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Management Review

New Jersey State Employees Deferred Compensation Plan
Department of the Treasury
Division of Pensions and Benefits

MERCER

Investment Consulting

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Executive Summary

Introduction

Mercer Investment Consulting was retained by the State Treasurer to conduct a review of the State Employees Deferred Compensation Plan (EDCP). Pursuant to the request for proposal, the review was to include the following:

1. Investment Options
2. Investment Policy Statement
3. Investment Management Structure and Costs
4. New Investment Strategies and Instruments
5. Custodian
6. Adequacy of Services Provided to Program Members
7. Efficiency and Effectiveness of the Division's Organizational Structure and Resources
8. Use of External Consultants
9. Statutory Provisions and Administrative Rules
10. Internal Controls and Risk Management
11. Code of Ethics

In addition to the specified items, Mercer was to provide advice about any other aspect of the plan that was deficient or in need of change. These items, including the 11 items listed above, fall into five broad categories:

- Governance of the Plan
- Plan Characteristics and Features
- Investment Offering
- Custodial Services
- Administration and Recordkeeping

Project Approach

In conducting this project, Mercer interviewed various staff and stakeholders and reviewed documents. In identifying best practices, we drew on Mercer's broad experience with many of the largest private sector 401(k) and public sector 457 plans in the country. In particular, we focused on five benchmark plans. These were the plans in the states of:

- Washington
- Oregon
- Ohio
- California
- Pennsylvania

The first four were selected because they conduct internally one or more of the activities commonly outsourced to third party administrative service providers.

For survey data, we drew heavily on Mercer's U.S. Report from the 2002 Defined Contribution Survey and its 2001 Survey on Employee Savings Plans which have data on 401(k) plans, the 2002 survey by the Profit Sharing/401(k) Council of America, and the National Association of Government Defined Contribution Administrators, Inc. 2001 Survey of 457 Plans.

Summary of Findings and Recommendations

While the individual sections of the report address these issues in more detail, and consider additional issues, the following summarizes significant findings and recommendations.

Governance of the Plan

Efficiency and Effectiveness of the Division's Organizational Structure and Resources

The Board has broad statutory administrative powers and duties under State statute to take all measures necessary for the implementation and administration of the enabling law but formal Board governance mission statements, policies and directives do not appear to have been established. The Board should take on a more proactive governance role over the EDCP and establish formal Board policies. The Board should assess the adequacy of current staffing to serve future Board activity and consider establishing committees as appropriate.

The Board should seek legal clarification of the nature and scope of responsibilities of the Board for the EDCP relative to the State Investment Council, the Department of the Treasury and the Division of Investment.

Statutory Provisions and Administrative Rules

The EDCP is established under a combination of State statutes and a separate written plan document. We recommend reviewing the compliance and operational issues identified in this report with legal counsel and making necessary changes.

Code of Ethics

The Trustees and staff of the EDCP are subject to the Department of the Treasury Code of Ethics. There is not any ongoing or formal Code of Ethics orientation, training or education program for Trustees or staff. We recommend establishing a code of conduct and ethics that is specific to the EDCP and developing and implementing an ongoing code of conduct/ethics education and training program for new and existing Trustees and staff.

Plan Characteristics and Features**Participation**

Approximately 30% of employees eligible to participate in the EDCP make contributions. Based on our knowledge of New Jersey's demographics, including that:

- local employers are not eligible,
- the State is not (geographically) large and is relatively urban, and
- the average salary of state employees is over \$40,000.

We believe the participation rate could be close to 40% of eligible employees.

Accepting Non-457 Plan Rollovers

The EDCP does not currently allow participants to roll non-457 assets into the Plan. Under the current internal recordkeeping structure, accepting rollovers would not merit incurring the additional programming and modification costs. If plan administration is outsourced, rollovers could be permitted.

Loans

Participants are not permitted to take loans against their account balances. Given that the State's defined benefit plan gives members the ability to take loans, and the cost to change the current internal recordkeeping structure to

accommodate loans, we would not recommend offering loans at this time. However, if plan administration is outsourced, loans could be permitted.

Benefit Payments/Distributions – Form of Payment

The Plan does not provide an annuity option which guarantees payments over the participant's life. Although annuity usage is typically low, the Board should consider adding an annuity feature to the Plan. If the decision is made to outsource administration, third party administrators routinely offer annuity shopping services at little or no cost.

Investment Offering

The State's four investment options (money market, bond, equity and small cap) provide employees the opportunity to diversify among three broad asset classes (stocks, bonds, and money market securities) but the number of funds is well below the average for both public and private sector savings plans and limits diversification opportunities. We recommend considering an increase to the number of investment options as described below.

- The EDCP offers participants a money market but not a stable value fund. Mercer recommends the Board consider two possibilities.
 - Continue to offer only a money market fund, or
 - Eliminate the money market fund and the current intermediate duration bond fund and replace it with a stable value fund.

Under either option we recommend considering the addition of a core-plus bond fund to give participants additional fixed income diversification opportunities.

- The EDCP does not currently offer balanced, asset allocation or lifecycle funds. We recommend adding lifecycle funds to the Plan.
- The Plan does not offer an international equity option. We recommend the Board consider adding an international equity fund to enhance participant diversification opportunities. An international equity fund would give participants an opportunity to invest in stocks not covered by the domestic equity funds and exposure to foreign currencies.

Each of the Plan's four funds has a documented investment objective and investment strategy. We recommend developing a broad investment policy statement specific to the EDCP which should include:

- a summary of the EDCP's objectives, investment performance and risk standards,
- the monitoring process,
- actions to consider if a fund does not meet its policy standards, and
- identification of the responsibilities of interested parties.

Custodial Services

Capabilities

Based on the information provided by PNC in response to Mercer IC's request for information, PNC appears to be capable of meeting EDCP's basic asset safekeeping, trade settlement, and reporting needs, but PNC's capabilities are generally less developed than most custodians that service plans similar to EDCP in size and complexity. Furthermore, PNC does not view stand-alone custody as a core business line and lacks a well-developed strategy for developing, enhancing, and growing its institutional custody business.

As an internally managed, monthly valued plan that invests exclusively in domestic securities, EDCP has relatively straightforward custody needs for which PNC appears to provide adequate core services. However, as the Plan increases in size, or as investment/administrative structures become more complex, PNC's product and service deficiencies may significantly inhibit EDCP's ability to administer the Plan's assets in accordance with industry best practices, particularly if the State is considering the implementation the following initiatives recommended by Mercer IC elsewhere in this report:

1. Transition from monthly valuation to daily valuation

Whether assets are invested in commingled/mutual funds or in separate accounts, administering assets in a daily valuation environment requires highly sophisticated systems and rigorous internal controls to prevent costly calculation errors. While PNC did not provide Mercer IC with specific information about its daily valuation/unitization

capabilities, Mercer IC does not view PNC as a market leader in this area and has concerns that PNC's capabilities may not be in line with industry best practices.

2. Implementation of non-U.S. asset classes

If EDCP elects to include a non-U.S. equity investment option using a separately managed account, EDCP's custodian must have the capability and experience to trade and administer non-U.S. assets in the local market, either through a proprietary subcustody network (best practice) or through an outsourcing arrangement with a global custodian. EDCP will also need its custodian to execute foreign exchange transactions on its behalf. While PNC did not provide Mercer IC with specific information pertaining to its foreign exchange or global custody capabilities, Mercer IC does not view PNC as a market leader in these areas and has concerns that PNC's capabilities may not be in line with industry best practices.

3. Increased use of external investment managers

The complexity of asset administration increases with the addition of investment options and the use of external managers. As the safe keeper and book of record for Plan assets, the custodian is the lynchpin for all trade communications, cash movement, and reporting between the recordkeeper and the fund managers. To ensure efficient plan administration, the custodian must be able to support a wide variety of third-party managers using all available methods of trade communication, both electronic (e.g., SWIFT) and manual (e.g., facsimile) technology. While PNC appears to have experience working with third-party managers, PNC did not provide Mercer IC with specific information about its investment manager servicing group or its on-line reporting services, nor is it clear whether PNC has experience supporting third-party managers in a daily valuation environment. As such, Mercer IC cannot assess PNC's specific capabilities.

Fees

Assuming EDCP's plan investments and structure remains unchanged, PNC's fee schedule for core custody services appears to be generally competitive with the market, although EDCP may benefit by negotiating a more flexible schedule that better aligns fees with sources of cost. Mercer IC recommends a more flexible, balanced fee structure that includes a combination of fixed costs (e.g., account structure fees) and variable costs (e.g., transaction-based fees and asset-based

fees). Such a structure will allow EDCP to adjust its investment structure, trading style, and portfolio construction without experiencing significant fee volatility.

If permitted by EDCP's investment guidelines, the Plan's current holdings and relatively low securities turnover make it a particularly well-suited candidate for participation in a securities lending program. If properly managed, securities lending can be an effective means to generate incremental income to offset plan expenses, such as custody fees. Securities lending is not without risk, however, and EDCP should carefully review all its options and conduct thorough due diligence before engaging a securities lending agent or lending its securities on a principal basis.

Administration and Recordkeeping

Costs

For the year ending in June, 2003, the total costs to administer the Plan were \$905,000. This translates to about \$27 per participant or approximately .09%. The EDCP's administrative costs are extremely low for a plan of its size, but the level of services is much lower than that of comparable plans. In assessing its fees to participant accounts, we recommend the Board consider a tiered fee structure.

Valuation Frequency

The EDCP is valued on a monthly basis. We recommend the Board strongly consider daily valuation. Specific benefits of a daily valued environment include:

- increased participant control of investment allocation
- benefit payments and hardship distributions can be made more quickly and at actual value
- fewer participant-level anomalies in returns credited
- services are more commensurate with competing savings opportunities

Processing Turnaround

Processing times for activities such as contribution reconciliation and posting, withdrawals and distributions paid and confirmations mailed are generally in the range of 10 to 20 business days. If the administration of the plan is outsourced, processing times will decrease significantly. If the administration is not outsourced, we recommend that efforts be made to reduce processing times.

Education and Enrollment

Educational outreach is minimal. During the fiscal year ending June 30, 2003, there were 36 hours of seminars conducted. The EDCP has one staff member assigned to member outreach and this person spends only about 50% of his/her time on education. It is our opinion that the EDCP does not provide an adequate level of outreach due to inadequate staffing. 457 plans often have at least one full-time representative for every 10,000 to 15,000 participants.

Communication Materials

All communication materials are developed in-house and are extremely limited. It is our opinion that EDCP participants would benefit from a more comprehensive array of educational materials, including a website with modeling tools.

Customer Service

Plan participants currently have access to a call center and a voice response system from which participants can obtain their monthly account balance and current unit values. Review of call statistics for the last three months indicate an average speed to answer of less than 20 seconds and a call abandonment rate of less than 3% which are within industry norms. Our biggest concern regarding the EDCP customer service is staffing. Staffing of a phone center, especially if the Plan is valued daily, is one of the more difficult activities to staff in-house. The two biggest difficulties are training and educating staff and providing back up during periods of high call volume. The EDCP website should be transactional.

Audits

There is no outside audit of the Plan's internal administration and recordkeeping services. If services continue to be provided in house we recommend that an auditor be hired to conduct such an audit (SAS 70).

Internal or External Recordkeeping and Administration

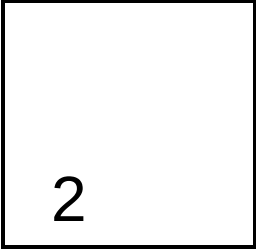
All administrative and recordkeeping services for the EDCP are conducted internally. We recommend the Board consider outsourcing recordkeeping and some or all administrative services. The reasons include:

- vendor expertise,
- technology resources,
- enhanced employee services, and
- reduced administrative burden.

Outsourcing recordkeeping and many of the administrative and/or educational aspects will have many benefits to the EDCP many of which are discussed in detail in our report; however, in support of our recommendation we would also like to make some additional comments:

- We recognize that EDCP's administrative costs are exceptionally low; however, while there is a conceptual advantage to "no frill" services, we believe the additional costs of outsourcing some or all plan recordkeeping and administrative, in light of the significant enhancements participants would see, is reasonable. We would also like to note that many of the changes that would require significant changes to the current in-house recordkeeping systems, such as loans, are standard services available from service providers. Costs for outsourcing services are difficult to isolate by looking at comparative plan data because services vary greatly and we would recommend conducting a competitive bid for services before making a final decision.
- The EDCP, as its own administrator, has only its own experience and learnings to apply. Most recordkeepers keep their services efficient and profitable by establishing a service delivery model and applying it in large degree to all their clients. While this may seem restrictive, it can in fact give clients advantages because the service provider learns what works and can apply successful approaches to other clients. In addition, it means that the cost of developing materials and services can be amortized across a large book of business. These economies of scale mean that more time, money, and effort can be spent on each tool, strategy and communication collateral to the benefit of the service provider's customers. While customization and tailored services are desirable (and the norm for large plans such as the State's); having to create materials or tools from scratch for only one plan is expensive and, as our review of the EDCP's materials and tools indicates, results in less robust materials and tools.

- The current structure means that the EDCP requires greater lead time to implement changes than most plans. While this may not always be a problem, it means desirable changes cannot be implemented as quickly as the Board might like. Also, if a legislative change, such as the Bush proposal, passes and required system changes are significant, the Board runs the risk that the EDCP could fall out of compliance. It should be noted, however, that an outside recordkeeper could take over administration of plan records in less than six months, if necessary.
- Any decision on the EDCP cannot be made in a vacuum. Any decision to outsource EDCP recordkeeping and administration should integrate with any pending changes as part of long range activities and decisions regarding the defined benefit plan operations. It should be noted that while total retirement outsourcing capabilities are available; the complexity of the state defined benefit plan will likely significantly reduce the universe of qualified providers to the EDCP. The defined benefit plan also has a much higher number of members. For these reasons, internal administration may make sense for the defined benefit plan when it makes less sense for the 457 plan.

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Governance of the Plan

Efficiency and Effectiveness of the Division's Organizational Structure and Resources

Our review of the efficiency and effectiveness of the EDCP's organizational structure and resources examined the structure and duties of the Trustees, Trustee policies and directives, Trustee meetings and committees, Trustee delegation and staff.

Current Situation

The Deferred Compensation Board (Board) consists of three statutory ex officio members:

- The State Treasurer,
- The Commissioner of Insurance, and
- The Director of the Division of Budget and Accounting in the Department of the Treasury, or their designees.

Each of the statutory ex officio members has appointed designees to represent them.

State law requires the EDCP to designate the Division of Investment as the named fiduciary for the investment of funds under the plan. State law requires the EDCP to provide the investment options as determined by the Board. The investment options must be authorized and approved by the State Investment Council.

The Board has broad statutory administrative powers and duties under State statute to take all measures necessary for the implementation and administration of the enabling law, including:

- Delegating all or part of the administration of the Plan, including the investment of plan assets to any division(s) within the Department of the Treasury.
- Contracting for investment management, subject to approval of the State Investment Council and subsequent delegation of that contracting to the Division of Investment.
- Establishing the design of the plan.
- Surveying State agencies and employees regarding the plan.
- All other administration and operational aspects of the plan.

The Board holds bi-monthly meetings during which it transacts its business. These meetings typically last one to two hours. A typical agenda includes:

- Review and approval of minutes
- Review of financial and investment reports
- Administration updates from staff
- Appeals – Emergency withdrawal determinations and other administrative decisions

Formal Board governance mission statements, policies and directives do not appear to have been established, except that an investment policy is in place.

Some Board members have indicated a concern that it should be taking a more active policy making role for the EDCP.

Some Board members have indicated a desire for more education and training regarding the plan. Some of the areas mentioned include:

- Fiduciary duties and responsibilities
- Trends in plan design
- Trends in the state of the art of plan administration and recordkeeping
- Trends in investment design and member and employer services

The EDCP is administered by the staff of the Defined Contribution Plans Unit of the DP&B within the Department of the Treasury. The DP&B is also responsible for administering 15 other benefit funds providing defined benefit, defined contribution, and unemployment compensation and health benefits to eligible State employees. Each of these other benefit funds is governed by a separate board of trustees.

The Board has not established any committees.

The Defined Contribution Plans Unit is responsible for the administration of the Deferred Compensation Plan, the Supplemental Annuity Collective Trust and the Alternative Benefit Program's §401(a) OPR and §403(b) tax-sheltered annuity programs under the Supplemental Annuity Collective Trust, the Alternative Benefit Program and the Additional Contributions Tax-Sheltered Program. The Board generally views the Division staff as competent and performing their duties well. There is a general impression among some Trustees that the EDCP may be understaffed, but this has not been investigated.

Standard general job descriptions have been established for the EDCP administrative staff by Division of Pensions and Benefits. The Board does appear to have separate position descriptions for the EDCP executive and support staff relative to their specific duties. The Board does not appear to have formal hiring and firing authority over staff. This authority appears to lie with the DP&B.

Administration costs must be born by the participants and not the State as per statute. Current administration costs are among the lowest for similar sized plans. Some Board members have indicated a willingness to consider reasonably higher administration costs in exchange for program enhancements.

There is some uncertainty as to the scope of Board authority over the investment and staffing of the EDCP which is part of the DP&B, which is part of the Department of the Treasury. The statutory role of the Division of Investment and the Investment Council also creates uncertainty as to the nature and scope of the Board's authority.

The Board currently does not exert substantial governance authority, oversight or guidance over the design or ongoing administration functions of the EDCP. The subject matters addressed at Board meetings appear to be limited in scope and tend to address the ministerial aspects of the EDCP rather than higher level policy-making and oversight functions. The administrative staff functions well and effectively within the scope of their assigned duties for a plan of this size and nature. However, these staff functions have not been guided by specific policies established by the Board.

