The Management of Defined Contribution Pension Plans in Local Government

GANG CHEN, CAROL EBDON, KENNETH A. KRIZ, AND OLIVIER MAISONDIEU LAFORGE

Despite the growing importance of defined contribution pension plans in state and local governments, little research exists on how those plans are actually managed. Our study fills a gap in the literature through using a mixed-methods approach on a sample of local governments in Nebraska. We employ a mail-out survey to get broad-based information on DC plan administration throughout the state, and use face-to-face interview techniques on a subsample of plans to investigate the details of plan management. We find several deviations from promulgated best practices, and substantial variation in administrators' knowledge of and role perception related to DC plans.

INTRODUCTION

Concerns with public pension funds are widespread. Most corporate plans are underfunded, but this "pales in comparison to the shortfalls in public pension plans" (Barr 2009). Most public employees are still covered by defined benefit (DB) pensions, in which retirees receive a contractual benefit regardless of investment results (Munnell, Aubry, and Muldoon 2008). However, studies have noted a $1.38 trillion shortfall in state funding for promised retirement benefits (The Pew Center on the States 2012), and that 93 percent of state funds were underfunded at the end of 2008 (Bonafede, Foresti, and Browning 2009). Retirement benefits will be a major issue as baby boomers retire and live longer lives than previous generations. Yet

Gang Chen is an Assistant Professor in Rockefeller College of Public Affairs and Policy at the University at Albany-SUNY. He can be reached at *gchen3@albany.edu*.
Carol Ebdon is a Professor in School of Public Administration at the University of Nebraska at Omaha. She can be reached at *cebdon@unomaha.edu*.
Kenneth A. Kriz is Regents' Distinguished Professor of Public Finance, Wichita State University. He can be reached at *ken.kriz@wichita.edu*.
Olivier Maisondieu Laforge is an Associate Professor in College of Business Administration at the University of Nebraska at Omaha. He can be reached at *ojml@unomaha.edu*.

many governments are financially distressed and having difficulties meeting promised benefits, particularly after the large investment losses in the 2008 financial crisis, compounded by declines in tax revenues.

The difficulty in funding public DB pensions creates issues for governments and taxpayers, as well as employees and retirees. Addressing the gap between assets and liabilities requires increased contributions into the systems, and/or reduced pension benefit levels. This may mean higher taxes, larger payments into the systems by employees, and reduced retirement security. Other potential impacts include reduced property values, as well as reduced bond ratings which would result in higher borrowing costs for capital projects (Hess 2005).

Due in part to the challenges facing DB plans, in recent decades there has been a shift in the private sector to defined contribution (DC) plans, where a retiree's benefit is based on the accumulated assets in an individual's retirement account. Employees select investment vehicles from a menu of options. A DC plan has several advantages over a DB plan. DC plans provide portable benefits when employees change jobs, and they bring more certainty to the employer, because benefit amounts are not guaranteed (Peng 2009). However, DC plans shift the investment and funding risks from the plan sponsor to the plan participant.

Underfunding problems with DB plans have led some governments to introduce DC plans (The Pew Center on the States 2010).[1] DC plans are already common as public DB plan supplements, but an increased transition from DB to DC plans is expected (Fore 2001). In the last decade, 12 states have introduced some form of DC plan (Munnell et al. 2008b). Only five states[2] use DC plans as their primary plan (Snell 2012). Some local governments establish their own DB plans, others join state-level pension systems, while others offer their own DC plans either as a supplement to a DB plan or as a primary plan.

Despite the increasing importance of DC plans in government, there is little research and data on plan administration and decision making. Our study addresses this gap by exploring DC plans in Nebraska local governments. We surveyed cities and counties regarding existing practices, and conducted in-depth interviews in six governments. We find several areas where DC plan management is not aligned with best practices identified in the literature. These findings provide a cautionary tale for governments that may be considering new or expanded DC plans for their employees.

LITERATURE REVIEW

The literature has identified best practices in DC plan management that generally fall into five areas: selecting providers, monitoring performance, investment options, providing financial

1. There are several public sector DC plans. The 401(k) is only used in governments that adopted it prior to 1986 (SigRist and Brown 2000). Section 403 (b) plans are used by educational institutions and nonprofits, and Section 457 plans are used by state and local governments (Kilgour 2006). Governments also may adopt a Section 401(a) money purchase plan (Kilgour 2006), in which sponsors make specified contributions (GAO 2009).

2. Alaska, Michigan, Minnesota, Utah, and West Virginia.

education to participants, and communicating with participants. Each of these will be addressed here.

