

MONROE COUNTY COMMUNITY SCHOOL CORPORATION
BOARD OF SCHOOL TRUSTEES
Regular Meeting, May 7, 2008

FOR INFORMATION: Update from the 401(a)/403(b) Plan Review Committee

The MCCSC has sponsored tax deferred annuity (403(b)) programs for many years. Staff members have had the ability to defer income on a pre-tax basis into income earning accounts in accordance with the provisions of IRS Code Section 403(b). There are currently five MCCSC approved 403(b) product vendors from which staff members may choose a company or companies with which they wish to invest their contributions. The current approved vendors are New England Mutual Life, American United Life (AUL), Variable Annuity Life Insurance Company (VALIC), TIAA Cref and IU Credit Union Investment Services (American Funds).

A 401(a) plan was established in the year 2000. The 401(a) plan is an employer sponsored plan in which employer matching contributions are deposited. The current recordkeeping, compliance and investment functions are performed by VALIC.

The MCCSC matches staff members' 403(b) contributions with contributions to their 401(a) accounts up to a maximum of 2.25% of certified staff base salary and 1% of support staff base salary. These matching contributions are paid by the MCCSC into staff members' 401(a) accounts with VALIC (Variable Annuity Life Insurance Company) on a tax deferred basis. Staff members earn income on both the 401(a) and 403(b) account balances on a tax deferred basis until the funds are withdrawn following retirement. Taxes are paid at the time the funds are withdrawn.

There are currently 1,668 open 403(b) accounts for active and retired MCCSC employees with total assets of \$36,211,000 in these accounts as of June 30, 2007. Approximately \$2,500,000 is contributed to these accounts annually at the present time.

There are currently 1,412 open 401(a) accounts for active and retired MCCSC employees with total assets of \$7,828,000 and annual contributions of approximately \$920,000.

The current plan structure provides for a "bundled" product platform wherein vendors market their products to staff members, provide investment advice, monitor their own performance for compliance with IRS regulations and distribute withdrawals to staff members in accordance with staff member directives as long as those directives comply with IRS regulations. In the existing environment where responsibility for compliance has been somewhat vague, the MCCSC has relied on hold-harmless agreements with vendors to provide assurance of compliance and protection from the financial penalties that may be levied if the Plan does not comply with IRS requirements.

The Internal Revenue Service issued new regulations in July 2007 which will take effect January 1, 2009. Once the new IRS Regulations were issued a 401(a)/403(b) Plan Review Committee was formed to study the impact of the regulations and make recommendations for changes to the Plan to better ensure compliance with IRS regulations and to update the provisions of the plan to make it more suited to the current financial environment.

Among the new Plan requirements are:

- **School Corporations are now directly responsible for the correct administration of their plans.** While responsibility for compliance with regulations has been somewhat vague in the past, it is now

quite clear that school corporations are responsible for compliance of their 403(b) plans with Internal Revenue Service regulations.

- Universal Availability to All Staff Members—While some restrictions on participation are possible within the Regulations, due to potential “tracking” issues we do not believe it would be appropriate to place minimum participation or “hours worked” requirements on staff members in order for them to qualify to participate in the 403(b) program. Therefore, the Board will receive a recommendation that all MCCSC employees be eligible to participate in the 403(b) program.
- Annual Notification—All employees must be notified at least annually if they are eligible to participate in 403(b) programs.
- Written Plan Document—The MCCSC currently has a written plan document. Some modifications to the Plan Document will be recommended to the Board for approval at the May 20, 2008 meeting of the School Board.
- Deferred compensation withholdings must be remitted to vendors within 15 days. The MCCSC already complies with this requirement.

The Committee received legal and plan design advice from Mary Beth Braitman and Wayne McClain (Ice Miller) and financial and plan design advice from Douglas Johnson, CFP® (J.A. Benefits). A broad range of employee groups were represented on the committee with the following individuals serving on the committee: Jim Harvey (Superintendent), Randy Tackett (AFSCME), Gina Arthur (AFSCME), Norma Owens (AFSCME), Virgil Franks (AFSCME), Sandy Steele (ISTA), Linda Richardson (MCEA), Gray Estabrook (MCEA), Terry Daugherty (MCEA), Billie Carlson (Secretaries), Sharon Olson (Secretaries), Barb Buckner (Administrators), Tim Thrasher (Comptroller) and Peggy Chambers (Assistant Superintendent for Human Resources and Personnel).