The low administration costs of the plan are viewed as desirable and a key attribute to the success of the EDCP. However, it also reflects a lower level of member services, a very basic plan design and less than state-of-the-art recordkeeping, member services and investment structure.

Best Practice

Size and Composition – The size of state-wide §457 plan boards is very broad with numbers ranging from one to as many as 13 or more in some cases. More typically, however, the boards of trustees of other state-wide §457 deferred compensation programs are composed of between five and nine members. These boards generally are composed of a mix of elected, appointed and ex officio members. Frequently, the board also serves as the board for the state public employee retirement system. Where the board is not related to the state public employee retirement system, it tends to be smaller, typically with between three and seven members.

Board Delegation – There is a trend for boards to delegate a higher degree of the ongoing administration of deferred compensation plans (e.g., investment manager hiring and firing and emergency withdrawal determinations) to administrative staff or to third-party administrators, subject to established board policies and guidelines. While there is a trend for outsourcing the initial fact finding and adjudication of unforeseeable emergency/hardship distribution applications and QDROs, final adjudication tends to remain at the plan level. Best practice would be to delegate these functions to plan staff subject formal guidelines established by the Board.

Board Meetings – The number of board meetings among the peer plans reviewed is split with about half holding monthly meetings and half holding quarterly meetings. The length of meetings among the peer plans ranges between two to four

hours on average. Plans (e.g., Ohio and Utah) that are largely or fully self-administered meet for longer periods because of the need to monitor plan activities more closely, particularly those related to self-administered investments. Subject matters addressed during board meetings, accordingly, vary by the level of out-sourcing of plan functions. For all plans, the subject matters addressed during board meetings typically include: minutes, investments, marketing and enrollment, recordkeeping, unforeseeable emergency adjudication, legal and legislative updates, committee reports and general administration updates; however, the level of activity for out-sourced plans is less. Some boards listen to marketing presentations by prospective investment managers/funds, although this is not common and is an activity usually handled by staff.

Committees – The use of board committees varies widely by plan and appears to be a function of the size of the board and the complexity of plan administration. Smaller boards tend not to establish committees because of the practical difficulty of dividing board functions among a small number of trustees. More complex plans (e.g., those which are largely self-administered, those who manage their own investments, or which manage multiple plans) are more likely to establish committees. Committees commonly used include those dealing with unforeseeable emergency appeals, investments, budget, personnel, audit, and communications.

Staffing – The size and nature of staff also varies widely among the peer plans and appears to be largely dependent on the level of in-sourced vs. out-sourced functions. Staffing for internal functions appears to be greater for the peer plans than for EDCP, although this can be partly attributable to the EDCP's more simplified plan administrative structure.

Outside Consultants – Outside consulting services are commonly retained by the peer plans and most other plans in our database. Outside consulting subject matters include: investments, compliance, legal/tax, plan design and operations, member marketing and communication, strategic planning and general administration.

Conclusion

The Board should seek legal clarification of the nature and scope of responsibilities of the Board for the EDCP relative to the State Investment Council, the Department of the Treasury and the Division of Investment. In addition, the Board should consider whether statutory changes clarifying and unifying these currently divided roles should be sought.

After completion of the above -described review, the Board should take on a more proactive governance role over the EDCP and establish, as appropriate, formal Board policies in the following areas:

- Investments and manager selection guidelines
- Conflicts of interest, ethics and fiduciary standards
- Delegation of board authority
- Board meeting (e.g., frequency, length, officers, agenda, rules of order, testimony etc.)
- Staff position descriptions and performance evaluation
- Board self-performance evaluation
- Member/claims appeals
- Emergency withdrawal appeals
- Board and staff education
- Board and staff travel and expenses
- Strategic planning

Finally, the Board should reassess the adequacy of current staffing levels for the EDCP to serve the level of future Board activity and the needs of the EDCP either as it is currently structured or if changes are made.

Use of External Consultants

The process by which deferred compensation systems acquire professional service providers, including investment managers, auditor, legal counsel, consultants and others requires careful consideration.

Current Situation

The EDCP appears to be subject to the State procurement rules with regard to the acquisition of professional service providers. The Board does not appear to have established or adopted its own policies in this regard. In addition, there does not appear to be a formal policy regarding permitted contact of individual members of the Board with current or prospective professional service providers independently from the Board as a whole or EDCP staff.

The trustees and staff are subject to the State code of ethics rules, and the EDCP is subject to State procurement rules and requirements.

Best Practice

Public sector eligible IRC §457(b) deferred compensation plans frequently access the services of external consultants to provide advice and specific services not otherwise available through internal resources. The appropriate use and management of external resources potentially impacts every aspect of plan administration. Examples of external consultants used by these plans include:

- Investment consultants,
- Education or advice providers,
- Communication consultants,
- Attorneys,
- Auditors,
- Compensation consultants,
- Technology consultants,
- Recordkeepers, and
- Investment managers

Most large deferred compensation systems have formal policies regarding the procurement of outside professional service providers. When the plan or parties are independent from the state statutes, the policies tend to parallel the statutes and provide the similar levels of control of the process.

Most other public retirement plans give their boards the authority to hire and fire actuarial and investment consultants with consideration given to staff recommendations. Where state law does not otherwise restrict the use of legal counsel to the attorney general, the boards of trustees of deferred compensation plans have the authority to hire and fire outside legal counsel with consideration given to staff recommendations.

The trend is to delegate the hiring and firing of external consultants to staff, if staff resources are expert enough to handle that function, subject to board policies and guidelines.

Outside financial auditors are typically hired by the board, except where state law may require the use of the state auditor. Compensation consultants are typically hired by the board for executive management positions. The CEO typically hires compensation consultants for non-executive positions, where such is not otherwise precluded by employer personnel or civil service policies.

Conclusion

We recommend the Board establish a formal policy regarding the appropriate and permitted use of external consultants. The Board should also establish a formal policy regarding trustee and staff member contact with vendors during the process for acquisition of outside service providers.

We recommend the Board consider establishing a formal policy delegating to appropriate executive management the hiring and firing of identified outside service providers. Consideration should be given to delegating hiring and firing decisions over service providers only if the Board determines that staff expertise is adequate to perform the function.

Statutory Provisions and Administrative Rules

Current Situation

The EDCP is established under a combination of State statutes and a separate written plan document. The EDCP is intended to be and is operated as an eligible deferred compensation plan under IRC §457(b).

Best Practice

Eligible IRC §457(b) plans are required to be established pursuant to a written plan document with provisions sufficient to demonstrate that the plan is intended to operate in accordance with applicable federal law and related regulations.

The governing documents appear to generally satisfy the written plan requirements applicable to eligible IRC §457(b) plans. Specific observations and exceptions are described below:

- The assets of the EDCP are properly held in trust for the exclusive benefit of participants and beneficiaries [Plan Document §5.2]
- New Jersey Permanent Statutes §52:18A-167(2) provides that the administrator must retain the discretion to reject the investment direction requests of participating employees. This provision is no longer required since the federal Small Business Job Protection Act of 1996 established that assets of §457(b) deferred compensation plans must be held in trust.
- New Jersey Permanent Statutes §52:18A-169 (and the related provision in Plan Document §5.1) provides that the State, the Board and members of the Board, the Division of Investment and its employees, and the State Investment Council and its members are not liable for any loss incurred by any employee by reason of participation in the Plan. This type of provision raises questions about the ability of participants in the EDCP to legally enforce their rights under the trust provisions of Plan Document §5.2.
- The federal Uniformed Services Employment and Reemployment and Reemployment Rights Act requires the EDCP to allow military service veterans to make-up missed contributions during periods of eligible military service. No complying provisions were noted in the statutes or Plan Document.
- The definition of “includible compensation” in Plan Document §2.2 is generally complete ; however, it does not specifically exclude §403(b) one-time irrevocable salary reduction deferral election amounts.
- The new final IRS §457 regulations contain specific provisions regarding the treatment of “special pay” (e.g., cashed out vacation leave, sick leave, annual leave, back pay, severance pay) with regard to eligibility for deferral, timing of deferral elections and treatment as includible compensation. The governing documents do not address these new regulatory provisions.
- The new final IRS §457 regulations provide that Normal Retirement Age for purposes of determining eligibility for making regular catch-up contributions must include a provision that if the basic retirement pension plan of a participant is not either a defined benefit pension plan or a money purchase plan under §401(a), then Normal Retirement Age must be age 65. The definition of “normal retirement age” in Plan Document §2.2 does not contain this provision for participants whose basic retirement plan may be a §403(b) plan.

- The new final IRS §457 regulations provide that the participant and not the employer is primarily responsible for excess deferrals that occur because the employee participates in the §457 plan of more than one employer. Plan Document §3.4(a) provides that amounts deferred under any other IRC Section 457 plans must be coordinated for the annual maximum deferral. This provision does not specify that the EDCP is responsible when the multiple plans are all sponsored by the State and the participant is responsible when the multiple plans are sponsored by different employers.
- Plan Document §4.2 provides the State of New Jersey shall be the owner of all deferred compensation and shall be the sole beneficiary of any investment contract entered into pursuant to this Plan. This provision might be viewed as inconsistent with the trust and exclusive benefit requirements of the IRC and Plan Document §5.2.
- IRC §457(b) plans must contain explicit provisions complying with the required and minimum distribution provisions of IRC §401(a)(9). Non-standard complying provisions are found in Plan Document §5.2, which appear to be incomplete. Typically, the IRS requires specific reference that the Plan will comply with §401(a)(9) and contain more detailed provisions.
- Federal IRC provisions require that rollover contributions from non-457 plans must be separately accounted for in order to comply with applicable early withdrawal penalties. Plan Document §6.3(c) and (d) provide that such contributions will be accounted for in the same manner as other contributions. Plan Document §6.3(e) provides that such rollover contributions must be administered as required by the IRC. It is unclear whether this IRC requirement is properly reflected in the Plan Document.
- The governing documents do not provide a disclaimer that the State (and other appropriately named entities) are not fiduciaries and are not liable for any loss resulting from a Participant's or Beneficiary's exercise or failure to exercise control over his or her individual account provided under the EDCP and that a Participant or Beneficiary is not a fiduciary by reason of the exercise or failure to exercise control over his or her Individual Account as permitted under the EDCP.

- Plan Document §8.1 allows members to purchase permissive service credit through direct transfers to eligible defined benefit plans. This provision does not specifically reference the use of EDCP moneys to restore service credit through re-deposits under IRC §415(k)(3).
- The Plan Document does not address whether unclaimed accounts are subject to any existing State unclaimed property laws.

Conclusion

We recommend the Board and/or staff review the compliance and operational issues noted above with legal counsel and make necessary or appropriate changes.

Code of Ethics

Current Situation

The responsibility placed on trustees of public retirement systems is unlike any other. Many times the funds involve billions of dollars and hundreds of thousand of members. Additionally, fiduciary standards, the highest standards under the law, are imposed upon trustees. Their decisions, including their actions at the very first board meeting, are held up to legal and public scrutiny.

The Trustees and staff of the EDCP are subject to the Department of the Treasury Code of Ethics. The Code of Ethics is broad-based, addressing the following major topics:

- Use of State property
- Gifts and gratuities
- Conflicts of interests
- Outside employment and activities
- Political activities
- Attendance at outside events and functions, acceptance of honorariums, compensation for published works, and use of official titles for fund raising

The Code of Ethics also specifically addresses the following relevant subtopics:

- Fees for speeches
- Personal securities trading restrictions
- Personal financial disclosure requirements
- Restrictions on brokerage and securities trading employment

The Trustees and staff are required to sign Code of Ethics compliance statements. Aside from this, there does not appear to be any ongoing or formal Code of Ethics orientation, training or education program for Trustees or staff.

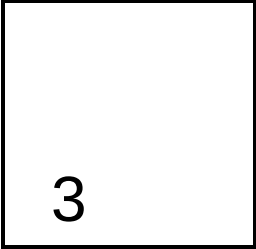
Best Practice

The existence of a formal code of conduct and code of ethics policies are typical of well-run deferred compensation plans.

Conclusion

The New Jersey State Code of Ethics appears to be comprehensive in nature and relevant to the EDCP though there is some indication that not all of the Trustees and staff have a full understanding as to the nature and scope of how the Code of Ethics applies in practice to the ongoing administration of the EDCP.

We recommend establishing a code of conduct and ethics that is specific to the EDCP. The Board should also develop and implement an ongoing code of conduct/ethics education and training program for new and existing Trustees and staff.

3

Plan Characteristics and Features

Participation

Current Situation

Approximately 30% of employees eligible to participate in the EDCP make contributions.

Best Practice

We have not looked to private sector 401(k) plans for information on best practice because most of these plans have matching contributions.

For public sector 457 plans, survey data on participation percentages varies greatly and depends on a number of factors such as whether other savings plans are available (such as 403(b) or 401(k) plans) or if participants in a part-time, seasonal or temporary plan are counted. For the benchmark plans, it should be noted that California has a 401(k) plan and Oregon, Ohio and Washington have participating local employers, for which the state Plan is one of several plans that the local government may offer to its employees.

BENCHMARK PLAN	NUMBER OF PARTICIPANTS	PARTICIPATION PERCENTAGE
California	73,000	37%
New Jersey	33,000	30%
Ohio	115,000	18%
Oregon	21,000	48%
Pennsylvania	47,000	43%
Washington	44,600	37%

Conclusion

Based on our knowledge of New Jersey's demographics, including that local employers are not eligible, the State is not (geographically) large and is relatively urban, and the average salary of state employees is over \$40,000, we believe the participation rate could be close to or above 40% of eligible employees. In addition, the majority of the individuals interviewed identified improving participation as an area for improvement. See below for conclusions on expanded educational activities.

Plan Assets and Average Account Balance

Current Situation

The EDCP has approximately \$1.05 billion in assets with an average account balance of about \$32,000.

Best Practice

Average account balances vary greatly and depend on a number of factors. California's 457 plan, for example, has mostly longer service participants as most new participants join the State's 401(k) plan.

BENCHMARK PLAN	PLAN ASSETS	AVERAGE ACCOUNT BALANCE
California	\$4.4 billion	\$46,000
New Jersey	\$1.05 billion	\$32,000
Ohio	\$4.3 billion	\$33,000
Oregon	\$550 million	\$28,000
Pennsylvania	\$1.1 billion	\$21,000
Washington	\$1.5 billion	\$29,000

Conclusion

The State's average account balance is within the norm for similar plans. While average account balances are beneficial if collecting asset-based fees for plan operations, unusually high average account balances can indicate that the plan is not being used by newer or lower paid employees.

Eligibility

Current Situation

To be eligible employees must be employed by the State or an eligible agency, authority, commission or instrumentality. They must be enrolled in a State administered retirement system, be a permanent employee or have at least 12 consecutive months of employment or be an appointee of the Governor. While State agencies can participate in the EDCP, local employers cannot.

Best Practice

Allowing all employees of the government to participate in the 457 plan is a best practice. While some governments may prohibit participation for groups that are eligible for a 403(b) plan, even that practice is not common. Also, while we occasionally see short waiting periods, such as three months, this is the exception, not the rule. Generally, because all plan costs are passed back to employees, 457 plans have not applied any significant eligibility restrictions. All the benchmark plans have eligibility provisions similar to the EDCP's.

Some states allow local employers to participate in their plans (Ohio, Washington, and Oregon). While expanding eligibility to local employers increases the size of the Plan and provides a benefit to the local employers, there are a number of negative aspects:

- It diverts resources from educating and serving state employees.
- If the EDCP is not the exclusive plan for the local employer and fees are collected from participants on an asset fee basis, the state participants (with higher average account balances) subsidize the local employer participants.
- There is additional recordkeeping and administration (preparing joinder agreements, receiving contributions from outside payroll sources, preparing local employer reports, etc.) and usually higher unit costs.

Conclusion

The EDCP has appropriate eligibility provisions. We would not recommend expanding to local employers unless care was taken to minimize an adverse financial impact on current participants.

Contributions

Current Situation

The EDCP is a voluntary, pre-tax, salary deferral plan and no employer contributions are made to the plan.

Best Practice

While some states have added matching contributions to their plans, such a practice is part of total retirement plan design.

Conclusion

We recommend no change.

Accepting Non-457 Plan Rollovers

Current Situation

The EDCP does not currently allow participants to roll non-457 assets into the Plan.

Best Practice

For 457 plans, there is no standard best practice. In the private sector, 97% of savings plans accept rollovers.

Conclusion

There are a number of issues associated with accepting non-457 assets into the Plan. The primary reason to accept non-457 rollovers is to allow participants to take advantage of the EDCP's low costs for more of their retirement assets to give them and the convenience of having these assets in one place.

There are two primary disadvantages to accepting rollovers of non-457 plan assets:

- The IRS has recently clarified that non-457 assets rolled into a 457 plan cannot be withdrawn until they become eligible for withdrawal (e.g., unforeseen emergency, termination of services, etc.). If the assets had remained in the qualified plan or an IRA the participant would be able to withdraw them at any time.
- If the EDCP accepts non-457 rollovers, it must account for these amounts separately since they are subject to a 10% early withdrawal penalty. While vendor retirement plan recordkeeping systems are structured to maintain multiple sub-accounts in the participant account record, accepting rollovers into the EDCP would likely require a programming change to the internal system.

Under the current internal recordkeeping structure, we do not believe that accepting rollovers would be worth incurring the additional programming and modification costs. While a loan feature would give participants access to their rollover assets, adding a loan feature to the current internal recordkeeping system could be difficult.

Hardship Withdrawals

Current Situation

The Plan permits in-service withdrawals upon an unforeseen financial hardship as permitted by law. Decisions as to whether a participant's request satisfied the requirements imposed by the IRS are made by staff. The Board of Trustees rules on appeals.

