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North Carolina Supplemental Retirement Plans

Administrative Fee Review

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Fee Benchmarking

Methodology

- The North Carolina Department of State Treasurer engaged Callan to review the administrative and investment-related fees for the North Carolina Supplemental Retirement Plans (NCSRP or 401(k) and 457(b) Plans)

Administrative Fees

- To benchmark plan administration fees, NCSRP fees were compared to blind bids for plans of similar size and complexity
 - Note, it is difficult for recordkeepers to accurately scope administration fees related to the NCSRP without a full review of participating employers and data sharing practices, which we would expect in a full Request for Proposal bid. The bids provided by the comparable vendors are informational and identify the range of fees a retirement program similar to NCSRP could expect
- Additionally, we provide a comparison of administration fees based on information from Callan's recordkeeping fee database. Callan's fee database contains hundreds of data points and is regularly updated. It is comprised of fee data from the following sources:
 - The fees in the database represent fees for recordkeeping services such as administration, plan sponsor and participant website maintenance, call center services, compliance functions, participant communications, in-person meetings, reporting, trust & custody, and check cutting. Importantly, these fees are not inclusive of costs for individual participant transactions (e.g., loan initiation, withdrawals, QDROs)
 - Recent recordkeeper and custodian searches
 - Recent fee studies
 - Ongoing client monitoring

Investment Fees

- To evaluate the competitiveness of investment management fees, expenses for each option were compared to those of funds with:
 - Similar investment strategies or objectives (e.g., large cap U.S. equity funds compared to other large cap U.S. equity funds)
 - The same management style (i.e., passively managed funds compared to peer groups comprised of other passively managed funds)
 - The same vehicle type (e.g., separate accounts compared to peer groups comprised of other separate accounts)
- It is important to note that our analysis is focused solely on fees and does not factor in the ranking or quality of returns that a manager has delivered. Performance differences may be one factor that explains the dispersion of fees seen in the marketplace

Background

Intro to DC Plan Fees

- The starting point for any discussion around DC fees is to understand the total revenue needed to provide the requested services
- Revenue is collected through investment fees, administration fees, transaction fees, and many other potential sources
- Fees should be reasonable and services clearly outlined

- Fee comparisons are challenging given that there are many factors, which can influence fees, and fees are not the only criteria used by prudent fiduciaries to make decisions
- There are many factors to consider in evaluating the reasonableness of plan administrative fees:
 - Complexity of plan
 - Services provided by the recordkeeper
 - Number of participants
 - Plan assets
 - Number/type of investment options
 - Number of payroll feeds
 - Unique plan features

Types of Plan Fees



Investment Management Fees

Investment Management Fees are set at the fund level and are assessed pro-rata based on the assets invested in the fund.

In a mutual fund environment, the operating expense ratio and revenue shared with the recordkeeper are set with the Investment Manager; opportunities to negotiate a lower fee may be available when plan assets in the fund reach certain levels.

Collective trusts and separately managed accounts may permit greater flexibility in assessing fees.



Plan-Level Administration Fees

Administration fees reflect the services required to administer the plan on an ongoing basis.

Typically there is a flat per participant fee or, somewhat less common, an asset based fee that is set by the vendor.

These fees can be collected directly from the plan sponsor, the participant, forfeiture accounts, or revenue sharing, or some combination of any of the above.

Additionally, separate fees may apply for communication and education support, etc.



Participant-Level Transaction Fees

Participant transaction fees are fees assessed based on an individual's action: taking a loan, requesting a distribution, submitting a QDRO, investing in self-directed brokerage.

These transaction fees may generate considerable revenue for the recordkeeper and should be considered in any review of plan fees.

These fees can generally be negotiated in the context of the overall recordkeeping relationship.



Other Revenue

In addition to the other sources of revenue outlined, the vendor may also receive additional compensation from other sources: investment advice providers, rollover partners, self-directed brokerage relationships or trading fees, general account-backed fixed annuities or "spread" products, "sleight of hand" changes with respect to share classes and revenue-sharing, etc.

It is important to inventory and assess all fees as a component of your ongoing due diligence.