The committee also reviewed plan structures for the 403(b) and 401(a) plans and explored the relative advantages and disadvantages of keeping both plans separate or using a common administrator and/or investment advisor for both plans. The committee reviewed the current 403(b) plan multi vendor structure, a single vendor bundled structure (similar to the current 401(a) Plan structure) and an unbundled approach utilizing a record keeper, a trustee, a plan investment advisor and an investment advisor for staff members. Finally, the committee reviewed administrative and investment options from a variety of vendors. The following criteria were used in the evaluation process which has taken place over the last eight months:

Criteria

- Flexibility to administer the plans as designed.
- Competitive investment offerings.
- Transparent and competitive fees.
- Ability to assist the employer in plan administration, recordkeeping and actuarial services.
- Ability to keep Committee up-to-date on market trends in administration and plan design.
- Ability to assign dedicated experienced contacts for plan sponsor assistance.
- Participant access through VRU, Internet and customer services representatives for 403(b).
- Innovative and effective participant education / communication program.
- Timely and accurate plan sponsor reports and participant statements.

- Availability of on-line reports from the recordkeeping system for sponsor access.
- Completion of all required IRS testing.
- Competitiveness of overall fee structure for both plans.
- Flexibility to use existing actuary as needed.

During the process the committee looked at all three approaches outlined above and weighed the costs and benefits of each approach. During that process many individual vendors, including administrators/record keepers, insurance companies and investment companies, were evaluated.

It became apparent through the process that the current structure does not facilitate compliance with the new regulations. The committee found the current multiple vendor approach, with no independent means to monitor vendor compliance, does not provide adequate assurance of compliance with the Regulations. The current approach and investment options are not sufficient given the new law and the objectives set forth by the committee to reduce plan costs.

The committee found through research that combining the 401(a) and 403(b) plans for administrative and investment services will provide participants significant savings in administrative and investment advisory fees. The most efficient and cost effective way to provide administration, compliance and investment services is to use an “unbundled” approach. That approach includes using an independent record keeper, a trustee to manage plan assets, a plan investment advisor and an investment advisor for staff members. Each is independent and paid for services rendered on a flat fee basis that does not increase as the total dollars invested in the plans increase. Currently, vendors receive additional compensation as total assets under the plan increase. Cost savings will be realized for all participants in both the 401(a) and 403(b) plans using the unbundled approach.

Our best estimates are that plan costs under the new plan structure will be approximately 60 basis points (.60%) less than under the current plan structure. The combined assets of the two plans total \$45,000,000. The potential savings associated with implementation of the new unbundled plan come to approximately \$270,000 annually. The new plan structure will provide improved assurance of compliance with IRS Regulations and lower plan costs. Lower costs mean there will be more money in the accounts of our staff members when they retire. The committee understands the marketplace is ever changing and the committee will remain vigilant as other options become available.

The administration and the committee will recommend on May 20th that the School Corporation implement an “unbundled” administration and investment platform. A recommendation for approval of contracts for the record keeper, the individual investment advisor, the plan investment advisor and the trustee will be recommended to the Board for approval during that meeting. A recommendation will also be presented recommending approval of a restated 403(b) Plan Document.

The timeline for approval of the contracts with service providers and the amended plan documents is crucial. Although the effective date for the new IRS Regulations is January 1, 2009, implementation of the new investment platform is scheduled for the beginning of the 2008-09 school year. Meetings are being scheduled between now and the end of the school year so the plan changes can be explained to staff members. It will be important for the contracts with the various service providers to be approved by the Board so representatives of those companies can assist with the staff meetings. Approval of the Plan Document will provide the record keeper with the information necessary to educate the staff and administer the Plan correctly. Since the shift to the new platform will take place at the beginning of the 2008-09 school year all educational components and enrollments must be in place prior to that time. It will be difficult to contact staff members during the summer so as much communication and education as possible must take place before school is dismissed for the summer.