Best Practice

Virtually all 457 plans permit hardship withdrawals and permitting them is a best practice. Most commonly, the merit of hardship withdrawal applications is determined by the plan sponsor, although this activity can be outsourced to a third party administrator. About 85% of 457 plans recently surveyed use in-house staff or committees to rule on hardship withdrawals, instead of delegating the responsibility to the plan's third party administrator.

In terms of time commitment, 457 plan staff usually spend 5% or less of their time reviewing and making determinations on hardship applications.

Conclusion

Staff and the Board exercise appropriate discretion over approval of hardship applications. While the responsibility for deciding hardships can be delegated to a third party, this does not relieve the sponsor of liability if the third party administrator did not exercise proper judgment. In addition, many third party administrative service firms will not accept fiduciary liability for the hardship determination services they provide. For that reason, many sponsors choose to maintain control but to have the third party administrator conduct the application process and to provide recommendations and/or comments on whether the application satisfies the requirements. Some sponsors will delegate responsibility for small applications (e.g., under \$10,000) to their administrator and rule on larger ones in-house. If responsibility for small applications is delegated, we would recommend a spot audit to ensure compliance with the IRS rules.

If the current structure is maintained, we would recommend the State continue to conduct hardship withdrawal determination. If plan administration is outsourced, we would recommend either continuing to rule on hardships internally or delegating authority to a third party administrator under the conditions outlined above.

De Minimis In-Service Distributions

Current Situation

The EDCP makes in-service distributions for participants whose account balance is less than \$5,000 and who have not made a contribution to the Plan in the past two years. This lump-sum cashout is made at the participant's election although a Plan could automatically make these distributions.

Best Practice

Most 457 plan sponsors permit de minimis distributions at the participant's election. 401(k) plans are not permitted to make such distributions.

Conclusion

We recommend keeping the current provisions. While there are administrative cost benefits to cashing out de minimis accounts (a \$2,500 account balance generates only \$2 in annual administrative fee revenue), in our opinion, the negative message a mandatory cashout would convey to a participant on the importance of saving for retirement, outweighs the benefit. We would, however, suggest:

- Conducting periodic targeted communications to inactive participants to encourage them to rejoin the plan;
- Considering whether some portion of a participant's fee should be fixed dollar instead of asset-based. See Section 5 for additional discussion.

If the number of participants with small account balances increases to a level where the costs are negatively impacting active participants, the EDCP may wish to reconsider its position at that time.

Service Credit Purchase

Current Situation

The EDCP permits employees to withdraw funds to purchase service credit.

Best Practice

Virtually all 457 plans that participate in a retirement system where service credit can be purchased permit withdrawals for purchasing service credit.

Conclusion

We recommend no change.

Loans

Current Situation

Participants are not permitted to take loans against their account balances.

Best Practice

Most private sector 401(k) plans permit loans, primarily to aid in satisfying discrimination testing requirements. Government employers do not have discrimination testing requirements and offering loans is not institutionalized enough to be considered a best practice. Our experience indicates that city plans are more likely to offer loans than other governments. For state plans, offering loans is more common when the state also offers a 401(k) plan. This is true for the benchmark plans of which only California has a grandfathered 401(k) plan.

BENCHMARK PLAN	LOANS PERMITTED
California*	Yes
New Jersey	No
Ohio	No
Oregon	No
Pennsylvania	No
Washington	No

*Loans permitted in both the 457 and 401(k) plans

Conclusion

Since the State's defined benefit plan gives members the ability to take loans, the need for loans is less than it is for most plans. Also, all loans offered by an employer, whether from a defined benefit or defined contribution plan, must be coordinated for purposes of determining whether the loan satisfies the allowable loan maximum (<\$50,000 or 50% of account balance). The requirement to coordinate loan balances would increase the administrative burden.

Many of the large state 457 plans have not added loans since it was formally confirmed in regulations that it could be done; however, it continues to be an item of discussion.

Under the current internal recordkeeping structure, we would not recommend offering loans. It is a feature that we expect could not be easily added to the current recordkeeping system and would greatly increase administrative complexity. However, a loan feature serves as a litmus test to some of the critical questions underpinning this report. The loan feature is one that service providers have had to incorporate into their recordkeeping and administrative platforms and each vendor amortized the cost to add this feature over its entire book of business. The cost of programming and testing this change on the EDCP system is one that would be borne solely by EDCP participants, although the cost could be amortized over several years (see comments on reserves below).

If a decision is made to outsource administration, consideration could be given to adding a loan feature. A description of advantages and disadvantages of loans is included in Appendix 1.

Deemed IRAs

Current Situation

The EDCP does not currently allow for deemed IRA accounts.

Best Practice

EGTRRA authorized the use of deemed IRA accounts, effective January 1, 2003. The concept is that the accounts will follow rules generally applicable to IRAs, but can be offered under a 457 plan (also available under 401(k) or 403(b) plans). Proposed regulations regarding deemed IRA accounts have elicited considerable comments from the governmental pension community. One of the major concerns is the provision in the proposed regulations that the entire plan will be disqualified if any individual employee's deemed IRA fails to satisfy the applicable IRA rules. With some of the design concepts still not finalized, virtually no large retirement plans have implemented deemed IRAs, and none of the benchmark plans have.

Conclusions

We recommend that deemed IRAs not be added to the EDCP at this time.

Benefit Payments/Distributions - Automatic Cashout of Small Accounts upon Termination

Current Situation

The EDCP does not automatically cashout small accounts.

Best Practice

Private sector plans often cashout small accounts. This is done for a number of reasons:

- For equity reasons: Under an asset based fee schedule, small accounts are subsidized by participants with larger account balances.

- For administrative reasons: To reduce the probability that participants cannot be located when distributions must commence.
- For liability reasons: Participants no longer associated with the employer are assumed to be more likely to take negative action against the plan.

457 plans rarely automatically cashout small accounts. Among of the benchmark plans , only Oregon automatically cashes out participants.

Conclusion

While cashout of small account balances is almost universal in 401(k) plans, it has historically not been done in 457 plans . The primary reasons include:

- Prior to the passage of EGTRRA, 457 plan distributions could not be rolled over to an IRA or another qualified plan. An automatic cashout would subject the participant to income tax on the distribution.
- 457 plans have been historically paternalistic.
- Government employees are considered more likely to be rehired more frequently than their counterparts in the private sector.

For the administrative, equity and liability reasons outlined above, we recommend the Board consider implementing automatic cashout of small accounts.

Benefit Payments/Distributions - Form of Payment

Current Situation

The EDCP offers lump sum and installment payments to terminating participants. While installment payments can be made over the life expectancy of the participant the Plan does not provide an annuity option which guarantees equal payments over the participant's life.

Best Practice

Offering only lump sum and installment payments is quite common in the private sector. Less than half of respondents to Mercer's DC Plan Survey offered installment distributions and only 25% offered a life-contingent annuity benefit. The 2002 Profit Sharing Council Survey indicates that for large (over 5,000 participants) employers, only 19% make annuities available to retiring participants and only 16% make them available for participants who terminate before retirement age.

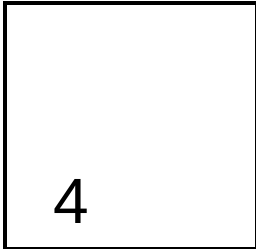
Most 457 plans make annuities available to participants.

BENCHMARK PLAN	ANNUITIES OFFERED
California	Yes
New Jersey	No
Ohio	Yes
Oregon	No*
Pennsylvania	Yes
Washington	Yes

* Expect to add in 2004

Conclusion

Although annuity usage is typically low, the Board should consider whether an annuity feature should be added to the Plan. If the decision is made to outsource administration, it should be noted that third party administrators routinely offer annuity shopping services. If the current structure is maintained, adding an annuity feature would be an additional administrative burden and a cost benefit analysis should be conducted.



Investment Offering

Number of Investment Options

Current Situation

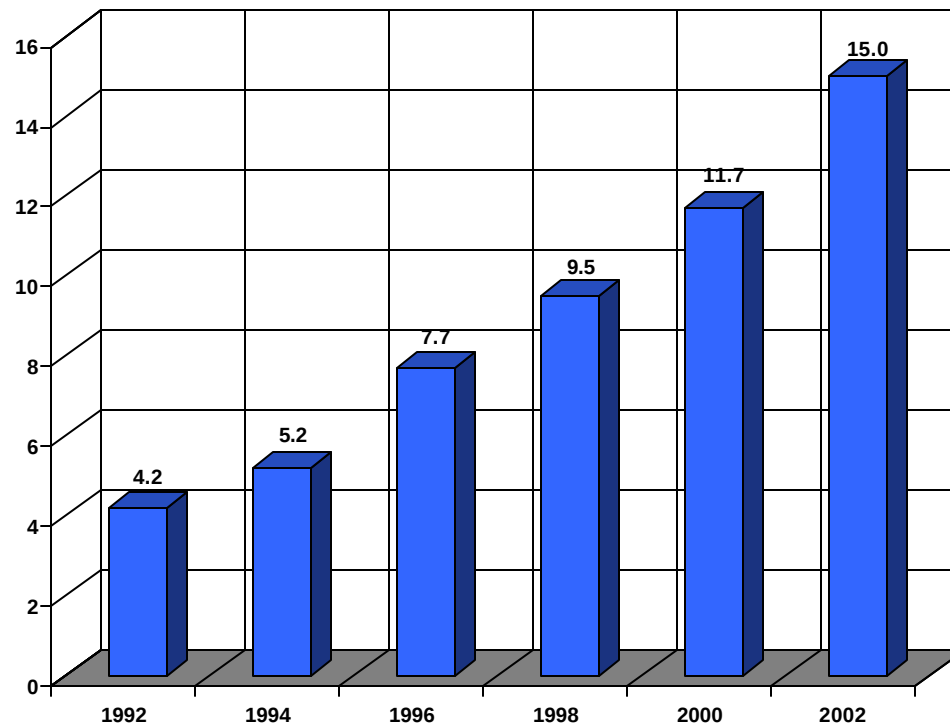
The EDCP currently offers four investment options:

- Money market
- Bond
- Equity
- Small cap

Best Practice

Most private sector savings plans offer considerably more options to participants. General survey data indicates that the average number of funds per participants in defined contribution plans is 15 and that the average number of investment funds offered has increased dramatically over the last 10 years as illustrated below:

Average Number of Investment Options Offered



Source: Mercer US Report from the 2002 Global Defined Contribution Survey

Public sector 457 plans use an even higher average number of investment options. The 2001 NAGDCA survey of 457 plans found that state plans had an average of 35 investment options. As indicated below, most of the benchmark plans offer fewer investment options:

BENCHMARK PLAN	NUMBER OF INVESTMENT OPTIONS
California	44
New Jersey	4
Ohio	28
Oregon	9
Pennsylvania	7
Washington	12

Conclusion

The State's four investment options are well below the average for both public and private sector savings plans. We recommend considering an increase to the number of investment options as described in detail below.

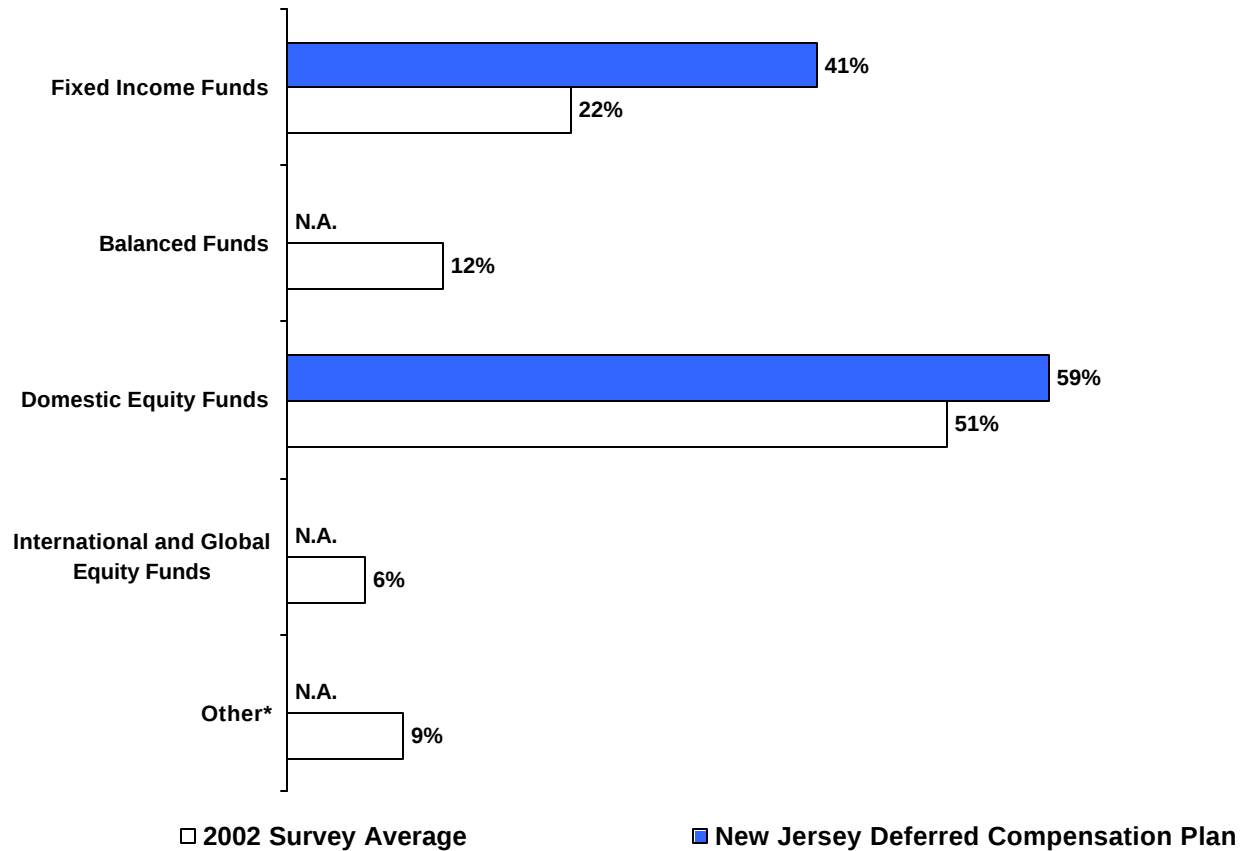
Participant Investment Patterns

Current Situation

The average deferral to the EDCP is almost \$4,000. EDCP participants invest in an average of 2.2 funds.

Best Practice

Among the basic investment types, participant asset allocations among private sector savings plans compare to EDCP as follows:



*Includes real estate and brokerage accounts.

For the benchmark plans, the following statistics are provided:

BENCHMARK PLAN	PERCENT FIXED/VARIABLE	NUMBER OF INVESTMENT OPTIONS	AVERAGE # OF FUNDS PER PARTICIPANT²
California	44/56	44	3.7
New Jersey	15/85 ¹	4	2.2
Ohio	56/44	28	2.5
Oregon	49/51	9	3.25
Pennsylvania	39/61	7	2.5
Washington	37/63	12	2.75

¹Note that fixed or stable value options are those that provide a guarantee of principal. EDCP participants who might ordinarily select stable value may be investing in the bond fund.

²This information is consistent with general government 457 plan survey data.

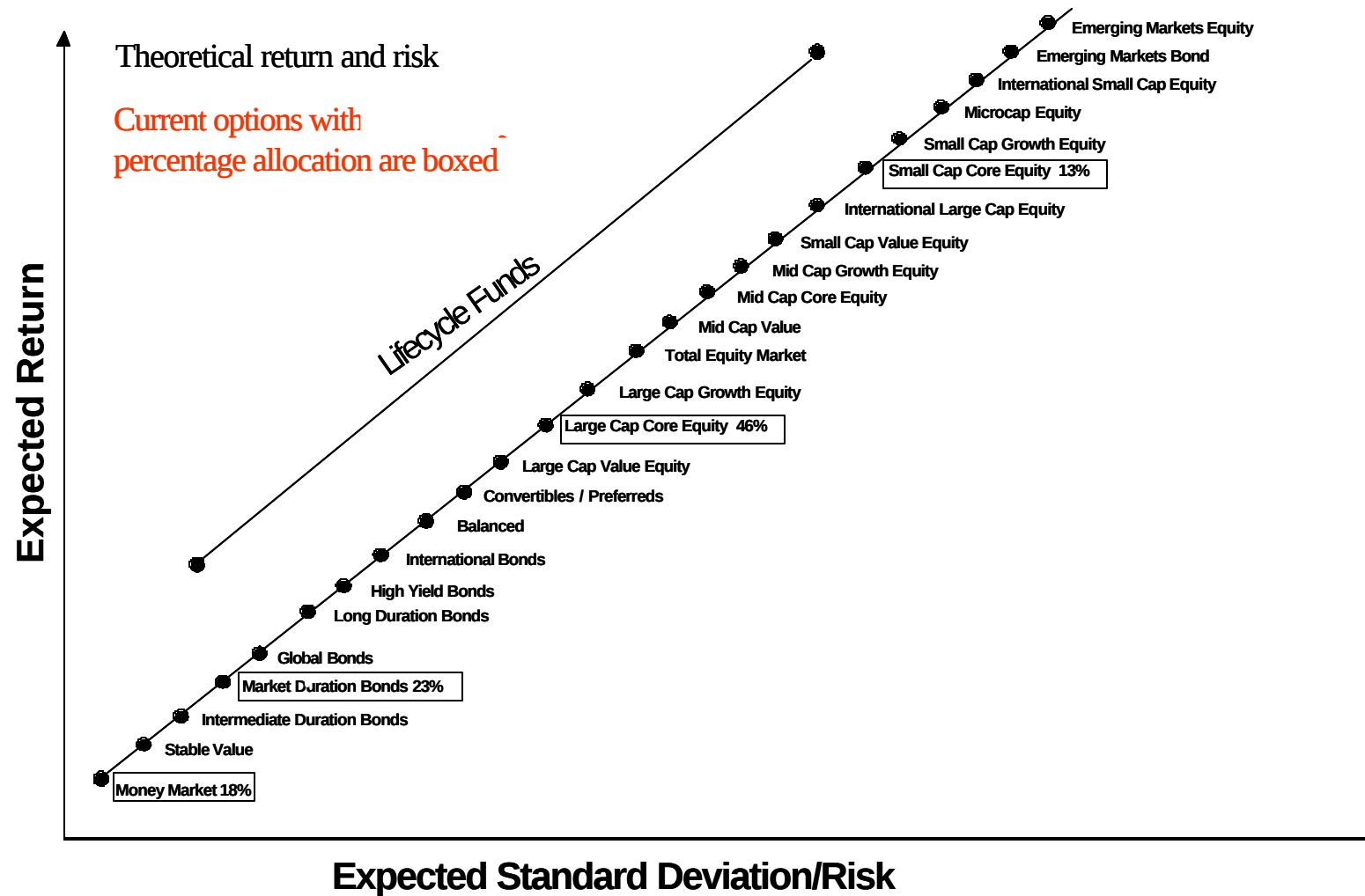
Conclusion

Since the EDCP does not have a fixed investment option, it makes direct comparison of investment percentages difficult. It is interesting to note that even plans with many times the number of investment options have an average number of funds per participant that is not significantly greater than the EDCP's.