Plan sponsors usually hire service provider(s). For example, an investment manager may provide investment options, or a consultant may provide financial advice to participants or select and monitor the investment manager. One survey found 34 percent of DC plan sponsors use a bundled service, in which plan administration, investment options, enrollment service, and recordkeeping are provided by one provider (NAGDCA 2009). Two major methods are used for provider selection: request for proposal (RFP; 32.5 percent) and investment consultant search (40.3 percent) (NAGDCA 2009). With an RFP, the sponsoring government solicits proposals directly from potential service providers (Ferrera 2001). Alternatively, investment consultants with expertise on DC plans may be hired first by the sponsor to assist in the selection of investment service providers (Ness 2006).

Monitoring is important to ensure adequate performance by providers, but requires financial expertise. Scholars suggest that quarterly reporting and continuous monitoring should be standard (Stone 2010). Reviews can be conducted according to requirements in the plan documents (Gordon and LaBarge 2010). Participants' opinions and complaints are also important in the monitoring process.

A broad range of investment options is suggested (GFOA 2009), but Cranch and Notto (2008) note that too many options bewilder the participants. The median number of investment options for state and local DC plans has been found to range between 11 and 20, but 14.4 percent of plans had 1–10 options, while 9.3 percent had 50 or more options (NAGDCA 2008a).

Financial education of participants is vital in DC plans because these plans shift responsibilities from the employer to the employee (Muller 2003). Scholars wonder whether the average individual has the knowledge to make rational decisions about participation, contribution, and investment (Holland, Goodman, and Stich 2008). Annual surveys by the National Association of Government Defined Contribution Administrators (NAGDCA) have found the average participation rates for public DC plans to range only from 23 to 34 percent between 2007 and 2011. Research has also found that public DC participants fail to adjust their asset allocation when personal circumstances or the economic environment change; for example, less than 40 percent in one study changed their equities allocation between the volatile period of 1997–2002 (Rugh 2003). Other irrational behaviors have been found in private DC plans that also may apply to public DC plans, such as the use of naïve diversification in contributing evenly among the plan options (Benartzi and Thaler 2001). Research shows the effectiveness of financial education for employees (Holland, Goodman, and Stich 2008; Muller 2003). However, one survey (NAGDCA 2008a) found that only 53 percent of responding plans offered investment advice, while a 2012 survey by Plan Sponsor Council of America (PSCA 2012) revealed only 24.1 percent of nonprofit organizations provide investment advice to plan participants.

Effective communication works in two directions. Plan sponsors disclose plan information to the participants through regular participant statements, investment policies, and performance reports. Sponsors also should obtain employee feedback for use in plan decision making by methods such as satisfaction surveys and seminars. However, according to previous surveys, only 30 percent of state and local DC plan sponsors conduct annual satisfaction surveys (NAGDCA 2008b).

Limited research has been conducted on public sector DC plans, especially with small and medium size local governments. Many studies are based on private sector plans, and we do not yet know whether these findings also apply to the public sector. The annual NAGDCA survey is useful, but focuses on state plans and large local plans, while the PSCA survey focuses on nonprofit plans. Literature has identified best practices in several areas, but little research has compared actual practices in local governments to the recommendations.

METHODOLOGY

This study seeks to address gaps in our knowledge of DC plans, by exploring the use and management of these plans in Nebraska local governments.[3] The Nebraska Public Employees Retirement Systems (NPERS) manages five pension plans that include some local employees. The State is statutorily required to fund the actuarially required contribution each year. Three of these state-managed plans are DB plans. The School Employees Plan covers employees of all but the largest school districts in the state; it was 76.5 percent funded as of 1 July 2012 on an actuarial basis. The Judges Plan covers local and state judges and was 91.6 percent funded as of this same date. The State Patrol Plan was 78.1 percent funded; State Patrol members are not covered by Social Security (NPERS 2013).

State employees and most county employees were members of two statewide DC plans until a cash balance option was added in 2002. All new members are enrolled in the cash balance plan, while active plan participants in 2002 were given the option of converting to the cash balance plan. With the cash balance plans, the annual rate of return for the members is the Federal Mid-term rate plus 1.5 percent, but members are guaranteed at least a 5 percent return. The State Cash Balance plan was 91.5 percent funded as of 1 July 2012, while the County plan was 91.9 percent funded. All but the two largest of the state's 93 counties are included in the County plan (NPERS 2013).

Municipalities are not covered by state-managed plans; any retirement plans for municipal employees must be developed and administered locally. The state also has 1,267 special districts (airports, utilities, cemeteries, fire districts, etc.) Some of the larger special districts, the largest school district and counties, and a few of the largest cities have their own DB retirement plans (particularly for uniformed police and fire personnel who do not participate in Social Security).