Current State

Table 1: General Characteristics as of December 31, 2019

	Combined Plans	401(k)	457(b)
Participant count - total number of account balances	318,291	261,419	56,872
Participant count - unique SSNs	286,073	--	--
Recordkeeper	Prudential	Prudential	Prudential
Average participant balance	\$42,660	\$43,598	\$27,488
Median participant balance	--	\$13,252	\$3,980
Participation rate	--	30%	11%
Average deferral rate	--	5%	6%

- Prudential Retirement provides administration and recordkeeping services for three plans within the NCSRP:
 - NC 401(k) Plan
 - NC 457(b) Plan
 - NC 403(b) Plan, which is not included in the scope of this review
- The general characteristics in Table 1 are based on information provided by Prudential in February 2020

Current State

Table 2: Estimated Revenue Based on Current Fee Structure

	Combined Plan Revenue	Per Account / Per Participant	401(k) Plan Only Revenue	Per Account	457(b) Plan Only Revenue	Per Account
a. Plan Administration Fees	\$9,867,021	\$31 / \$34	\$8,103,989	\$31	\$1,763,032	\$31
b. Event-based Transaction Fees	\$1,065,510	\$3 / \$4	\$873,660	\$3.34	\$144,600	\$2.54
Total Service Fees	\$10,932,531	\$34 / \$38	\$8,977,649	\$34.34	\$1,907,632	\$33.54

- Prudential currently collects approximately \$34.35 per account, or an average of \$38.22 per unique participant in the NCSRP in annualized direct administration fees
 - The \$31 per balance fee covers recordkeeping services such as administration, plan sponsor and participant websites, call center services, participant communications, meetings, reporting, etc. Participants with a balance in both plans would pay \$62 annually towards administrative services
 - In addition, Prudential charges a loan origination fee, which is covered in the “Transactions” section of this report
 - Prudential also collects \$883,236 in float income, which equates to \$2.77 per account or \$3.09 per unique SSN, in addition to the direct fees collected. Float income in DC plans is generated when money that flows in and out of the plan is held temporarily in an interest-bearing account while awaiting investment or payout
 - *Float can be minimized by prompt processing of contributions (e.g., same day investment for contributions received before 1pm ET), encouraging participants to utilize ACH payments for loans and distributions, and assessing any other areas of plan administration where plan assets are not invested for a period of time.*

Note, the Plan fees identified above are point-in-time calculations based on participant counts and average transaction volumes for the 3-year period ending on December 31, 2019

Callan

Administration Fee Benchmarking

Blind Bids and Benchmarking Process

- In evaluating service fees, Callan asked six recordkeepers to complete a blind mini-survey (in which the name of the plan sponsor is kept confidential) where the recordkeepers were asked to provide pricing for the DC plans, based on participant counts and average transaction volumes 3-year period ending on December 31, 2019
 - The recordkeepers that were included support public plans as a part of their normal service offering
 - Two of the recordkeepers declined to provide a bid due to difficulties scoping services. One vendor provided an extremely conservative bid, which was inconsistent with other vendors
 - Note, it is challenging for recordkeepers to accurately scope administration fees related to the NCSRP without a full review of participating employers and data sharing practices, which we would expect in a full Request for Proposal bid. The bids provided by the comparable vendors are informational and identify the range of fees a retirement program similar to NCSRP could expect
- The surveyed recordkeepers were asked to provide the revenue they would require to administer the DC plan given an open architecture investment structure (i.e., no proprietary fund requirements)
 - The bidders were asked to provide a flat per participant fee, as well as any additional fees
 - To provide pricing, they were given high-level information on the assets, investment structure, participant levels and statistics, features, complexities, etc.
- The following slides provides the results of the blind survey, including the recordkeepers' quoted administrative fees based on the hard dollar fee approach

Administration Fees

Table 3: Fee Benchmarking -- Combined Plan Revenue, Unique Participant Count

	Vendor 1*	Vendor 2	Vendor 3	Average	Median	Prudential
Per Ppt Quoted Admin Fee	\$53	\$65	\$39	\$52	\$53	\$31
Total Admin Fee in Dollars (estimated)	\$15,018,833	\$18,594,745	\$11,156,847	\$14,923,475	\$15,018,833	\$9,867,021
Participant Transaction Fees	\$3,292,367	\$887,925	\$1,331,888	\$1,837,393	\$1,331,888	\$1,065,510
Total Estimated Fee in Dollars	\$18,311,199	\$19,482,670	\$12,488,735	\$16,760,868	\$18,311,199	\$10,932,531
Total Estimated Fee Per Ppt	\$64	\$68	\$44	\$59	\$64	\$38
Total Estimated Fee Per Account	\$58	\$61	\$39	\$53	\$58	\$34