Overall Diversification of Fund Lineup

Current Situation

The chart below arrays the EDCP's current fund lineup along the theoretical risk-return spectrum .



Best Practice

Private sector plans tend to offer a wide array of asset classes as illustrated below:

Employee-Directed	% of Plans Offering Option*	Offered in New Jersey Deferred Compensation Plan
Short-term/Money Market	73%	✓
Stable Value	78%	
Bond:		
Index	20%	
Active	80%	✓
Balanced – Active	81%	
Domestic Equity:		
Index	44%	
Large Cap Value - Active	69%	
Large Cap Core - Active	32%	✓
Large Cap Growth - Active	80%	
Small Cap Value – Active	43%	✓
Small Cap Core - Active	18%	
Small Cap Growth - Active	58%	
Global Equity	32%	
International Equity	78%	
Real Estate/REIT	8%	
Sector	26%	
Lifecycle	48%	
Brokerage/Mutual Fund Window:		
Brokerage	13%	
Mutual fund	8%	
Company stock	33%	

*Plans with less than \$250 million in assets.

Source: William M. Mercer, Incorporated Survey on Employee Savings Plan 2000-2001

In addition, the table below identifies the investment options available in the benchmark plans:

BENCHMARK PLAN	STABLE VALUE	MONEY MARKET	BOND	BALANCED	ASSET ALLOCATION OR LIFECYCLE	INDEXED EQUITY FUNDS	LARGE CAP CORE EQUITY	LARGE CAP VALUE & GROWTH	SMALL CAP	MID CAP	INTERNATIONAL	REAL ESTATE	BROKERAGE WINDOW
California	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes
New Jersey	No	Yes	Yes	No	No	No	Yes	No	Yes	No	No	No	No
Ohio	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	No
Oregon	Yes	Yes	Yes	Yes	No	Yes	Yes	Yes	Small/Mid	Small/Mid	Yes	No	No
Pennsylvania	Yes	Yes	Yes	Yes	No	No	Yes	No	Small/Mid	Small/Mid	Yes	No	Yes
Washington	Yes	No	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes	Yes	No	No

Conclusion

The EDCP's investment fund line-up covers the three main asset class categories – money market, bonds, and stocks. This structure gives each Plan participant, regardless of his or her risk-return preferences, the opportunity to create a diversified portfolio customized to meet his or her retirement savings objectives.

We understand that historically there has been a philosophy to offer a streamlined investment lineup. Mercer agrees that a smaller investment lineup is beneficial. Administrative costs are lower and a small lineup is easier for novice investors to understand and thus use effectively – studies have shown that defined contribution plan participants allocate the large majority of their savings in three to four funds, regardless of the number of options available.

However, while the current four-fund lineup is sufficient to give participants the opportunity to diversify among the three main asset class categories we believe participant investment and diversification opportunities can be significantly enhanced with even a one fund expansion. Our recommendations regarding possible expansion of the EDCP's investment option lineup are outlined below.

Money Market and Stable Value Funds

Current Situation

The EDCP offers participants a money market but not a stable value fund.

Best Practice

Money market funds invest in short-term loans, generally one year or less, to the U.S. government and corporations. A stable value fund invests in contracts underwritten by insurance companies and banks that pay a steady interest rate based on the performance of an underlying fixed income portfolio. Stable value returns are typically higher than those of money market funds, and have been significantly higher recently. However, money market funds are more liquid and respond more quickly to changes in market interest rates.

Most private and public sector plans offer participants at least one fund that provides a guarantee of principal with modest interest income – either a money market or a stable value fund. A growing number offer both. Participants have shown a significant interest in investing in both types.

Most 457 plans and all of the benchmark plans offer a stable value option.

Conclusion

Mercer recommends the Board consider two possibilities.

1. Continue to offer only a money market fund.
2. Eliminate the money market fund and the current intermediate duration bond fund and replace it with a stable value fund. Stable value funds can be either internally or externally managed. The State of Washington currently manages its stable value fund internally (diversified portfolio of guaranteed investment contracts (GICs), bank investment contracts (BICs), and short-term cash funds).

Under either option, we suggest considering the addition of a core-plus bond fund as discussed below.

While the current money market fund does provide core diversification, a stable value fund provides a guarantee of principal with investment returns that historically average 0.50% to 1% more than money market funds over an interest rate cycle.

Bond Funds

Current Situation

Plan participants have approximately 23% of their assets invested in the bond fund. The Plan's relatively low number of investment options likely accounts in part for this above average allocation.

Best Practice

As indicated above, almost all plan sponsors offer a bond fund. This is also true in the public sector – all of the benchmark plans offer a bond fund.

Despite the prevalence of these funds in savings plans, when offered the opportunity, participants invest only a small percentage of assets in market valued bond funds, most choosing to invest in stable value options when offered. However, bond funds are an important diversification tool for tailoring portfolio risk to a participant's investment profile.

Conclusion

We suggest the Board consider adding a second bond fund. The Plan's fixed income choices (money market and intermediate-term investment-grade bond) are relatively conservative. Given the Plan's low number of investment options and participants' interest in the fixed income funds, a bond fund that maintains a longer duration and/or opportunistically invests in high yield and foreign securities, known as a core-plus strategy, would broaden the diversification opportunities for the Plan's fixed income investors. Also, if the Board decides to offer a stable value fund, a core-plus bond fund would not require an equity wash provision which would likely require programming changes to the current recordkeeping system.

Balanced, Asset Allocation or Lifecycle Funds

Current Situation

The EDCP does not currently offer balanced, asset allocation or lifecycle funds.

Best Practice

Over eighty percent of plans offer a balanced fund, and all of the benchmark plans offer balanced funds. Balanced funds are invested in a combination of stocks and bonds providing participants with a "ready-made" portfolio with automatic rebalancing. Unlike asset allocation funds, balanced funds maintain a relatively constant allocation with little or no attempt to time the markets by making short-term tactical shifts between stocks and bonds. Unlike lifecycle funds, balanced funds are not tailored for a variety of specific participant investment profiles.

While balanced funds are still offered in plans, most plans are switching to lifecycle funds. Historically, participants had to transfer their account balances among lifecycle funds themselves if they wanted their asset allocation to become more conservative as they neared retirement. In recent years, lifecycle funds with target years for "maturity" have been introduced. These funds become more conservative over time as their target year approaches, often eliminating the need for a participant to actively transfer assets among funds.

A lifecycle funds program is an attractive choice for participants who want maximum assistance in constructing and rebalancing their portfolio. Approximately 46% of plan sponsors offer lifecycle funds, and three of the five benchmark plans offer such products. Generally, several lifecycle funds are offered in a plan, ranging from bond- to stock-oriented. In plans that offer lifecycle funds or balanced funds, the funds hold an average of 12% of participant assets.

Conclusion

While adding lifecycle funds would not necessarily enhance the lineup's diversification, we recommend adding lifecycle funds to the Plan if there is a concern that participants are seeking or would benefit from additional assistance in constructing and maintaining (i.e., rebalancing) their portfolio. The funds can be created from the investment options that comprise the core lineup, depending on the recordkeeping capabilities. A recent trend has been to create custom target-date portfolios as described above.

Actively Managed Equity Funds

Current Situation

The State's two equity funds are both actively managed.

Best Practice

Equity funds are the most diverse investment category among defined contribution plans, with choices differing by investment style (growth, core, or value), size of companies invested in (large, medium, or small cap), international versus domestic, and a variety of specialty funds. Offering participants the opportunity to diversify within this asset class is important because of the higher risk associated with individual funds.

Conclusion

The EDCP should consider additional equity funds. The following sections outline many of the options typically available to participants in their retirement plans.

Indexed Equity Funds

Current Situation

The State's two equity funds are both actively managed.

Best Practice

Funds that attempt to replicate the performance of a market index (often the S&P 500) have grown in popularity. Forty-four percent of plans offer an index equity fund, and four of the five benchmark plans offer them. Index funds typically have low expense ratios, but participants forgo the opportunity to outperform the index via active portfolio management decisions.

Conclusion

A main benefit of indexed funds relative to actively managed funds is their low expenses. Given that the EDCP's current expense levels are comparable to indexed fund management, the potential expense reduction is not substantial and thus there is no compelling reason to add an indexed fund.

As described in IFS's Operational Review of the State's Pensions, the State should develop a position as to the degree of active risk to take in the domestic equity portfolio. However, since EDCP investments are participant directed, if the State decides to introduce passive management, we recommend a separate indexed fund as opposed to adding a passive element to the current Equity fund. This structure will allow each participant to customize the amount of active risk in their account to align risk/return preferences.

Given the efficiency of the large cap domestic equity market, we recommend considering a passively managed fund as a complement to the Plan's equity fund. We do not recommend passive management within the small cap or international equity asset classes. Active management has been much more successful in these markets, where the greater number of stocks and thinner analyst coverage has produced information inefficiencies that active managers have been able to take advantage of. If the Board believes that participants should have access to a fund that tracks the broad market with minimal risk of underperformance, one of the most popular is an S&P 500 Index fund.

Large Cap Core Equity Funds

Current Situation

Plan participants have approximately 46% of their assets invested in the large cap core fund.

Best Practice

Large cap represents the largest segment of the domestic equity market. Core funds invest in a mix of growth and value stocks, and also stocks with characteristics that fall in between. Approximately 75% of plan sponsors offer a large cap core fund (32% actively managed, 44% indexed). All the benchmark plans offer this type of investment option.

Conclusion

We recommend the Board continue to offer an actively managed large cap core option.

Large Cap Value and Growth Equity Funds

Current Situation

The State does not offer large cap value or growth funds.

Best Practice

Value equity funds have historically been considered a conservative equity investment providing protection in down markets. For several years prior to 2000, value stocks underperformed growth stocks in both up and down markets, often by very wide margins. As a result, the popularity of value investing waned and many value managers adjusted their style to include some stocks traditionally held by only core or growth managers. Since 2000, value stocks have performed significantly better than the growth segment of the market resulting in an increase in their popularity and validating the basic investment concepts of diversification, style discipline and rebalancing. Nearly 70% of plans offer a large cap value fund, and three of the five benchmark plans offer this type of investment option.

Growth equity funds offer participants the opportunity to invest in the most rapidly growing companies in the U.S. Rapid growth often equates to strong stock performance, particularly during bull markets. Dependence on continued growth subjects these stocks to additional risk during periods of economic slowdowns. Eighty percent of plans offer an actively managed large cap growth equity fund. They became quite popular during the last bull market.

Conclusion

The Plan's equity fund is intended to give participants exposure to both value and growth stocks as part of a diversified large cap portfolio. We do not believe dedicated value or growth funds are necessary, however, if the State is seeking to increase the number of equity investment options we recommend considering both value and growth funds as a means of providing participants with additional choices within the Plan's most popular asset class category. We do not recommend adding just a value or growth fund as this could result in high tracking error by inadvertently leading participants to favor either the growth or value segment of the market.

Small and Mid Cap Equity Funds

Current Situation

The State offers a small cap core fund, which is invested in a mix of value and growth small cap stocks, and holds approximately 13% of the Plan's assets.

Best Practice

Like large cap funds, small and mid cap funds are available with different investment styles (value, core and growth). These funds often provide the greatest opportunity for the highest long-term returns in defined contribution plans, although at a relatively high level of risk. The additional risk associated with these funds argues for providing participants the opportunity to diversify. More than half of plan sponsors offer at least one small cap fund. All of the benchmark plans offer small and large cap investment options.

Conclusion

We recommend the Board continue to offer the small cap fund. Given the relatively low allocation to small cap and the fund's broad diversification within the small cap segment of the market, we do not believe it is necessary to consider adding separate small cap value and growth funds. However, if the Board seeks to increase the number of domestic equity investment options, a mid cap fund would provide investors with additional investment and diversification opportunities via a fund that focuses on a segment of the market that the large and small cap funds do not provide much exposure to.

International Equity Funds

Current Situation

The Plan does not offer an international equity option.

Best Practice

International equity funds have become much more common among defined contribution plans over the last several years with 78% now offering such actively managed funds. All five benchmark plans offer international funds. These funds offer participants the opportunity to diversify into investments that may not depend heavily on the performance of the U.S. economy. Participant allocations have been low however, as international stocks have frequently underperformed U.S. stocks. When offered, an average of just 6% of participant assets are invested in international equity funds.

A notable occurrence in recent history is that international equity funds have been used by a small percentage of retirement plan participants for frequent purchase and sell transactions in an effort to capture personal gains through “market timing”. This churning activity has a negative impact to the investment manager, and therefore to the other participants investing in the fund. As a result, most international equity funds reserve the right to impose exchange limitations in situations where they feel inappropriate exchange activity is taking place. Applying these exchange limitations typically require a versatile recordkeeping system.

Conclusion

We recommend the Board consider adding an international equity fund to enhance participant diversification opportunities. An international equity fund would give participants an opportunity to invest in stocks not covered by the domestic equity funds and exposure to foreign currencies.

Real Estate Funds**Current Situation**

The EDCP does not have a real estate fund.

Best Practice

A fund that invests directly in real estate or indirectly via shares of real estate investment trusts would provide participants with diversification opportunities outside of the money market, fixed income, and equity asset classes. Also, for those participants that seek a real estate investment, a tax-deferred arrangement is especially attractive because of the relatively high dividend income real estate generates. However, real estate funds are not popular within the defined

contribution plan market. In the private sector, approximately 7% of defined contribution plans include a real estate fund in their lineup with an average participant allocation of 4% among those plans. In the public sector, very few 457 plans and none of the benchmark plans offer a real estate fund.

Conclusion

We recommend the Board consider adding a real estate equity fund for the diversification and tax benefits cited above.

Self Directed Brokerage Option

Current Situation

The EDCP does not offer a brokerage account.

Best Practice

Brokerage accounts are a relatively recent addition to defined contribution plans. They provide participants access to a wide range of mutual funds and individual securities outside of their plan's core investment fund line-up. Typically there is a fee charged to the participants electing the option. There are administrative obstacles (including system interfaces) and fiduciary considerations in providing access to a range of investments too broad to monitor. The percentage of plans offering a brokerage account has grown to 21% (13% brokerage windows, 8% mutual fund windows). Pennsylvania and California are the only benchmark plans to offer an SDBO. Such plans often include relatively sophisticated investors. The usage of the window by participants is quite small when the option is offered.

Conclusion

We do not believe that there is an immediate need to consider a brokerage account unless there is participant demand.

Investment Management Fees

Current Situation

The Plan's four internally managed funds are assessed investment management fees of approximately 0.02%.

Best Practice

A best practice includes keeping investment management fees low. There has also been a trend toward moving to institutional pricing.

Conclusion

Investment expenses assessed against the Plan's internally managed funds are substantially less than the median for similar size separate accounts managed by investment management companies.

Investment Expense Comparison

Fund	12/31/02 Assets (\$ millions)	Investment Expenses (%/\$)	Median Fee for Similar Size Sep. Acct. (%/\$) ¹	Savings Compared to Sep. Acct. Market Medians
Money Market ²	\$ 185	0.02% / \$37,000	0.19% / \$351,500	0.17% / \$314,500
Bond	\$ 237	0.02% / \$47,400	0.23% / \$545,100	0.21% / \$497,700
Equity	\$ 462	0.02% / \$92,400	0.41% / \$1,894,200	0.33% / \$1,801,800
Small Capitalization Equity	\$ 126	0.02% / \$25,200	0.74% / \$932,400	0.66% / \$907,200
	\$1,010	0.02% / \$202,000	0.37% / \$3,723,200	0.35% / \$3,521,200

- Based on the 12/31/02 asset allocation, the annual savings is 0.35%, or \$3,521,200

¹ Data source is Mercer Investment Consulting Investment Management Fee Study — February 2002

² Based on peer groups of short-term bond funds.

- Each fund's investment expenses ranks in the lowest decile of its asset class

If the State decides to use outside investment managers as part of a fund lineup expansion, expenses on those funds may be substantially higher than on the internally managed funds.

Statement of Investment Policy

Current Situation

Each of the Plan's four funds has a documented investment objective and investment strategy.