3. The National Association of Government Defined Contribution Administrators, Inc. (NAGDCA) conducts an annual survey of state and large city DC plans. While our approach mirrors that resource, there are two major differences that make ours a substantially different piece of research. First, the NAGDCA survey is directed primarily at states with some larger sub-state units of government included (e.g., in the 2012 survey 49 of the 84 plans surveyed by NAGDCA were state plans and the average size of the plans was in the vicinity of $1 billion). Our survey is directed at smaller local governments where administrative capacity is expected to be lower. Second, the NAGDCA survey asks more about participant behavior (such as funding levels) whereas ours focuses on behavior of the plan administrator.

However, most local governments in the state are in relatively rural areas, with small population (the state has 1.8 million people spread across 77,000 square miles, with most of the population located in the Omaha and Lincoln areas). With relatively few employees, it is more likely that these smaller governments have DC pension plans rather than the more complex DB plans. For this reason, studying Nebraska localities should provide useful information regarding DC plan management.

We conducted a survey of all the 515 cities in the state to obtain a broad level of information about practices across the state.[4] The survey was mailed in February 2011 to all of the city clerks, who are typically responsible for financial functions in most of the communities. These individuals were asked to pass the survey on if another official was more appropriate to respond. To improve the response rate, cover letters to the cities were co-signed by the Director of the Nebraska League of Municipalities. Follow-up emails were sent to those who had not responded to the written survey.

The survey included 53 questions in total regarding the government's retirement funds. Questions related to both DB and DC plans. Twenty-three of the questions focused on DC plans. These included data on plan size, contributions, investment options, information disclosure, monitoring, and education processes.

The survey results provide a valuable overview of the status of current DC practices. However, we were also interested in learning more detail about how officials perceive their role in managing DC plans, and how they select service providers, monitor plan performance, and educate participants. We chose six local governments for more in-depth study. The cases were selected to obtain variation in government type, population, plan types and plan administrators. One is a large county government, while the other five are cities. One individual in each of the six governments was interviewed, with each one playing a lead role in oversight of the DC plan. Anonymity was guaranteed to the interviewees in order to obtain candid responses. In addition to interviews, supplemental data were collected from the government websites and Comprehensive Annual Financial Reports (CAFRs), where available.

This study has limitations. The survey results and case study findings may not be representative of the cities and counties in the state as a whole, or of those beyond this state. Therefore, it is not possible to generalize the results of this study. However, given the limited existing research on public sector DC plans, the study is valuable in pointing out current practices and potential issues, as well as helping to identify directions for future research.

SURVEY RESULTS

This section addresses the survey results. Of the 515 municipalities, 198 (or 38.4 percent) responded. While the response rate is somewhat encouraging, nonresponse bias was possible.

4. Counties were also surveyed, to determine if they had locally administered plans. However, most of the responding counties that reported having local plans appeared to be referring to the state-managed plan. As a result, we excluded counties from the analysis.

Larger jurisdictions might have more resources and expertise to respond to surveys, which could result in a sample that may be expected to show better practices than those of a typical sample. We did find large variation in mean populations between respondents and nonrespondents, but the median population is similar (331 for responding cities versus 378 for nonrespondents).

Sixty-one (30.8 percent) cities reported having locally administered DC plans. Several cities have more than one plan, so the total number of plans in the sample is 81. A government can provide multiple plans with different contribution rates and investment patterns. In the following analysis, the study focuses on each plan as the unit of analysis. Only five cities reported that they had their own DB pension plans. Therefore, DC plans are the dominant type of locally administered retirement program.

Plan Administration and Provider Selection

Plan administration is mostly carried out externally. Of the 61 plans responding to this question, 36 (59 percent) use an outside administrator (see Table 1), primarily an insurance company. While there is nothing wrong prima facie with insurance companies, some offer rather limited investment options. And both insurance and investment company administrators may face inherently conflicting interests in investment offerings. There is also an interesting population pattern. Smaller cities tend to use external consultants or a single city official for plan administration. Using a board or commission to administer plans seems to be the case only in the larger cities. This may be explained by resource scarcity; the method of choosing plan administrators may be somewhat ad hoc, however, in smaller jurisdictions.