* Vendor 1 noted increased complexity due to plan complexity; additional premium was used to calculate costs of increased complexity

Green = Lower Fees, **Red** = Higher Fees

- The surveyed recordkeepers were asked to provide the revenue they would require to administer the DC plans assuming an open architecture investment structure (i.e., no proprietary fund requirements)
- As shown in the table above, the current revenue received by Prudential is lower than the median comparable bid (\$59 per unique participant) and the lowest bid (\$44)
 - In addition to the bids captured in Table 3, we also received an extremely conservative bid that appears to be inconsistent with the fees quoted by other vendors. This vendor indicated their bid was driven by the number of participating employers and payroll processing needs. The bid provided by this outlier was \$112 per participant with a \$50 loan fee, for a total service revenue requirement of \$115 per unique participant. Including this bidder would increase the average revenue requirement from \$59 to \$73 per unique participant
- Prudential also receives float income in addition to the direct administration fees
 - Float income in DC plans is generated when money that flows in and out of the DC plan are held temporarily in an interest-bearing account while awaiting investment or payout. Prudential reported receiving \$883,236 in the 12-month period ending December 31, 2019
 - The bidders were not able to provide estimated float income due to the number of variables that impact the generation of float income

Note, the Plan fees identified above are point in time calculations based on participant counts and average transaction volumes 3-year period ending on December 31, 2019

See pages 10 and 11 for additional information on participant transaction fees

DC Plan Transaction Fees

Table 4: Comparison of Quoted Transaction Fees

	Vendor 1	Vendor 2	Vendor 3	Average	Median	Prudential
Loan Origination	\$50	\$50	\$75	\$56	\$50	\$60
Loan Maintenance	\$25	Included	Included	\$25	\$25	\$0
In-Service Withdrawals	\$25	Included	Included	\$25	\$25	\$0
Termination Distributions	\$25	Included	Included	\$25	\$25	\$0

- The revenue from transaction fees can be used to make up for lower annual administration fees
- The loan origination transaction fees charged by Prudential is higher than the median fee charged by other vendors
- The average and median in this table represent only the comparator bidders that charged a fee for that transaction

Estimated Revenue from DC Plan Transaction Fees

The bidders' quoted transaction fees were applied to the 3-year average transactions volumes to generate the estimated fees below