Best Practice

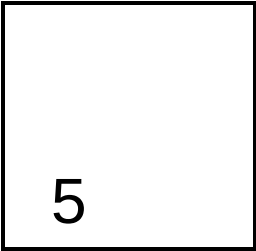
The existence and maintenance of an investment policy is considered a best practice for retirement plans. For plans with over \$250 million in assets, 73% maintain a written investment policy. This figure increases to 91% for plans with \$1 billion or more in assets. (Source: 2002 Mercer Global Defined Contribution Survey)

Conclusion

We recommend expanding the current investment policy documents by developing a broad investment policy statement specific to the EDCP. In addition to fund objectives and strategy, the policy should cover the following:

- A summary of the EDCP's objectives and the role of each investment fund within the Plan
- Investment performance and risk standards and the monitoring process
- Actions to consider if one or more funds does not meet its policy standards
- Responsibilities of interested parties. This includes the State in its role as sponsor, administrator, and investment manager, the custodian, and Plan participants.

An investment policy would provide a basis for maintaining an investment structure consistent with the Plan's objectives and a consistent process for monitoring the Plan's investments and determining when changes are warranted.

5

Custodial Services

Mercer IC's Global Custody and Asset Administration Group maintains a database of custodian information and has regular contact with custodians. Mercer IC evaluates custodians based on a questionnaire each custodian submits to Mercer IC, on on-site due diligence, and on prior client experience with the custodian. Mercer IC's objective is to assess whether a custodian can meet a client's needs and if the custodian has a rigorous internal control environment.

To ensure consistent custodian evaluations, Mercer IC identified over 250 criteria, grouped into 16 broad categories, which are important for custody clients. Using the U.S. Federal Financial Institutions Examination Council's (FFIEC) trust bank examination guidelines, FFIEC supervisory letters, and accepted global industry standards as a basis, Mercer IC developed standards that define best practices for its client base. Mercer IC evaluates each custodian against these criteria.

Custodians are given a number ranking from one to five for each criterion. The rankings are a number equivalent to "Does Not Meet Standards (1)," "Below Standards (2)," "Meets Standards (3)," "Exceeds Standards (4)," and "Far Above Standards (5)." Mercer IC aggregates the criterion ratings to calculate the broad category ratings which are listed for each category below.

Because PNC had not previously participated in Mercer IC's custodian database, Mercer IC requested that PNC complete

Mercer IC's database questionnaire to provide detailed information about its institutional custody business, including product and service capabilities, strategic plans, technology, and risk controls.

PNC submitted a limited response to Mercer IC's request for information. PNC declined to respond to any questionnaire sections that do not specifically pertain to services and/or deliverables that PNC currently provides to EDCP. As such, some of the criteria that Mercer IC would ordinarily include in a due diligence assessment of a vendor's total custody capabilities have not been included in this evaluation due to a lack of information. Categories that have been excluded include: On-line Reporting, Global Custody, Foreign Exchange, Securities Lending, Performance Reporting, Compliance Monitoring, and Unitization.

While the products and services represented by these categories may not be required by EDCP at this time, an understanding of the breadth and depth of a custodian's total capabilities is critical when assessing its suitability as a vendor, particularly as a plan increases in size or as a plan's administrative structure and service needs become more complex.

For the purposes of this evaluation, PNC is benchmarked versus two Peer Groups. Peer Group A represents the composite benchmark scores of four U.S.-based global custodians. A "global custodian" is defined as a custodian that maintains a proprietary global subcustody network and that conducts client business directly in non-U.S. markets. Peer Group B represents the composite benchmark scores of four domestic custodians.

Financial Strength

Current Situation

Financial information for PNC's holding company is provided in the table below.

PNC Financial Services Group Inc	
Short-term Credit Rating (S&P/Moody's/Fitch)	A-1/P-1/F1 ³
Long-term Credit Rating (S&P/Moody's/Fitch)	A-/A2/A
Credit Outlook (S&P/Moody's/Fitch)	Stable/Stable/Stable
Core Capital Ratio	8.20%
Total Capital Ratio	11.30%

Best Practice

Mercer IC reviews risk-adjusted capital ratios, short- and long-term credit ratings, and net operating income trends to assess a custodian's financial strength.

³ Bank holding company short-term credit not rated by major agencies. Information represents short-term credit ratings of PNC Bank, N.A., primary subsidiary of PNC Financial Services Group Inc.

Conclusion

PNC	Peer Group A	Peer Group B
3.25	3.61	3.65

Based on publicly available information, nothing has come to Mercer IC's attention that would cause particular concern about PNC's financial health. PNC trails both Peer Groups due to slightly lower short-term and long-term credit ratings. Mercer IC's criteria, in and of themselves, do not necessarily indicate whether an institution are financially sound. As such, New Jersey should continue to monitor the financial status of its custodian.

Commitment & Direction

Current Situation

PNC declined to provide Mercer IC detailed information concerning its short- and long-term strategy for developing its custody business line, nor did PNC provide any information concerning the personnel and financial resources dedicated to maintenance and development of systems and technology. As such, Mercer IC is unable to quantitatively or qualitatively evaluate the adequacy of PNC's resources to service its existing customers or develop the business, and must rely on general comments provided by PNC and Mercer IC's experience in the custody marketplace.

Best Practice

The top domestic and global custodians treat institutional custody as a distinct business line, independent from investment management or commercial banking, and actively pursue custody-only client relationships on a regular basis, with less emphasis placed on whether the client represents a potential target for cross-selling non-custody product. Vendors should be able to provide detailed plans for the long-term viability of their institutional custody business, which should clearly demonstrate a sufficient commitment of systems and staffing resources to service existing clients and facilitate future growth.

Conclusion

PNC	Peer Group A	Peer Group B
2.08	3.90	2.78

Custody is not a major business line for PNC and appears to exist primarily to support PNC's other businesses⁴ (i.e., investment management and commercial banking). PNC's commitment to servicing stand-alone custody accounts and investing in the long-term development of its business appears relatively weak compared to the banks comprising Peer Groups A & B.

Asset Administration

Current Situation

PNC appears to have sufficient capabilities for collecting and monitoring corporate action information and collecting/posting income for commonly held domestic securities. However, its methods for matching data to client accounts and passing applicable information on to clients appear to be less automated than the market leaders.

⁴ "PNC does not aggressively pursue custody-only account relationships as this is not part of the organization's core business plan. Therefore, we are not responding to this section in detail." [From PNC's response to Mercer IC's *Custody Questionnaire*, p. 6.]

Like most custodians, PNC outsources proxy voting to Automatic Data Processing, Inc. (ADP). However, PNC appears to have less in-house proxy voting administration expertise and maintains a less automated method for monitoring receipt of proxy responses from investment managers, which increases operational risks.

Best Practice

Custodians should have an efficient method for collecting corporate action information, with a network of reliable sources for collecting and reporting corporate action information on non-traded or thinly traded securities, and an established electronic method for communicating corporate action information. Custodians should conduct frequent reviews of outstanding corporate actions to ensure appropriate client follow-up and maintain an automated control function that flags items outstanding over a given length of time or past the action date. Custodians should not accept verbal instructions from clients regarding voluntary corporate actions, and all faxed client responses should be accounted for in an automated fashion. Custodians should maintain an in-house group of proxy voting specialists to complement services outsourced to a third-party vendor and have systems and procedures in place (where not offered by the outsourcing agent) to ensure proxy information is efficiently collected, provided to the client, and acted upon by the client on a timely basis. A custodian should conduct formal and periodic monitoring to ensure accurate income accruals and collection.

Conclusion

PNC	Peer Group A	Peer Group B
2.43	3.47	2.85

PNC trails both Peer Groups because its internal controls with respect to corporate actions, proxy voting, and income collection appear less rigorous and its procedures are less automated than market-leading custodians. Should New Jersey opt to include a non-U.S. separately managed investment option in its future lineup, PNC's capabilities may be stretched.

Settlement

Current Situation

Based on information in its questionnaire response, PNC appears to provide investment managers with settlement information on a daily basis, but does not pre-match securities or monitor pending fails, and plays a less active role in resolving failed trades.

Best Practice

Most global custodians included in Peer Group A provide investment managers with intra-day information related to both pending and actual failed trades and proactively coordinate with investment managers and depositories to clear trades in the event of a counterparty fail.

Conclusion

PNC	Peer Group A	Peer Group B
2.70	4.21	2.60

With respect to domestic trade settlement, PNC's capabilities are similar to the vendors included in Peer Group B. PNC trails Peer Group A because its systems capabilities with respect to monitoring potential failed trades and rectifying actual fails are less developed. Should New Jersey continue to manage plan assets internally or utilize third-party managed separate account vehicles, the systems capabilities of a global custodian with respect to monitoring pending and actual fails and settling trades in the event of a counterparty fail would likely be of value.

Securities Valuation

Current Situation

PNC appears generally capable of pricing most commonly traded equity and fixed income securities, but has a relatively limited network of pricing vendors, and for many asset types relies on a single vendor for pricing data. PNC receives weekly or bi-monthly (rather than daily) pricing information for more illiquid securities (e.g., mortgage-backed securities, private placements, or municipal bonds). PNC does not appear to maintain a rigorous automated front-end check of incoming pricing data.

Best Practice

Custodians should conduct automated cross-referencing of pricing information from multiple vendors to ensure accuracy and maintain daily pricing feeds on a wide variety of securities types in order to accommodate plans that require daily valuation of assets.

Conclusion

PNC	Peer Group A	Peer Group B
2.72	3.76	2.90

While PNC appears capable of working in a monthly-pricing environment, it is unclear whether PNC has the necessary systems, processes, and internal controls to effectively service EDCP if it moves to a daily valuation environment. PNC's infrequent pricing feeds on illiquid assets may be problematic as the plan's investment complexity increases.

Accounting & Reporting

Current Situation

PNC's trust accounting system appears capable of handling monthly accounting related to domestic assets. PNC uses the AM Trust accounting platform, a system developed by Advisor Technology Services (ATS), a holding of Fidelity Capital, the venture capital arm of Fidelity Investments. In 1Q2003, ATS announced plans to exit the trust accounting platform business, but stated that it would continue to provide basic support for the AM Trust product for the next several years. PNC indicated to Mercer IC that it will continue to use AM Trust, as it owns the source code for the system and maintains internal resources to maintain and further develop the system's capabilities.

Best Practice

In the event that a custodian utilizes a trust accounting system developed by a third-party vendor, it should have access to the system's source code. For third-party systems, a custodian should maintain a large internal technology staff to complement the resources of the system developer and to facilitate independent custom enhancements to the system. The custodian's system should have multi-currency accounting and daily unitization capabilities in order to accommodate clients with non-U.S. separate account investments and daily valuation requirements.

Conclusion

PNC	Peer Group A	Peer Group B
2.70	3.52	2.67

The AM Trust system, in its present form, should be sufficient for servicing New Jersey's investments in their present state. However, should New Jersey move to a daily valuation environment in the future that requires the custodian to conduct daily unitization of accounts or opt to include non-U.S. investments, which require a multi-currency accounting capability, the AM Trust platform may be less suitable than the multi-currency accounting platforms used by major global custodians.

Technology

Current Situation

PNC did not provide significant information concerning its allocation of staff and capital to support its custody business and, as such PNC's strategy for maintaining and enhancing its custody-related systems is unclear. Based on the limited information provided, PNC's current systems appear adequate in the context of EDCP's current requirements. PNC's disaster recovery plan includes a daily off-site data back-up to a separate power grid. The disaster recovery plan is tested annually, and targets a 16 hour turnaround time for reinitiating custody operations.

Best Practice

Custody is a volume-driven business that requires large investments in technology order to adequately service clients, particularly for large clients with complex investment structures. As such, the major global custodians comprising Peer Group A make relatively larger investments in technology than do the mid-market players comprising Peer Group B.

Conclusion

PNC	Peer Group A	Peer Group B
3.00	4.13	2.94

PNC scores in line with Peer Group B, but trails Peer Group A due to Mercer's perception of the relative importance PNC places on maintaining and developing custody systems compared to the market. Should New Jersey move to a daily valuation environment or include a non-U.S. investment option for plan participants, the technological capabilities of a large global custodian would likely be a better fit for New Jersey's needs.

Custodian Fee Benchmark Evaluation

Current Situation

Based on the plan assumptions provided below, Mercer calculates PNC's annual fees to be \$80,648. EDCP's current custody fee schedule was provided by PNC in the form of a November 7, 1994 fee letter on Midlantic Bank, N.A.⁵ letterhead. Mercer IC verified the fee schedule by cross-referencing it to PNC invoices from January to May 2003.

Strategy	Account Type	Annual Transactions ⁶	Holdings	Market Value ⁷ (\$ millions)
Large Cap Equity	Separate Account	94	512	513.9
Small Cap Equity	Separate Account	144	443	134.4
Core Fixed Income	Separate Account	9	31	240.2
Total		247	986	888.5

Best Practice

A flexible, balanced fee schedule that incorporates a combination of fixed costs and variable costs allows plan sponsors to adjust investment structure, trading style, and portfolio construction without experiencing significant fee volatility. To assess the competitiveness of PNC's custody fees, Mercer IC conducted an indicative fee benchmark study, comparing

⁵ Midlantic Corporation and PNC Bank merged in 1995.

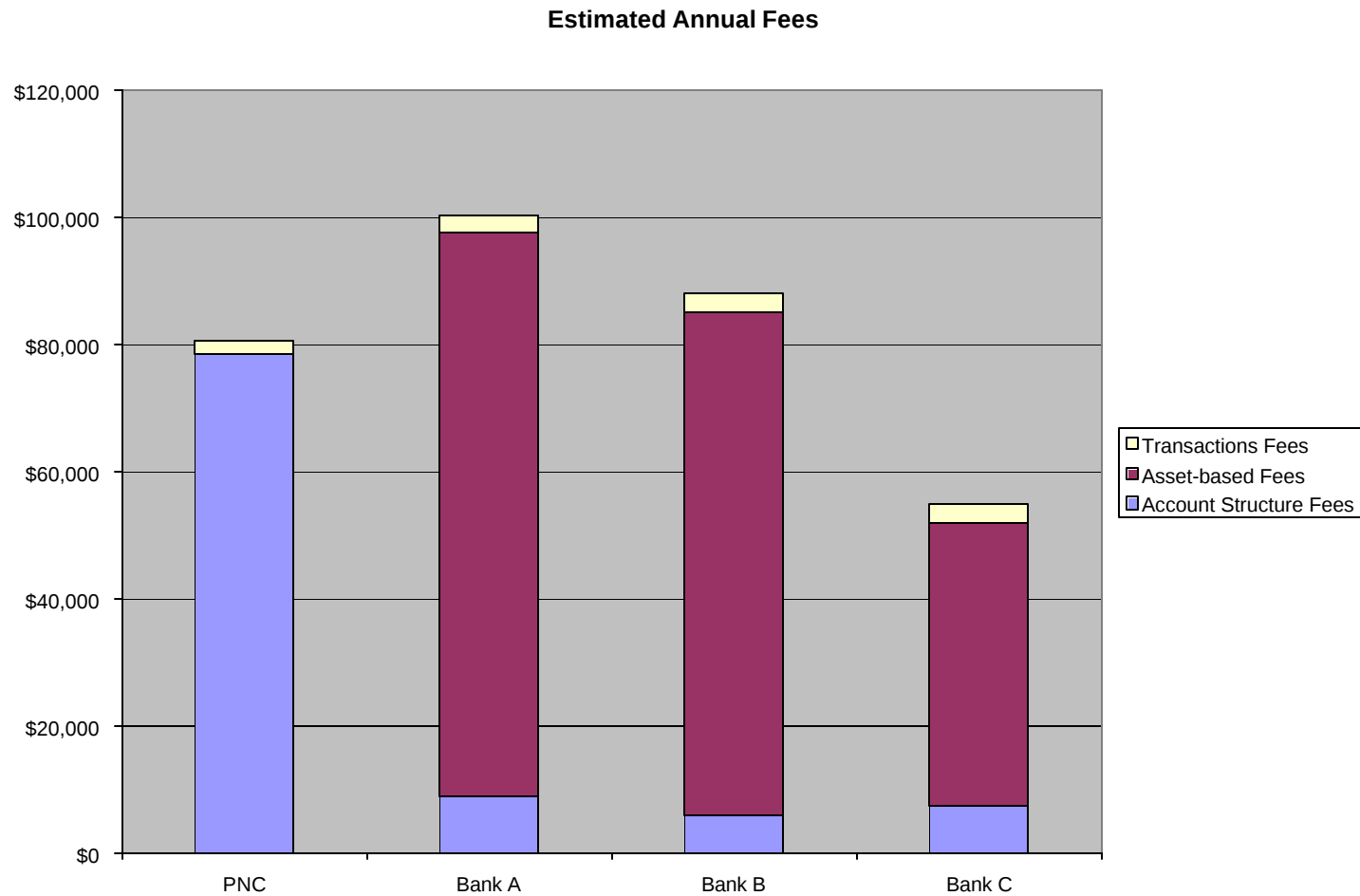
⁶ Transaction data is based on activity from June 30, 2002 to June 30, 2003.

⁷ Market values are derived from PNC account statements dated June 30, 2003.

PNC's current custody fee schedule to the indicative fee schedules of three prominent, U.S.-based global custodians. The comparative fee quotes are indicative, and therefore non-binding, but provide a highly accurate representation of the pricing EDCP would expect to receive in a competitive bidding situation. All fee information was solicited on a "blind" basis (i.e., EDCP's identity was not disclosed).

	PNC	Bank A	Bank B	Bank C
Account Structure Fees				
Domestic separate accounts - equity	\$13,008	\$6,000	\$4,000	\$5,000
Domestic separate accounts - fixed income	\$6,504	\$3,000	\$2,000	\$2,500
Holdings	\$59,160	\$0	\$0	\$0
Total Account Structure Fees:	\$78,672	\$9,000	\$6,000	\$7,500
Asset-based Fees				
Domestic separate account assets	\$0	\$88,848	\$79,136	\$44,424
Total Asset-based Fees:	\$0	\$88,848	\$79,136	\$44,424
Activity/Transaction Fees				
Domestic depository transactions	\$1,976	\$2,470	\$2,964	\$2,964
Principal payments	\$0	\$0	\$0	\$0
Total Transaction Fees:	\$1,976	\$2,470	\$2,964	\$2,964
TOTAL FEES	\$80,648	\$100,318	\$88,100	\$54,888
In basis points	0.91	1.13	0.99	0.62

The graphical exhibit below presents a comparison of PNC's custody fees broken down by source of cost under the current account structure.