We also asked about investment provider selection. Table 2 shows an almost even split between those that used an outside consultant and those who did not. There appears to be little relationship between city size and the use of an outside consultant for this administrative task. Statistics show that external investment companies (87.5 percent) and single city officials (85.7 percent) as plan administrators are more likely to use consultants for provider selection, while external insurance companies (33.3 percent) as plan administrators are less likely to use

TABLE 1
Plan Administrator by Population (Valid Responses: 61 Plans, 75 Percent of the Total Respondents)

Plan administrator	Number of plans	Average population of jurisdiction
Single city official	11	4,050
Board/commission	14	28,010
External—investment company	11	6,437
External—insurance company	16	8,692
External—consultant	9	3,640
Other/no answer	20	28,423
Entire sample	81	15,404

TABLE 2
Use of Consultant for Investment Provider Selection (Valid Responses: 60 Plans, 74 Percent of the Total Respondents)

Use consultant for investment provider selection?	Number of plans	Average population of jurisdiction
No	27	13,572.96
Yes	33	12,875.73
No response	21	21,734.71

consultants. When asked what information was used to select providers, there were a variety of responses. For example: "rep comes to visit individually to set up plan;" "We have used the same company since 1998 and each year we ask employees if they want to change–no requests have been made since 1998;" "morningstar research; S & P; fund companies;" "RFP process;" "booklet provided by plan;" and "Personal experience of the members of the City 457 Plan committee and the consensus of the City employees."

Investments

Of the responding plans, 54 percent had default investment options, with plans that were externally administered by insurance companies and consultants having higher rates of default investment options (71 and 66 percent, respectively). Table 3 shows a broad mix of default options. Plans administered by boards/commissions rely more heavily on target date funds (where investments are made in a mix of asset classes based on the participants' expected date of retirement), while funds administered by an insurance company have disproportionately high reliance on guaranteed investment contract (GIC) type funds as default options. This is not

TABLE 3
Default Investment Options (Valid Responses: 50 Plans, 62 Percent of the Total Respondents)

Plan administrator	Target date fund	Money market fund	Stable value fund	Bond fund	Guaranteed investment/ annuity	Not sure
Single city official	2	1				1
Board/commission	4		1			
External—investment	1	1		1		
External—insurance company	1	1		2	6	
External—consultant		4			1	

surprising in that often GICs and annuities are insurance products. Consultant managed funds rely more heavily on money market funds for default options.

There are only 34 plans that reported their asset allocation, so the analysis of asset allocation is based on those plans. Charting the asset allocation decisions of plan participants is difficult, but some broad patterns of investment preferences can be detected through looking at the overall allocation to each investment class. Table 4 shows the distribution by plan administrator. The majority of assets in these plans were invested in U.S. large capitalization equities. This is the most widely advertised and understood asset class. Overall, domestic equity funds accounted for just over one-half of all assets. Funds managed by a single city official or by an external consultant had the highest percentage of assets in domestic equities, with funds managed by an insurance company having a notably lower percentage allocated to domestic equity funds.

TABLE 4
Asset Allocation (Valid Responses: 34 Plans, 42 Percent of the Total Respondents)

Plan administrator	U.S. large cap equities (%)	U.S. small cap equities (%)	International equities (%)	U.S. Government bonds (%)	U.S. Corporate bonds (%)	Money market securities (%)
Single city official	38.26	33.50	2.25	0.00	16.69	0.17
Board/commission	33.42	20.50	14.17	1.38	10.30	1.22
External—consultant	50.88	20.57	5.91	0.00	0.75	2.27
External—insurance	18.76	10.90	5.59	0.00	3.20	0.03
External—investment	41.00	13.00	0.00	0.00	0.00	0.00
No response	25.38	17.76	15.99	0.26	5.06	6.10
Overall average	34.62	19.37	7.32	0.27	6.00	1.63

Plan administrator	Real estate (%)	Target date funds (%)	Balanced funds (%)	Stable value funds (%)	Guaranteed investment contracts (%)	Specialty funds (%)
Single city official	0.89	0.00	11.04	0.00	2.82	0.00
Board/commission	4.38	26.64	2.00	0.00	3.29	4.35
External—consultant	0.14	1.29	7.48	23.61	0.00	0.00
External—insurance	2.47	20.68	3.78	33.44	0.00	0.00
External—investment	0.00	0.00	0.00	0.00	0.00	0.00
No response	1.92	18.50	2.77	17.13	0.00	0.00
Overall average	1.63	11.18	4.51	12.36	1.02	0.73

Note: The following asset classes had zero or negligible asset allocations: international bonds, mortgage-backed securities, bank savings/CDs, annuities, commodities, venture capital/private equity, infrastructure funds, raw land/timber, and target risk funds.