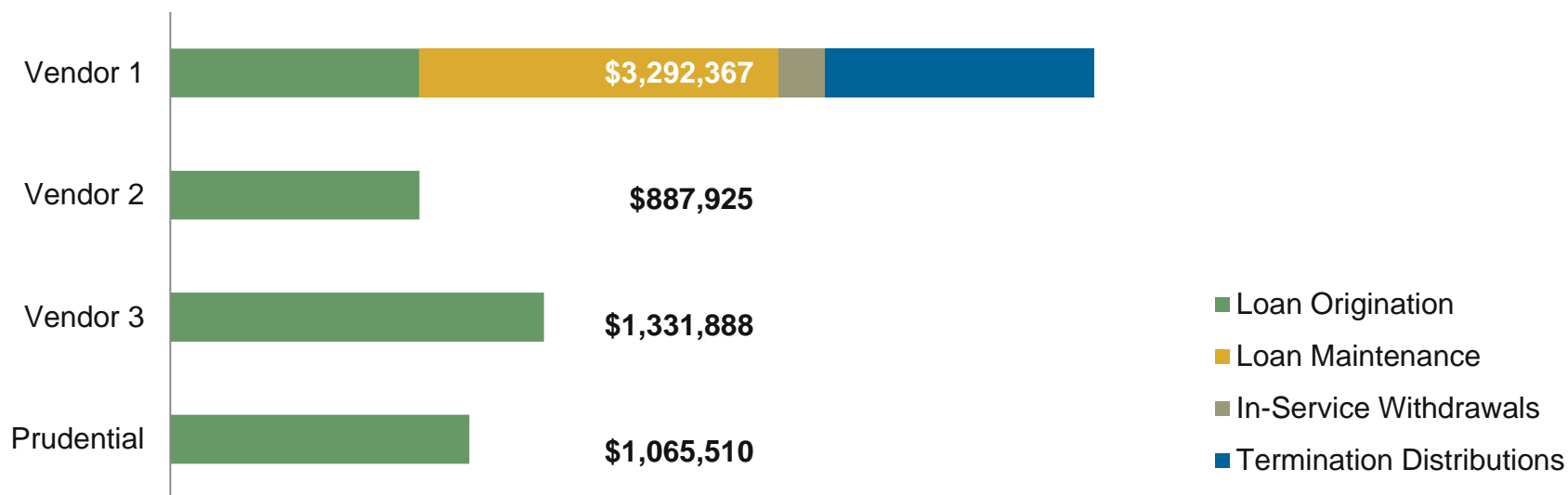


Table 5: Comparison of Applied Transaction Fees

	Vendor 1	Vendor 2	Vendor 3	Average	Median	Prudential
Loan Origination	\$887,925	\$887,925	\$1,331,888	\$998,916	\$887,925	\$1,065,510
Loan Maintenance	\$1,279,008	Included	Included	\$1,279,008	\$1,279,008	Included
In-Service Withdrawals	\$166,500	Included	Included	\$166,500	\$166,500	Included
Termination Distributions	\$958,933	Included	Included	\$958,933	\$958,933	Included
Totals	\$3,292,367	\$887,925	\$1,331,888	\$1,600,026	\$1,109,906	\$1,065,510

Database Fee Review

- In order to supplement the blind bids used to benchmark fees on the preceding pages, Callan also compared the fees charged to administer the NCSRP against DC plans in our fee benchmarking database
- In evaluating the competitiveness of fees, it is important to note that the NCSRP may differ in key ways from those included in the database. For instance, whereas many database fees are inclusive of trust & custody services, NCSRP administration fees do not include trust and custody services

Database Fee Review

Combined Plan Pricing

	Per Participant Administration Fee (\$)	Sample Statistics	Database	NCSRP
90 th Percentile	\$53	Average Assets	\$7B	\$12B
75 th Percentile	\$51	Average Accounts	75,499	286,073
50 th Percentile	\$38	Sample Count	11	
25 th Percentile	\$35			
10 th Percentile	\$35			
NCSRP – Combined Plans	\$34			

- Prudential charges \$31 per account for administration services against 318,291 accounts, for a total of \$9,867,021 in estimated annual revenue. When that amount is applied to the number of unique participants across both plans (286,073), the administration fee increases to \$34 per participant
- The NCSRP administration fees are below the median fee of the database sample

Database Fee Review

Separate Plan Pricing

	Per Participant Administration Fee (\$)	
	401(k)	457(b)
Average Accounts in Database Sample (Count)	75,499 (11)	59,781 (21)
NCSRP	261,419	56,872
90 th Percentile	\$53	\$56
75 th Percentile	\$51	\$52
50 th Percentile	\$38	\$40
25 th Percentile	\$35	\$35
10 th Percentile	\$35	\$24
NCSRP	\$31	\$31

- We also looked at the plans priced separately to understand how the volume of accounts in each plan could impact pricing
 - The NCSRP 457(b) Plan is approximately one-fifth the size of the 401(k) Plan by participant count
 - If the DC plans were priced separately, it is likely that participants in the 457(b) Plan would be assessed a higher fee

Contracting and Negotiations

- NCSRP has consistently worked with Prudential to address services and support included in their scope of services
- Callan recommends reviewing the current contract to identify areas where additional service level agreements and remediation may be appropriate, as well as opportunities to provide consistent support and outcomes to the NCSRP and plan participants