The following table compares PNC's fee schedule to those provided by three large U.S.-based custodians on a blind basis.

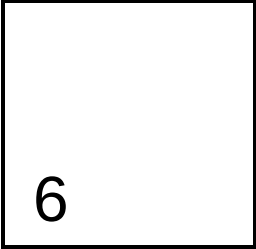
	PNC	Bank A	Bank B	Bank C
Account Structure Fees				
Per domestic separate equity account	\$6,504	\$3,000	\$2,000	\$2,500
Per domestic separate fixed income account	\$6,504	\$3,000	\$2,000	\$2,500
Per cash account	\$6,504	\$3,000	\$2,000	\$500
Per issue	\$60	\$0	\$0	\$0
Asset-based Fees				
Domestic separate account assets	0 bps	1 bp	1 bp on first \$500 mm; 0.75 bps on balance	0.50 bps
Activity/Transaction Fees				
Per domestic depository transaction	\$8	\$10	\$12	\$12
Per dividend/interest payment	\$0	\$0	\$0	\$0
Per principal paydown	\$0	\$0	\$4	\$0

Conclusion

1. Based on the assumptions outlined above, PNC's fee schedule for core custody services appears to be generally competitive with the market, although EDCP may benefit by negotiating a more flexible schedule that better aligns fees with sources of cost.

For example, EDCP's current investment structure, with three domestic active portfolios holding approximately 1,000 securities, results in competitive fees with PNC's schedule, but an increase in the number of holdings (e.g., from 1,000 to 1,200) without a corresponding increase in market value would result in EDCP's fees becoming uncompetitive relative to the market. This situation could occur if EDCP were to retain additional separate account managers. PNC's account structure fee of \$6,504 per portfolio is significantly higher than the market range of \$2,000 to \$3,000 per portfolio and represents a high fixed cost. PNC's transaction fee of \$8 is competitive for domestic depository transaction trade processing.

2. If permitted by EDCP's investment guidelines, the Plan's current holdings and relatively low securities turnover make it a particularly well-suited candidate for participation in a securities lending program. If properly managed, securities lending can be an effective means to generate incremental income to offset plan expenses, such as custody fees. Securities lending is not without risk, however, and EDCP should carefully review all its options and conduct thorough due diligence before engaging a securities lending agent or lending its securities on a principal basis.

6

Administration and Recordkeeping

Administration and Recordkeeping Costs

Current Situation

For the year ending in June, 2003, the total costs to administer the Plan were \$905,000. This translates to about \$27 per participant or approximately .09%. It should be noted that costs in prior years average only about \$785,000. Realistically however, costs would be higher if the level of educational services were more commensurate with industry norms or if significant changes or improvements are made to the recordkeeping platform.

Best Practice

Because plans vary greatly in their design, the types of administrative services required and the demographics of the group covered, comparisons of plan costs using survey data are difficult. Nevertheless, we have summarized below the approximate total administrative costs for the benchmark plans. This information is different from the amount actually collected from participant accounts due largely to reimbursements paid by investment firms.

PLAN		APPROXIMATE COST	
		Per Ppt	% of Assets
California ¹	73,000	\$57	0.19%
New Jersey	33,000	\$27	0.09%
Ohio	115,000	\$46	0.12%
Oregon	21,000	\$75	0.265%
Pennsylvania	47,000	\$40	0.18%
Washington	44,600	\$43	0.13%

¹Adjusted to exclude approximate costs for 3121 plan administration but includes 401(k).

Conclusion

The EDCP's administrative costs are extremely low for a plan of its size, but the level of services is much lower than that of comparable plans.

Fees Collected From Participant Accounts

Current Situation

Currently .08% is collected from participant accounts of which approximately 0.06% is allocated to administrative costs and 0.02% to investment management. Interestingly, initial EDCP fees were collected as a fixed dollar amount per month plus an asset based fee.

The current fee schedule has no fee cap or reduction for larger account balances. It should be noted that the top 25 EDCP plan participants all have account balances of more than \$400,000. The largest account balances are almost \$600,000.

Best Practice

Asset-based fees continue to be the most common fee collected from participants' accounts. Primary reasons for its popularity include a historical precedence set by service providers who traditionally manage assets and the desire not to discourage participants from enrolling. However, as account balances increase, tiered schedules, fee caps or mixed (per participant and asset-based) fees are becoming more common.

BENCHMARK PLAN	FEE STRUCTURE
California	Tiered fee ¹
New Jersey	0.08%
Ohio	\$8 per participant ²
Oregon	0.265%
Pennsylvania	\$12.50 and 0.14%
Washington	0.13%

¹ Tiered schedule ranges from \$24 a year for account balance of less than \$20,000 to \$48.60 for account balances greater than \$100,000.

² Does not apply to participants in payout status.

Conclusion

While continuing to collect an asset-based fee is appropriate, we suggest the Board consider a combination fee or an asset-based fee with a cap for large balances. It should be noted that implementing this type of change would likely require programming charges since currently costs are netted from the funds before returns are credited.

Fee Collection vs. Costs Incurred

Current Situation

The EDCP collects fees from participant accounts on an asset fee basis but most plan administrative costs are either fixed costs or are driven by the number of participants. Few plan administrative services have a direct relation to the amount of assets in the plan. Because the EDCP collects its fee on an asset-based fee basis and due to the market downturn and the desire to keep from increasing participant fees, the EDCP has dipped into its reserves. At the end of the last fiscal year, the EDCP had approximately six months of operating expenses.

Best Practice

The schedule under which fees are collected from participant accounts does not need to be the same as those paid or expenses for services; however, care must be taken when the structures are different to avoid running large deficits or excesses. Plans monitor this issue carefully and generally maintain a reserve to avoid dramatic or frequent changes in fees as well as to provide resources for extraordinary expenses. Most of the benchmark plans have an operating reserve of between three and twelve months of operating expenses.

Conclusion

We recommend the EDCP maintain reserves of at least six months to one year of operating costs since substantial reserves are likely to be needed for system and service enhancements. If plan administration is outsourced, our recommendation would be lower.

Administrative Systems

Current Situation

Recordkeeping for the EDCP is provided by the State's Office of Information Technology (OIT) using an internally developed system.

Best Practice

In the private sector, it is Mercer's experience that internal administration is quite uncommon outside of financial organizations who sell this service externally. The Mercer survey indicates that only 2% of plans handle recordkeeping internally. Of the largest state 457 plans in the country only the State of Ohio's program is recordkept internally. Ohio acquired its recordkeeping system from a national defined contribution plan vendor and has enhanced the system since its acquisition. The system processes on a daily basis using a night processor to post transactions. The Federal Savings Thrift Plan also uses an internal recordkeeping system.

Conclusion

While a detailed analysis of the actual recordkeeping system is beyond the scope of this review, we view the major negative aspects of conducting recordkeeping internally as:

1. **Resource allocation:** When using an internal system, it is customary to have to compete with other system users for processing capacity as well as support for enhancements. We understand that since the OIT must serve a number of internal customers, all with unique demands, the resources that the EDCP has received are far short of those that would be available to a private recordkeeping vendor. For example, the Plan's June 30, 2003 quarterly statement was not issued until two months after the period end due to the competing demands for resources. For a private recordkeeping firm, issuing participant statements is a top priority. Timing for issuing statements typically ranges from 5 to 20 business days after the end of the quarter.
2. **Flexibility:** Most commercial systems must be able to administer many different types of plans and are developed with platforms that are relatively easy to customize. For example, systems are built to accommodate many investment options and investment options can be added to a plan without programming changes. The EDCP system is much less flexible. The required programming changes to add a fourth fund to the EDCP investment lineup took over a year to complete.
3. **Depth of experienced staff:** Internal processing arrangements do not have access to the depth of staff that an outside service provider would have. For example, major service providers have 100 to 200 systems personnel compared to two to three FTEs for the EDCP. Having experienced system personnel is not compromised with the departure of one or even many individuals.

4. Small base over which to amortize major development costs: service providers budget at least \$30 million per year for technology improvements. When major changes to the existing system are required or desired, development changes can be costly. A private recordkeeper can amortize its development costs over a large book of business. For example, major recordkeepers maintain records for millions (from 2 to over 10 million) participants.
5. Economies of scale: The cost of maintaining and enhancing an internal record keeping system is high. Independent recordkeepers with millions of participants on their systems are able to run their systems at very low unit costs. Internal administration makes the most sense when the plans being administered are very large. For example, the Ohio plan has 115,000 participants. The industry standard is usually quoted as 1 million participants, a number that has steadily increased as service and technology become more sophisticated.

Valuation Frequency

Current Situation

The EDCP is valued on a monthly basis. To make transactions, a participant's form must be in the EDCP office by the last working day of the month. Timing of all transactions is given to participants on the website or distribution forms as follows:

- Distributions – 27th day of the following month.
- Change in investment election – next pay date following the end of the month.
- Change in payroll deduction – 2nd pay date following the end of the month.
- Investment transfer – balance forward recordkeeping enables investment transfers to be made “as of” the last day of the month.

Best Practice

Mercer's survey data indicates that 95% of plans have daily valuation, up from 70% about five years before. Interestingly, daily processing is 100% for plans with 10,000 to 30,000 participants and 94% for plans with more than 30,000.

Virtually all 457 plans, including all of the benchmark plans, are valued daily. The move to daily valuation was initially driven by the desire to make more timely and appropriately valued distributions, although the recent proliferation of investment options has accelerated this movement. Daily valuation of plan assets would be considered a best practice.

Conclusion

We recommend the Board strongly consider daily valuation. In theory, daily valuation is not a requirement for defined contribution plans because assets under these plans should be invested for the long term. (In addition, ERISA Section 404(c) requires only quarterly transfers for a plan to be afforded protection for losses resulting from a participant's investment direction.) However, the use of non-daily valuations impacts the timing of any changes participants initiate, potentially increasing the plan sponsor's exposure in this highly scrutinized area. We also understand that there has not been great demand from EDCP participants for daily valuation, although no survey on this issue has been conducted. However, there are a number of reasons why we would recommend daily valuation for the EDCP:

- All assets in the Plan are participant salary deferrals and employees bear all the investment risk.
- Many plan sponsors of 457 plans have found or believe that since participation is voluntary, some members participating in the 457 plan are aggressive/sophisticated investors and want a significant degree of control over the timing of their investment changes.
- Recent market volatility has increased the possibility that more risk-averse participants may wish to make an immediate change to their investment at a point other than the end of the month.
- Benefit payments and hardships distributions can be made much more quickly and at actual value.
- There are fewer participant-level anomalies in returns credited in a daily environment than there are under a balance forward method. In essence, during times of extreme market volatility under a monthly valued system, participant distributions can be significantly impacted to the benefit or detriment of the remaining participants. (See Earnings Allocation discussion that follows.)
- Voice response and Internet access can be more confusing with monthly valuation since timing constraints need to be clearly communicated.

- The EDCP competes with other savings opportunities that are valued daily.
- The experience of plan sponsors who have implemented daily valuations has indicated that participants are less likely to make changes in a daily environment than in the more restrictive balance forward situation where timing is restricted.
- There is little increased cost to purchase daily valuation externally. (See Recordkeeping Costs.)

Earnings Allocation

Current Situation

Earnings are allocated to participant accounts based on their opening account balance. Contributions during the month are held in the EDCP's cash or holding account and are posted to participant accounts as of the last day of the month. Earnings in the EDCP cash or holding account are allocated proportionately to the four investment funds and included in each fund's return.

Withdrawals and benefit payments are based on the prior month's closing balances and, as noted, most payments are made toward the end of the month.

Best Practice

Daily valuation is almost universal so it is difficult to support a best practice for less frequent valuation; however, historically balance forward systems allocated earnings based on opening balance plus one-half of contributions and minus one-half of withdrawals.

Conclusion

Allocating earnings in a monthly valued system is an inaccurate process at best. The current allocation process benefits inactive participants slightly (an inactive participant's account shares in the cash or holding account earnings although the participant made no contributions during the month). In addition, the processing of withdrawals and distributions based upon the last month's balance leaves the remaining plan participants to benefit from the earnings generated prior to

distribution or to make up losses should the fund have performed poorly. In months with large distribution activity and significant market swings, the impact on participants can be noticeable. Our recommendation to move to a daily valued system would eliminate this issue.

Daily Recordkeeping and Administrative Costs

Current Situation

The EDCP's total administrative (recordkeeping and customer service) costs is approximately \$27 per participant.

Best Practice

Costs for administrative services alone is difficult to isolate since most plans purchase considerable educational services from their providers and costs vary based upon the size of the participant group and the complexity of the data exchange. However, recent competitive bids for administration services indicate that recordkeeping costs (including providing a call center and daily valuation for several investment options) range from \$35 to \$50 per participant.

Conclusion

Unit costs for external recordkeeping and administration, given the expanded nature of the services, are quite competitive. OIT has indicated that costs to enhance the current system to include daily valuation but not loans would be more than \$1 million. While the Board could explore purchasing an external recordkeeping system, a state of the art system would range in price from \$500,000 to \$1,000,000 and there would be additional costs for testing, implementation, and training necessary to customize the software. Additionally, costs to update systems associated with voice response and the call center may cost \$75,000 to \$150,000 each, and updating the internet module may cost \$125,000 to \$200,000.

Internal or External Recordkeeping and Administration

Current Situation

All administrative and recordkeeping services for the EDCP are conducted internally.

Best Practice

The trend for both private and public sector employers has been to outsource participant account balance recordkeeping. Usually that outsourcing involves also outsourcing some (usually significant) level of administrative services.

Survey data indicates about 95% of private sector plans currently outsource participant account balance recordkeeping. Public plans that have outsourced in-house recordkeeping in the last five to seven years include Georgia, Michigan, Minnesota and Washington. The State of Ohio continues to conduct recordkeeping internally but it outsources its call center, IVR and website.

Conclusion

Outlined below are some of the major issues associated with outsourcing or insourcing services. It should be noted that the issues outlined below are less dramatic if less frequent than daily processing is used.

Benefits of Outsourcing

- Minimal continuing technology investment required and resource allocation constraints reduced.
- Greater expertise to draw on and ease in migrating to advanced technologies.
- Lower training costs and reduced staffing requirements.
- Staff not required to conduct high volume production and administrative activities.
- Requirements of daily-valued recordkeeping with same day trading involve significant commitment of staffing resources including outside normal business hours.
- More vendors to choose from than available software for in-house use.
- Allows the Board to manage results, not the process.

Benefits of Insourcing

- Cultural integration and continuity maximized.
- Ability to control and manage service levels. No vendor oversight and control issues.
- Able to leverage somewhat defined benefit systems and staffing resources.
- Recordkeeping systems available for purchase, although expensive and hardware requirements sizable.
- Ability to completely customize services, although EDCP has few unusual features.
- No need to make profit on services.
- Avoid the need to synchronize data problems with outside vendor.

Benefits of Outsourcing

- Service provider able to obtain economies of scale not available to single plan sponsors.
- Healthy vendor marketplace which is sophisticated, price competitive and able to meet service requirements of the EDCP.

Benefits of Insourcing

The reasons plan sponsors usually make the initial move to outsourcing are vendor expertise, technology resources, enhanced employee services, and reduced administrative burden. We recommend the Board consider outsourcing recordkeeping and some or all administrative services. However, we recognize that in any political environment, privatization issues need to be considered. We would also recommend a move to daily valuation assuming any internally managed funds offered can either accommodate or be adapted to accommodate daily valuation.

Delivery Model

Current Situation

Delivery model is defined as how a plan receives its services from an outside administrative service vendor. Industry professionals generally divide the service delivery alternatives into three categories:

- Bundled
- Alliance or semi-bundled
- Unbundled

The EDCP does not use an outside administrative service vendor; however, if the Board decides to outsource administrative services this decision would have to be made. Appendix 2 contains a description of the different structures and their advantages and disadvantages.

Best Practice

Historically, the best practice for 457 plans has been an unbundled structure. All of the benchmark plans use an unbundled service structure.

BENCHMARK PLAN	SERVICE STRUCTURE
California	Unbundled
New Jersey	Not applicable
Ohio	Unbundled
Oregon	Unbundled
Pennsylvania	Unbundled
Washington	Unbundled

Conclusion

If a decision is made to outsource administration, we recommend an unbundled structure. This would give the Board the most flexibility in determining what services it wishes to outsource. For example, California, Oregon and Washington conduct some significant portion of educational and/or customer service activities internally. This approach will also enable to the Board to enhance internal “branding” of the Plan by continuing to provide some key or highly visible services internally.

Error Correction

Current Situation

The use of monthly balance forward recordkeeping greatly reduces the need for visible error correction since errors can be corrected and the associated gain or loss handled through the unit value calculation process. We understand that there is no formal method for addressing large errors should they occur and the maximum size of cumulative errors that are washed through the unit value is not set in policy.

Best Practice

Most plans use daily valuation and an outside recordkeeper. When an outside vendor provides the services the contract usually requires that the recordkeeper retroactively correct its errors and make up any loss a participant suffers. Even if the contract does not require this, it is best practice by the major recordkeepers to follow this policy. It should be noted that some recordkeepers may limit their liability for making up lost returns – for example, by not crediting lost returns for errors that a participant does not identify within 90 days after receiving the quarterly statement that contained the error.

Conclusion

Error correction has not been an issue for the EDCP; however, since there is no outside party to make up any major loss, we recommend that policy be set and appropriate resources identified for making the Plan whole for cashouts that have occurred. The maximum size of cumulative errors that are washed through the unit value should be set in policy.

