**$860,774**	**$1,083,549**

**The Employer Contribution Rate varies from year-to-year. Also, benefit estimates do not include the active cap on Social Security contributions currently at $110,100.*

For a holistic representation of the effect of the cost allocation plan on the estimated budget of the Plans see Table 4.

Table 4

	Current Budget	FY '12 Recurring
Revenue	$2,015,000	$1,815,000
Expenditures	$860,774	$1,083,549
Total Annual Excess	**$1,154,226**	**$731,451**

The Plans estimated annual Administrative Reimbursement Account surplus under this approach would decrease from $1.1 million to $730,000. As the Department continues to pursue fiduciary liability insurance, staff believes consideration of a fee reduction should occur at a later date.

Issue

If the current practice of dividing salary and benefit payroll equally between the Plans continues, the 457 plan expenditures will exceed its $205,000 estimated annual revenue. The only way to retain a balanced budget in the 457 plan without raising administrative fees is to split the salaries and benefits for all personnel pro-rata based on total assets held in each plan. This is the current practice used for all contractual service expenses of the Plans.

As of December 31, 2011, the asset-to-plan ratio is approximately 86/14 (401(k)/457). The Department's new accounting system can only handle integer-level percentages for any one account. No partial percentages can be made on the system.

Recommendation

If the Board adopts the cost allocation plan as presented, the Plans' budgeting process should be modified to round all salary and benefit allocation percentages to the nearest 5 percent. The 401(k) plan will pay 80 percent, or 4 of every 5 percent; while the 457 plan will pay 20 percent, or 1 of every 5 percent. All contractual service invoices will continue to be paid at the actual asset-to-plan ratio.

If the cost-allocation proposals and the expense allocation policy are approved, the chart in Table 5 will display the estimated annual expenses for each plan:

Table 5

Expenditures	401(k)	457
Salaries	$193,740	$48,435
Benefits	$52,032	$13,008
Contractual Services	$649,607	$97,068
Office	$4,923	$736
Other	$20,880	$3,120
Total Annual Expenditures	**$921,182**	**$162,367**