Investment Fees

Investment Option Fee Evaluation

Funds and Sub-Advisors	Assets*	Inv. Mgmt. Fee	Custodial Expenses ¹	NC Budget ²	Total Estimated Expense (%)	Total Estimated Expenses (\$) ³	Callan Median Expense ⁴	Difference
NorthCarolina Stable Value Fund	\$2,137,581,118	0.296%	0.0018%	0.025%	0.32%	\$6,900,112	0.36%	-0.04%
Galliard	\$2,143,449,613	0.296%	0.0000%			\$6,344,611	0.29%	0.01%
North Carolina Fixed Income Passive Fund	\$88,704,498	0.020%	0.0255%	0.025%	0.07%	\$62,537	0.15%	-0.08%
Blackrock	\$86,328,656	0.020%	0.0100%			\$17,266	0.02%	0.00%
North Carolina Fixed Income Fund	\$1,842,275,314	0.127%	0.0103%	0.025%	0.16%	\$2,984,486	0.40%	-0.24%
50% TCW	\$920,797,735	0.143%	0.0000%			\$1,316,741	0.22%	-0.08%
50% Prudential	\$921,477,617	0.110%	0.0100%			\$1,013,625	0.22%	-0.11%
North Carolina Inflation Sensitive Fund	\$432,102,798	0.090%	0.0153%	0.025%	0.13%	\$563,030	0.85%	-0.72%
Blackrock	\$432,102,803	0.090%	0.0100%			\$388,893	0.75%	-0.66%
North Carolina Large Cap Passive Fund	\$2,969,441,872	0.005%	0.0115%	0.025%	0.04%	\$1,232,318	0.08%	-0.04%
Blackrock	\$2,743,702,618	0.005%	0.0100%			\$137,185	0.03%	-0.03%
North Carolina Large Cap Core Fund	\$1,970,079,742	0.284%	0.0081%	0.025%	0.32%	\$6,249,093	0.63%	-0.31%
18.75% Hotchkis & Wiley	\$368,052,144	0.400%	0.0000%			\$1,472,209	0.40%	0.00%
18.75% Macquarie Large Cap Value	\$368,891,422	0.275%	0.0000%			\$1,012,607	0.40%	-0.13%
18.75% Sands Capital Management	\$375,431,277	0.450%	0.0000%			\$1,689,441	0.43%	0.02%
18.75% Loomis Sayles	\$369,283,187	0.379%	0.0000%			\$1,397,737	0.43%	-0.05%
25% BlackRock Advisors Inc., Large Cap Index*	\$488,421,719	0.005%	0.0100%			\$24,421	0.02%	-0.02%
North Carolina SMID Cap Passive Fund	\$330,984,894	0.005%	0.0146%	0.025%	0.04%	\$147,619	0.20%	-0.16%
Blackrock	\$306,804,766	0.005%	0.0100%			\$15,340	0.03%	-0.03%
North Carolina SMID Cap Core Fund	\$898,191,953	0.346%	0.0154%	0.025%	0.39%	\$3,468,817	0.89%	-0.50%
23.75% Earnest Partners	\$212,587,527	0.470%	0.0000%			\$999,161	0.66%	-0.19%
23.75% Wedge	\$213,339,699	0.470%	0.0000%			\$1,003,337	0.66%	-0.19%
23.75% Brown Advisory	\$211,822,298	0.514%	0.0000%			\$1,088,131	0.74%	-0.23%
28.75% BlackRock Advisors Inc., SMID Index*	\$259,771,688	0.005%	0.0100%			\$12,989	0.03%	-0.03%
North Carolina International Passive Fund	\$82,915,819	0.021%	0.0359%	0.025%	0.08%	\$67,908	0.25%	-0.17%
Blackrock	\$76,922,142	0.021%	0.0200%			\$16,154	0.08%	-0.06%
North Carolina International Equity	\$1,972,657,270	0.332%	0.0258%	0.025%	0.38%	\$7,551,332	0.81%	-0.43%
50% Baillie Gifford Growth	\$986,116,211	0.278%	0.0000%			\$2,741,403	0.51%	-0.23%
50% Mondrian Investment Partners Value	\$985,310,908	0.386%	0.0000%			\$3,802,315	0.51%	-0.12%
North Carolina TIPS Fund	\$236,946,526	0.025%	0.0127%	0.025%	0.06%	\$148,565	0.26%	-0.20%
Blackrock	\$220,814,670	0.025%	0.0000%			\$55,204	0.12%	-0.10%
Total	\$12,961,881,804	0.189%	0.0161%	0.025%	0.23%	\$29,375,818	0.33%	

*Investment fees are provided by NC DST ; Individual Manager Assets do not sum to Fund asset class totals due to residual/closing accounts.

¹ Based on annualized monthly fee accruals as of 12/31/2019

² The cost of the budget associated with the management of the Supplemental Retirement Plans, borne by each investment option in proportion to the pro-rate share of the applicable assets in that fund. This fee has been waived for 2019 and 2020.

³ Manager fee estimates reflect investment management fee only, does not include \$31 per participant record-keeping fee.

⁴ The median expenses for White Label composites are compared against the respective Callan Mutual Fund Institutional Universe, while the individual managers are compared to peers with the same vehicle and strategy. The total fund median represents asset-weighted investment management fees for plans greater than \$1 billion in the Callan DC index.

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