System Security**Current Situation**

The in-house record keeping system requires EDCP staff to have logon IDs and passwords that must be changed every 45 days. A mainframe security system from Computer Associates called ACF2 is also used to prevent accidental or deliberate modification or infection of files.

Best Practice

Requiring logon ID's and passwords and using an outside security system such as the one employed by EDCP would be considered a best practice. In addition, most administrators contract with an independent auditing firm to perform an annual Statement of Auditing Standards (SAS) 70 report of controls. In addition to the many processing controls that are audited in the SAS 70 report, the audit typically reviews the physical security of the recordkeeping systems (such as confirming that terminated employees no longer have access, etc.)

Conclusion

No changes are recommended with regard to system security itself, but we recommend an annual SAS 70 audit would be conducted to provide an evaluation of record keeping procedures, including security measures, which may identify opportunities for improvement.

Disaster Recovery**Current Situation**

OIT conducts disaster recovery tests every six to twelve months, with the last test conducted in May 2003. A secondary processing site is maintained in Philadelphia through a contract with SunGard. Production files are backed up and restored at the disaster recovery site, and batch jobs are run and online systems are brought up via the remote site as part of the testing. Database information is backed up weekly.

Best Practice

Having a secondary processing site available as part of disaster recovery is considered a best practice in the industry. The testing for disaster recovery procedures typically occurs as frequently as quarterly, and no less frequently than annually. As a best practice, most private administrative firms back up database information nightly.

Conclusion

If the current structure is maintained, we would recommend evaluating more frequent backups depending on the volume and frequency of data changes.

Quality Control**Current Situation**

Auditing practices include providing a file to the Division of Pension and Benefits to audit distributions and contributions for a specific month. EDCP does not have a SAS 70 audit performed by an independent auditing firm. The OIT maintains a

procedures manual and a user manual, and has a project management process that includes manager sign-offs and unit and systems testing.

Best Practice

Contracting with an independent auditing firm to perform an annual SAS 70 report of controls is considered to be a best practice. The SAS 70 report would include a report on controls placed in operation and perform tests of operating effectiveness. Reports note any exception areas that are identified in the testing. All of the benchmark plans have annual SAS 70 reports performed by outside auditing firms.

Conclusion

From the perspective of systems changes, an appropriate level of testing and management oversight appears to be in place. In addition, the EDCP should consider employing an independent accounting/auditing firm to perform annual SAS 70 audits.

Processing Turnaround

Current Situation

Processing standards were provided for contributions, distributions, and other functions performed by the EDCP. The table below identifies the EDCP processing time frames and the time frames considered to be best practice for an independent recordkeeper.

Activity	EDCP Processing (business days)	Best Practice (business days)
Contribution reconciliation and posting	10 – 20 days from receipt of payroll data	1 – 2 days from receipt of payroll data
Contribution investment	5 – 10 days from receipt of deposit	1 day from receipt of deposit
Withdrawals paid (forms)	10 days from receipt of form	1 – 3 days from receipt of form
Distributions paid (form)	10 – 14 days from receipt of form	1 – 3 days from receipt of form
Rollovers into the plan processed and invested	1 days from receipt of deposit	1 days from receipt of deposit
Confirmations mailed	7 – 10 from execution of transaction or request	2 – 5 from execution of transaction or request
Participant statements mailed	25 – 30 days from period end	10 – 20 days from period end

Best Practice

The table above indicates the time frames considered to be best practice.

Conclusion

If the administration of the plan is outsourced, the EDCP will be able to consider the processing turnaround capabilities as part of the selection. If the administration is not outsourced, we recommend that efforts are made to reduce the processing times, making necessary accommodations for the monthly processing cycle.

Performance Standards

Current Situation

Processing standards were provided for contributions, distributions, and other functions performed by the EDCP. These are included in the table above.

Best Practice

All of the benchmark plans have performance standards that they apply to their outside vendors. The State of Ohio has adopted performance standards for its internal operations. On the private sector side, performance standards for large plans is common, although overall, Mercer survey data indicates that only 26% have contractual performance standards, 19% of which apply monetary penalties.

Conclusion

If the current structure is maintained, performance standards should be applied to the internal services provided to the EDCP. If the recordkeeping and administration is outsourced, performance standards and appropriate performance penalties should be included in the service provider contract. A sample of best practice standards for outside defined contribution plan service providers is attached as Appendix 3.

Administrative Manual**Current Situation**

The Plan has documented processes for its internal operations and there is a recordkeeping processing manual provided by OIT. There is also an employer administration manual available on the website, although this manual has not been updated to reflect recent legislative changes.

Best Practice

It is standard practice for administrative service providers to provide detailed procedural manuals and all of the benchmark plans have such manuals provided by their recordkeeper.

Conclusion

If the current structure is maintained, full documentation should be completed. If the recordkeeping and administration is outsourced, an administrative manual should be required of the service provider.

Education and Enrollment (Marketing)

Current Situation

Marketing is an industry term that entails:

- communicating the availability of the plan,
- setting up general employee meetings to provide general information on the plan and the benefits of joining,
- conducting in-person or telephone consultations with interested employees about joining the plan, what an appropriate contribution would be based on life expectancies and financial needs during retirement and providing education to assist participants in determining what investment options to choose,
- assisting the employee in enrolling in the plan by completing the necessary paperwork,
- coordinating the participant's salary deferral with the employee's payroll center.

Educational outreach is minimal. During the fiscal year ending June 30, 2003, there were 36 hours of seminars conducted. The EDCP has one staff member assigned to member outreach and this person spends only about 50% of his/her time on education. The individual conducting the educational session is not licensed or registered.

Best Practice

Because 457 plans do not generally have matching contributions to encourage participation, there is a need for comprehensive communication and education activities. For instance, the State of Washington had 506 education meetings in 2002. These services are frequently outsourced to third parties.

Most plans serviced by outside service providers have professionally trained and licensed educational representatives. While training and licensing is not a guarantee of quality, it does set a minimum standard.

Large state plans are much more likely to conduct educational activities in house and while individual meetings may be conducted, it is less extensive than for plans with services provided by an outside party:

BENCHMARK PLAN	EDUCATIONAL SERVICE STRUCTURE
California	In-house
New Jersey	In-house
Ohio	Out-sourced
Oregon	In-house
Pennsylvania	Out-sourced
Washington	In-house

Conclusion

Most plans conduct education with the goals of increasing plan participation and appreciation. As indicated earlier, the Plan's participation percentage is lower than expected and several individuals interviewed indicated that the EDCP is not as well communicated as it should be.

Of all activities, conducting educational meetings is the one that is most easily adaptable to internal delivery. However, when internal, we recommend the use of outside resources to supplement internal capabilities and to access the most current and appropriate educational methods and information.

While in-person services are an expensive way to increase plan visibility and enrollment, it is our opinion that the EDCP does not provide an adequate level of outreach due to inadequate staffing. 457 plan service providers often will provide at a minimum one full-time representative for every 10,000 to 15,000 participants. State plans usually need a relatively low ratio because of the geographic distances to be covered.

We recommend the Board either outsource these services – note that vendor costs for one full-time representative can be as much as \$100,000 a year once overhead, training, and supervisory costs are factored in – or allocate more resources to these activities.

While licensing is not a standard for internal education and customer service staff (to have an NASD license, the individual must be associated with an investment firm), we recommend that if education continues to be provided internally that the EDCP include taking exams and obtaining certifications (such as INFRE's CRA or CRC) in its job requirements.

Educational Plan

Current Situation

The Board does not formally adopt an annual marketing or educational plan.

Best Practice

Most large plan sponsors have an educational plan. Most of the benchmark plans have a plan that they develop in partnership with their educational service provider. Fifty-six percent of private sector defined contribution plan sponsors have either a written or unwritten educational plan.

Conclusion

Whether services are conducted internally or externally, we recommend the Board create and formally adopt a written educational plan. This plan should include specific standards in terms of activities conducted and the comparative success of those activities. A written plan will provide a basis for understanding the results of educational activities in future years.

Communication Materials

Current Situation

All materials are developed in-house. They include multiple fact sheets, an information statement (the Plan document), and a quarterly newsletter. There have been occasional statement stuffers or paycheck messages employed. However, several of the standard educational materials, such as a printed summary plan or highlights brochure or topical brochures (e.g. investment basics and concepts), are not provided.

The EDCP website makes the materials above available but does not have a number of materials and tools that most comparable plans website provide. Some of these tools include a pay check calculator, a retirement income needs/resources projection calculator, and an asset allocation questionnaire/tool.

Best Practice

Best practice includes giving participants comprehensive, written plan information. At a minimum, the sponsor should provide a complete summary plan description, regardless of whether required by ERISA. Most booklets are usually at least 10 pages and professionally laid out and printed. This booklet should be supplemented with the basic information on investments, including the information required by section 404(c) if compliance with that provision is desired.

Most plans have more comprehensive educational materials, including retirement educational brochures. Even plans that conduct education internally and develop many of their own materials usually hire an outside vendor to prepare topical brochures or video in which professional development and design can be beneficial.

In Mercer's survey of employee savings plans, the most important communication messages were:

- 1) the importance of saving early, and
- 2) asset allocation/diversification.

As would be expected, educational documents that cover concepts such as the value of compounded earnings and tax deferral have become a standard core of most education campaigns within large retirement plans. Materials typically also assist participants in determining their own "investor profile" by identifying their time horizon and the level of risk they are willing to accept, which in turn helps participants make decisions on which investments may be most appropriate for them.

Best practice also includes topical information, newsletters and videos on plan related topics. For example, many plans have brochures specifically dealing with the payout and retirement election process. Also when there is participant direction, comprehensive investment education is an important best practice. A recent Department of Labor ruling relieved ERISA employers of potential liability resulting from providing most investment education services. These education services include not only information on the investment options themselves but also projections on expected account balance growth and advice on suggested asset allocation.

Almost 90% of government survey respondents have an enrollment booklet as do all of the benchmark plans. Over 60% utilize payroll stuffers. Due to the high level of in-person servicing in most public sector plans, only about 14% of plans use enrollment videos, down by almost 50% from 1997.

Conclusion

The EDCP educational materials are extremely limited. It is our opinion that EDCP participants would benefit from a more comprehensive array of educational materials and a more robust website with transactional capabilities. While topical educational efforts are made – for example, the August newsletter included an article on the effect of low interest rates on bond funds – there are additional resources that can be purchased from outside providers, either through outsourcing or on an ad hoc basis.

Investment Education and Advice**Current Situation**

Other than the printed information, the EDCP does not provide or make significant investment education or investment advice services available to participants.

Best Practice

Offering investment education is a best practice of all defined contribution plans, including the benchmark plans. While some 457 plans have made investment advice available to participants, this service is available in only a small minority of 457 plans. None of the benchmark plans make investment advice available.

While no public sector survey data is available, Mercer's survey of private sector plans shows that investment advice is offered in 25% of private sector plans and an additional 50% of sponsors are considering adding it to their plans.

The primary reasons that plans have not added the service are:

- The high cost of this service
- The low utilization experienced to date, and
- The concern that, given its complexity and the fact that most investment advice services are delivered over the Internet, many of the participants most in need of the services will not use the service.

Mercer survey data shows that offering investment advice has relatively little effect on participation, contributions or asset diversification. Of plans surveyed, 4% felt participation and contributions had been significantly impacted, and 7% felt diversification had been significantly impacted.

Conclusion

While the usage of investment advice services may increase, we recommend that the Board focus on the more basic aspects of participant education before considering the addition of investment advice.

Discretionary Investment Management

Current Situation

The EDCP does not make discretionary investment management services available to plan participants.

Best Practice

As the result of a recent DOL letter some investment management firms have begun to make discretionary investment management services available to their defined contribution plan participants. Under the most common constructs of this service, investment advisory firms manage a participant's assets for a fee. The fees are usually quite high, and virtually no public sector 457 plans, and few large private sector plans, make discretionary investment advice available to participants.

Conclusion

We recommend that the Board focus on the more basic aspects of participant education before considering the additional cost of investment advice.

Customer Service

Current Situation

Plan participants currently have access to a call center and a voice response system from which participants can obtain their monthly account balance and current unit values. The call center does not have a toll-free number, a feature that would be standard under an outsourced arrangement and would be appreciated, particularly by retirees.

The EDCP call center piggy backs on the defined benefit plan system. Review of call statistics for the last three months indicate an average speed to answer of less than 20 seconds and a call abandonment rate of less than 3% which are within industry norms. Although initial call center support is provided from the central DP&B call center, total EDCP call center staffing is approximately 2.0 (expressed as FTEs).

Best Practice

Using outsourced customer service is increasingly becoming a best practice for 457 plans and vendors are increasingly willing to guarantee that their service meets minimum standards. Outside providers often have redundant call centers and backup generators. In addition it is a best practice to provide more participant services through the internet, including transactional websites and online enrollment.

Despite the advances in telephone and web support, adequate staffing in a call center is important. The best recordkeepers have ratios of one full-time call center service representative to every 5,000 to 10,000 participants. Average speed to answer for a call transferred from the voice response system is approximately 20 seconds and standards for call abandonment are approximately 3%.

While services vary greatly among the benchmark plans and direct comparisons are not appropriate, we have provided the staffing information on the benchmark plans.

BENCHMARK PLAN	STAFFING AS FTEs	SERVICES
California	30+ ¹	Customer service and education
New Jersey	2.5	Customer service and education
Ohio	20	Customer service and education
Oregon	2	Education (includes local employers)
Pennsylvania	0	Services outsourced
Washington	13	Education and some customer service

¹Includes both internal staff and outside service provider call center backup.

Conclusion

Our biggest concern regarding the EDCP customer service is staffing. Staffing of a phone center, especially if the Plan is valued daily, is one of the more difficult activities to staff in-house. The two biggest challenges are training and educating staff and providing back up during periods of high call volume. Both the Washington and California plans which support call services in their office have outsourced some of the services to their outside recordkeeper. For example, California uses their recordkeeper as a back up (calls can roll over to their service provider's call center) and has been gradually increasing its use of this service. Washington has divided the types of calls that are handled between its internal call center and its recordkeeper's service center.

DC plan service providers allocate extraordinary resources to their participant access channels (call centers, voice response and internet access), the level of which cannot be easily duplicated internally, especially for a plan with only 30,000 participants. We recognize the EDCP can take advantage or "piggyback" on similar services provided under the defined benefit plan; however, we believe that there are a number of issues that argue toward strongly considering outsourcing or obtaining back-up for some or all of these services.

- Participant service needs are much higher for participant directed defined contribution plans than they are for defined benefit plans. The call center is a frontline resource for investment education and information. Call centers invest heavily in training their customer services representatives. For representatives, most national vendors average more than 200 hours of initial training and at least 20 to 30 hours of annual continuing education.
- Transactional internet services, which we expect would be very costly to add to the current structure, are a best practice. While daily valuation would make transactional internet services more meaningful, the ability to make changes through the internet is the most convenient way for many participants to make changes. Recent survey information collected as part of the OP&B strategic planning indicated that 70% of New Jersey residents have internet access at home. Internet usage by public sector 457 plans can be quite high. For example, in the State of Washington, almost 40% of plan participants have active internet accounts. Using the internet instead of paper forms for transactions is also more cost effective and reduces errors. Error reduction is important when earnings must be given when correcting errors (see Error Correction above).

- Online enrollment could increase participation. Online enrollment involves pre-populating a plan's internet database with indicative data for all active employees. With this, the system recognizes eligible employees, can accept the enrollment and creates a reverse payroll feed to initiate the salary deduction. Since the State has one payroll system that represents most of the Plan's eligible employees, online enrollment could initially be limited to this group.

Participant Statements

Current Situation

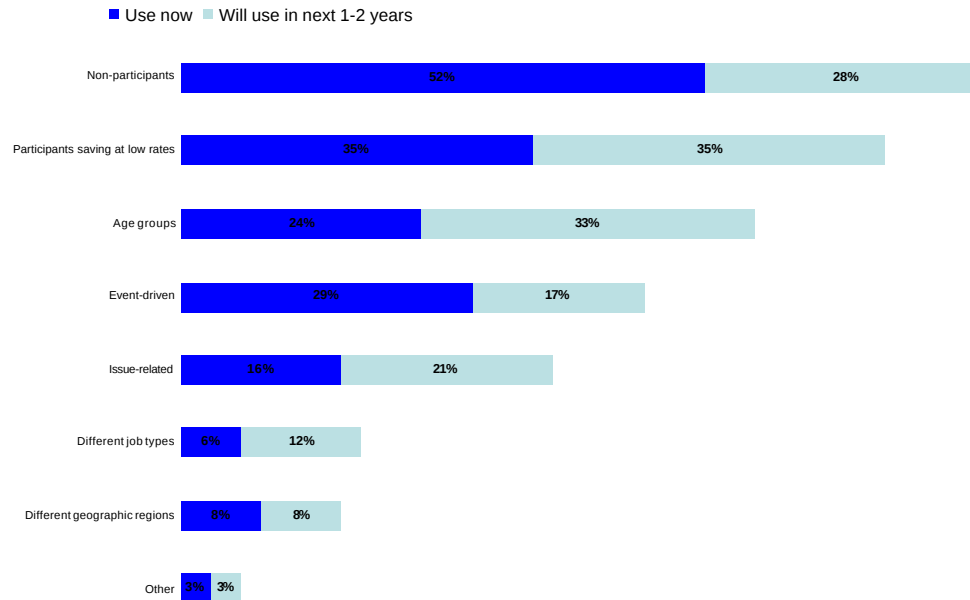
The EDCP participant statements contain basic information, including inception to date and quarterly activity. Fund performance information is also provided.

Best Practice

Quarterly participant statements are a best practice for most employers, including all of the benchmark plans. Traditional recordkeepers have, over the last five years, dramatically improved the value and attractiveness of statements. Recent innovations include the ability to generate statements from the website for custom time periods or to replace lost statements. Two of the most valuable additions to the information contained in statements are individual participant rates of returns and asset allocation percentages. Statements also can contain messaging targeted at participants based upon demographic features or participant behaviors. This use of targeted communications has proven to be a very effective ingredient in modifying deferral rates or asset allocations.

Targeted messaging would also be a very desirable feature although targeted mailings could be an alternative approach. The following table indicates the prevalence of targeted communications among private sector retirement plans:

Prevalence of Targeted Communications



Source: Mercer 2002 Global Defined Contribution Survey

Conclusion

Participant statements are one of the most powerful tools (studies have shown that participants do open and read their statements) and we recommend the Board take steps to offer enhanced statements to EDCP participants. Changes we would recommend include providing individual rates of return and list the performance benchmark indices directly below the applicable investment option.

Participant Surveys

Current Situation

EDCP has occasionally performed participant surveys in an effort to measure participant satisfaction.

Best Practice

Participant surveys are becoming more common in large governmental retirement plans. Surveys are often conducted every two years, and enable plan sponsors to understand the satisfaction level of their participants. Subsequent surveys enable plan sponsors to realize increases or decreases in satisfaction, and can potentially track participant reactions after plan changes are made.

Different methods are used to understand participant satisfaction in private sector retirement plans. The table below identifies the prevalence of methods. Notably, surveys are used by less than one quarter of plans surveyed.

Methods Used to Track Participant Satisfaction

	ANECDOTE	FEEDBACK	INQUIRIES	SURVEYS	FOCUS GROUPS	PARTICIPATION
Features	46%	38%	47%	23%	8%	38%
Plan Communication	42%	35%	41%	16%	7%	23%
Range of investment options	41%	39%	47%	17%	7%	26%
Investment performance	39%	38%	40%	10%	4%	19%
Administration	42%	40%	55%	20%	4%	11%

Source: Mercer 2002 Global Defined Contribution Survey

Conclusion

We recommend that the EDCP continue to survey participants regarding plan satisfaction. Surveys every two years would enable the EDCP to realize any increase or decrease in participant satisfaction.

Section 404(c) Compliance

Current Situation

ERISA Section 404(c) requires that employers give certain materials in order to take advantage of the protection it offers:

- a statement that the plan intends to be a 404(c) plan,
- where to get additional information,
- a description of all investment options, including objective and risk/return characteristics, and
- instructions on how to make investment changes and any restrictions

With the exception of the first item, the EDCP appears to comply with ERISA Section 404(c).

Best Practice

Most private sector plans are operated with the intent to comply with 404(c). Although Section 404(c) does not apply to government plans, most large 457 plans are designed with 404(c) requirements in mind.

Conclusion

We recommend no change.

Audits

Current Situation

The EDCP currently has a financial audit conducted each year; however, a comprehensive SAS 70 audit is not conducted.

Best Practice

It is best practice to have both financial and a SAS 70 audit conducted. A SAS 70 audit is an audit of recordkeeping systems and procedures that ensures that:

- appropriate controls are in place as they relate to the processing of transactions and recordkeeping services,
- transactions are executed in accordance with instructions and are appropriately authorized
- transactions are timely and properly recorded to participant accounts,
- cash receipts are properly authorized and recorded,
- interest and dividend income is properly identified and credited,
- access to the vendor's computer system is appropriately safeguarded and controlled,
- there are adequate security protections and disaster recovery plans in place.

ERISA Plans with 100 or more participants are required to have a plan financial audit and this information must be distributed to employees through a Summary Annual Report (SAR). Public sector employers, while not subject to ERISA, usually have a plan audit conducted. Survey data indicates that 90% of 457 plans have an outside audit conducted; 81% are audited annually. As a best practice, 33% of governments surveyed prepare annual reports to employees usually distributed either through a mass mailing or upon request.

Conclusion

We recommend the EDCP continue to have a financial audit conducted but add an operations and systems audit unless a decision is made to outsource these activities. Regarding the SAS 70 audit, if recordkeeping is outsourced, all major service providers have SAS 70 audits completed by an outside auditing firm.

Business Strategic Plan**Current Situation**

The EDCP does not have its own strategic plan for its administrative operations although the OP&B conducted a comprehensive study and adopted an IT strategic plan.

Best Practice

It is a best practice to have a strategic plan. Most service providers have a strategic business plan that focuses on developing new technologies and applications as well as participant education and other issues. A strategic business plan is also important for 457 plans that conduct such a significant portion of plan services internally -- Ohio, which maintains participant records, has such a strategic plan. The business strategic plan should continually evaluate new services and technologies and measure internal operations against the benchmarks and standards of outside providers and make regular, proactive decisions on what acceptable variance is.

Conclusion

It is our opinion that, if the EDCP continues to conduct the current level of operations internally, it should treat its operations as a business, set a five year plan for needed improvements, and apply reasonable standards to its performance.

Risk Management**Current Situation**

For participant defined contribution plans, the largest risks are investment and fiduciary; however, there are administrative and operational risks. The biggest risks are not processing transactions, including crediting contributions and making benefit payments, on a timely basis and making processing errors.

Best Practice

While most plans, both public and private sector, outsource recordkeeping and administration for reasons other than risk management, one of the benefits is that in the event of large processing errors, an outside party is responsible. These outside parties, in addition to having large operating budgets from which to draw funds to correct errors are also well insured. For example, most large administrators carry errors and omissions coverage of up to \$25 million per occurrence. They also have fidelity bonds and computer crime coverage.

Conclusion

While a plan sponsor will always have some risk exposure in offering a 457 plan, we recommend the Board consider outsourcing recordkeeping and at least some administration to reduce risk.

Appendix

Appendix 1

Loans

Market Description

- In the private sector loans are very common – about 90% of employers allow employees to borrow from their 401(k) plans. 401(k) plan sponsors consider loans a “necessary evil.” Sponsors feel they must offer loans, even though they are not required.
- The percentage of participants who have a loan outstanding averages about 15%.
- The average loan amount per borrower averages \$6,000.
- The average percentage of plan assets loaned out is usually between 1 and 3%.
- One-third of employees in a recent survey said they would stop or reduce their contributions to the plan if loans were not available.
- A 1997 GAO report indicated that participants in plans with loans contribute 35% more than participants in plans without loans.
- Mercer survey data shows that having loans improves participation. For example, only 80% of 401(k) plans with participation rates of less than 50% have loans while 96% of plans with participation rates of 80 to 90% have them.
- While only newly authorized under 457, many governments (City of New York, Michigan, Texas, New York Metro Transportation) have offered loans through their 401(k) plans. While not many state 457 plans have added loans, we are seeing increased activity by city plans to add this feature.

Advantages of Loans

- Makes the 457 plan more competitive with private employer 401(k) plans or the tax sheltered annuity plans of hospitals and schools.
- Creates an incentive for plan participation AND for increased deferrals – increase in participation is typically from lower paid employees.

- Are participant-friendly (no credit checks, typically low rates).
- Provides an attractive alternative to unforeseeable emergency withdrawals:
 - For the employer, because they are easier to administer – no detailed application, qualification and approval process.
 - For the employee because money is paid back to the plan and is available for providing retirement income.
- Appears to reduce the number of UE applications – anecdotal evidence from government employers who have had a loan program in place or recently added – because the participant has another avenue to pursue.
- The costs for loan administration can be charged directly to participants (most vendors charge an initial and ongoing administration fee of between \$50 and \$100. Under the current DCP administrative structure, adding such a fee to be collected from participant account would require programming changes.
- For participants on leaves of absence or who have terminated, a coupon repayment is sometimes available. Vendors are not universal in supporting coupon repayment but many do. This is a facility that could not be easily added to the EDCP as it is currently structured.

Disadvantages of Loans

- Disagrees philosophically with retirement purpose of the 457 plan.
- Participant loses pre-tax appreciation on the money while not invested in the plan.
- Must be repaid with after-tax money, which is taxed again at the withdrawal.
- Defaults are treated as a distribution and the participant owes income taxes.
- Participant may have to repay loan upon termination of employment.
- Money is ultimately being borrowed from the plan which requires assets be held for the exclusive benefit of plan participants – it is important that administration is handled correctly especially in the area of defaults.
- Loan application procedures for getting a loan. This will include having a loan application form, truth & lending disclosure forms, etc. In a traditional outsourced arrangement this would be included; however, it would create an

additional burden on EDCP staff. Because of these complexities the market place is moving to paperless loans. Treasury regulations specifically indicate that it is not necessary to have a participant signature if an electronic system meeting specific criteria is available. The criteria include confirmation of the loan provisions and a reasonable opportunity for the participant to be able to confirm, modify or rescind the loan before it becomes final.

Other Considerations

- Education – it is critical that there is clear participant education about how the loan program operates because of the potential effect on future retirement benefits and the income tax penalties associated with loan default.

Appendix 2

Service Structures

Market Description

- Industry professionals generally divide the service delivery alternatives into three categories:
 - Bundled
 - Alliance or semi-bundled
 - Unbundled
- In today's marketplace, bundled is only applicable to smallest plans
- Categories are best viewed more as a continuum than as an absolute classification system

Unbundled Arrangement	Alliance Arrangement
Client selects multiple investment providers	Vendor selects multiple investment providers
Investment in many types of funds and accounts	Broad array of specified fund families
Greater Board/staff time commitment	Lesser Board/staff time commitment
Cost not subsidized by investment management	Cost subsidized by investment management

Under **unbundled** service delivery approach to plan management, the plan sponsor selects separate providers for recordkeeping, trustee, and investment management services. Pricing of services is independent of investment and service providers selected.

Alliance service delivery is when two or more vendors engage in a partnership to provide a full range of services.

Advantages of Unbundled

- Ability to select best service providers for trust, investment, and recordkeeping services. Investment selection is independent of administrative arrangement so the investment offering and funds can be based on appropriateness, performance and investment strategy, and not affiliation.
- Greatest degree of flexibility to change a single service provider.
- Can accommodate complex plan provisions or service requirements. Less disruption when changes are made because investments or service arrangements can be changed independent from one another.
- Greatest ability to customize all components or to combine with services provided in-house. For example, easier to accommodate independent outside educational services or prepare own communication materials.
- Plan sponsor has most flexibility in determining how fees are assessed to participants and/or to pay fees itself.

Disadvantages of Unbundled

- Depending on fee structure chosen, participants may see more disclosed fees, although overall fees are usually not higher.
- Recordkeeper may not be a name recognized by participants.
- Requires more involvement by plan sponsor.
- Plan sponsor must deal with multiple providers, although the TPA usually handles much of the administrative interface as well as contractual and procedural details.
- More difficult to coordinate roles and responsibilities of various providers as they relate to participants. For example, since investments chosen by sponsor instead of provider, customer service representatives may not be able to provide as detailed response to investment-oriented questions as under a bundled or alliance arrangement.
- Daily valuation and same-day trading requires high level of coordination among providers.

Comments on Unbundled

- Unbundled arrangements have been popular with larger, governmental defined contribution plans because:
 - Sponsor has ability to negotiate costs.
 - Selection of services can be obtained independently.
 - Avoidance of pricing interdependence.
 - Ready availability of reimbursements or the ability to choose institutionally priced investment products that reduce overall plan costs.
- Anecdotal information from other competitive bid situations has been that the cost of independent TPA services, coupled with available offsets or assumptions of offsets provided by proposing investment companies, is less than under semi-bundled arrangements.

Advantages of Alliance

- Plan sponsor has to deal with only one organization. Coordinated information flows through primary provider requiring less plan sponsor involvement than unbundled approach.
- Plan sponsor has flexibility to choose investment options within menu offering, although usually some minimum of proprietary options must be met.
- Usually investment options priced to be interchangeable in terms of reimbursements/offsets paid to the “alliancer.” If not, pricing will change if investment options change.
- Employees may see less in disclosed fees.
- Pre-arranged alliance packaging may reduce some cost components.
- Providers often offer more custom communications, since the materials must be customized to some degree anyway.

Disadvantages of Alliance

- Possible cost fluctuations when changes to investment lineup are made due to complexity and inter-relation of pricing components.
- Flexibility to choose investment options may be restricted and ability to make changes controlled to some degree by the alliance provider.
- Alliance provider has incentive to direct funds to its products and to restrict use of outside funds.
- Sponsor not likely to know true costs since pricing components are not usually disclosed.

Comments on Alliance

- Alliance arrangements are popular because:
 - Sponsor has to deal with one vendor only.
 - This arrangement is usually only option when there are significant financial penalties applied at contract termination.
 - Investment flexibility has increased dramatically in recent years.
 - Up and downside financial risk is borne by alliance provider.

Appendix 3

Best Practices

Activity	Performance Standard
Standard Accounting Activity Turnaround Times	
Contributions	Monitor contributions to ensure that all contributions are properly credited to participant accounts and periodically checked for compliance with all IRS and State rules including annual limits. Upon receipt of the contribution remission, client must be notified same day of all contributions that cannot be posted. Notify client of participant accounts that are opened and do not receive a contribution within 30 days of the date the account was opened.
Distributions paid following receipt of request (forms)	All checks for payments shall be mailed no later than the second business day following the receipt of completed paperwork and the posting of the daily valuation cycle.
Distributions paid following receipt of request (paperless)	All checks for payments shall be mailed no later than the second business day following the posting of the daily valuation cycle.
Changes in Investment Elections	100% of all changes in investment elections received by close of NYSE requested by participants shall be processed on the same day.
New loans distributed following receipt of request (initiated via forms)	All checks for new loan requests shall be mailed no later than the fifth business day following the receipt of completed paperwork.
New loans distributed following receipt of requests (paperless initiation)	All checks for new loan requests shall be mailed no later than the fifth business day following the receipt of the request.
Posting of loan payoffs	Loan payoffs shall be processed and deposited to participant accounts within 2 business days of the receipt of the check.

Activity	Performance Standard
Rollovers In (processed & invested)	Rollovers in shall be processed and invested within 2 business days of receiving the rollover proceeds.
Transfers/Reallocations (daily traded funds)	100% of all fund transfers (purchases and redemption's) requested by participants shall be executed within the investments at that day's closing NAV or price, providing the request was entered by close of NYSE.
Withdrawals paid (initiated via forms)	All checks for payments shall be mailed no later than the second business day following the receipt of completed paperwork and the posting of the daily valuation cycle.
Withdrawals paid (paperless initiation)	All checks for payments shall be mailed no later than the second business day following the posting of the daily valuation cycle.
Notification to participants with Required Minimum Distributions	Participants requiring minimum required distributions shall be identified, mailed correspondence and election forms (if appropriate) and MRD shall be processed by December 1 of each calendar year.
Speed in correcting transaction errors	Transaction errors shall be rectified within 5 business days of a participant's notification of such error.
Automated Communications	
Confirmations of financial transactions	95% of participant confirmation statements shall be produced and mailed within two business days after transaction. None shall be mailed any later than 5 days after the transaction.
Confirmations of demographic data changes	95% of participant confirmation statements shall be produced and mailed within two business days after change. None shall be mailed any later than 5 days after the change.
Statements on demand	Statements on Demand shall be produced and mailed within 2 business days after participant request is affected.
Employer Plan Summary Report	Employer Plan Summary Report will be available within 30 business days from the quarter end.

Activity	Performance Standard
PIN mailings	PIN requests shall be produced and mailed within 2 business days after participant request is effected.
Distribution of enrollment material	Enrollment materials should be mailed within 2 business days after request is made.
Distribution of termination material	Distribution forms should be mailed within 2 business days after request is made.
Quality/Accuracy Measurements	
Participant statement accuracy	99% accuracy on quarterly participant statements.
Transaction accuracy (participant requested transactions)	99% accuracy on processing rate measured by calculating as the total number of transactions processed without errors by the total number of transactions processed; errors defined through audit and as reported.
Controls for Manual & Systems Processes & Procedures	
Distribution upon request of generic & participant specific documents (including administrative forms, prospectuses, plan document and/or brochure, participant statement copies, etc.)	95% of the documents made available shall be mailed within 2 business days of the request; 100% of the documents to be faxed shall be faxed the day of the request.
Excess system capacity requirements – web	Average of 25% excess capacity shall be maintained.
Excess system capacity requirements – VRU	Average of 25% excess capacity shall be maintained.
Excess system capacity requirements – processing	Average of 25% excess capacity shall be maintained.
Lead time for adding a new fund (for system changes)	20 business days.
Black out period for adding new fund	3 business days.

Activity	Performance Standard
Response time for resolving issue when research is required (contact initiated through service reps)	Written complaints will be responded to within 10 business days. Will report unresolved complaints after 30 days.
Fulfillment (acceptable error rates & turnaround times)	99% accuracy on fulfillment of mailed materials.
Standard Commitment for Channel Availability and System Recovery	
Unscheduled downtime – web access for participant and plan sponsor functions	99% availability rate measured by calculating the total number of hours the system is available divided by the total number of hours it was scheduled for availability (availability is measured 24 hours a day excluding scheduled periods of maintenance and system upgrades, with prior notification).
Unscheduled downtime - VRU access for participant functions	99% availability rate measured by calculating the total number of hours the system is available divided by the total number of hours it was scheduled for availability (availability is measured 24 hours a day excluding scheduled periods of maintenance and system upgrades, with prior notification).
Scheduled maintenance – VRU	4 hours a month.
Scheduled maintenance – web	10 hours a month.
VRU – speed to answer	Speed to answer via the VRU is 20 seconds or less, for 85% of the time period.
VRU – abandoned call rate	On average per time period, less than 1 percent of calls will receive a busy signal, and the abandoned call rate will be less than three percent.
Availability of recordkeeping system (exclusive of routine maintenance)	99 % availability out of 24 hours per day, 7 days a week; maintenance should not be scheduled for prime time and should not exceed 4 hours.
System recovery following disaster	72 hours.

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