Surprisingly, domestic bond investments accounted for less than 10 percent of all assets; the only plans with a significant allocation were those managed by single city officials or boards and commissions. Money market securities and alternative asset classes also accounted for a small percentage of investments. The alternative asset class with the largest allocation was international equities, but only plans managed by boards/commissions and plans without a response as to the manager had more than 10 percent of assets in this class. Target date funds, which are becoming highly publicized, attracted just over 10 percent of all invested assets, with particularly high levels of assets invested in funds managed by boards and commissions or external insurance companies. External insurance administered plans also differed in their asset allocation pattern, with just over one-third of all assets invested in stable value funds. This is not surprising as insurance companies often are originators of GICs and wrap products that form the underlying assets for stable value funds.

Monitoring

When asked about the process used to monitor the performance of investment providers, a wide range of responses was provided, such as: "Each employee reviews their own report about their own plan—All the city does once account [is] set up is to send in the monthly amount agreed on by employee and the city match;" "XXX has a fiduciary investment review that is done quarterly; and "it tracks performances over several periods and flags the lower performing funds, eliminating them if they fail" [Provider named omitted]. Many (perhaps most) plans appear to have no process for systematically reviewing investment provider performance, or they delegate the monitoring process to the plan participants. A few plans, however, have very strong monitoring processes, including regular meetings with providers and access to the internal audits done by providers.

We also asked questions regarding the fee structure: the average fund investment expense ratio (defined as the portion of the service fee specifically dedicated to offset investment trading fees) and the administrative expense ratio. These responses demonstrate an apparent low level of knowledge and monitoring of fees. Only 24 and 31 plans responded to these questions, respectively, of which 7 and 9, respectively, indicated that they did not know. The mean investment expense ratio for the 12 plans that answered this question with a specific percentage was 1.39 percent and the median was 0.89 percent; the lowest was 0.33 percent for a plan administered by an external consultant and the highest was 5 percent for a plan administered by a single city official. The average response for the 20 plans that answered the administrative expense ratio question with a specific percentage was 1.54 percent and the median 0.71 percent; the lowest was 0.14 percent for two insurance company administered plans, and the highest was 13 percent for a plan that did not identify its administrator.

Respondents were also asked when the plan last changed investment service providers (see Table 5) and the reason for the change. Of the 48 valid answers, about one-third indicated that they had never changed providers. If one includes answers such as "?", "Currently Looking," and "N/A," this rises to nearly one-half of the respondents. Of the other half, the modal response was within the last year (eight plans). Another eight plans changed providers within the last 2–6

TABLE 5
Most Recent Provider Change (Valid Responses: 48 Plans, 59 Percent of the Total Respondents)

Providers changed	Number
New plan	1
Never	15
?, N/A	6
Done by plan provider	3
Currently looking	2
Within 1 year	8
Within 2 years	4
3–6 years	4
7–10 years	3
More than 10 years	2

years, three plans changed providers in the last 7–10 years, and two plans answered that it had been more than 10 years since a change.

A wide variety of reasons for changes was given, such as:

- "Changed large cap growth managers. due to long term performance & expense ratio;"
- "Changing from an out-of-town investment service provider to a local provider with whom the employees had personal experience;"
- "Employee concerns regarding rates of return, investment options, and costs associated with investment options;"
- "Fiduciary responsibility; lack of choice options; lack of education;"
- "Offer more options to participants;" and
- "Old TPA (Third party administrator) was not handling requests in a timely manner, limited access to plan information and overall increase in expenses."

Most of the changes were for rational reasons: poor performance, a change in style, a wish to change the investment mix, or concerns of plan participants. A few responses cause some reflection, including ones where participants seemed to want local providers. While there may be a natural wish for good communication between provider and participant, there is little reason why this should be limited to only local providers. Ultimately, best practices suggest that performance should be a major reason for selecting plan providers.

Education

The fourth area of practices studied was financial education of participants. We found that investment service providers are overwhelmingly used to provide education. Boards/administrators and independent contractors are rarely used. Some boards and administrators provide informational materials such as pamphlets and prospectuses and web-based planning tools. The provision of informational materials (a rather low resource use but low impact method of educating participants) is the most often used educational resource. Next most used was new employee counseling, which is somewhat encouraging as this is often when participants can get "locked in" to certain patterns of retirement saving. The least frequently used method was investment seminars, which is somewhat disconcerting. Investment seminars can be valuable in educating participants about a variety of investment options and strategies.

Communication with Participants

The last area studied related to communication with participants. We asked whether the government or the service providers provided disclosures regarding the investment portfolio, investment returns, and service fees, and also asked about the frequency of disclosure. Two findings stood out. First, the jurisdictions are not often involved in the disclosure process, and appear to be largely delegating this to their service providers. Second, quarterly disclosures are far more common for disclosures of the investment portfolio and returns, but annual disclosures are about equally common for service fees. There were also several responses that were enlightening regarding knowledge of disclosure processes. Four plans administered by insurance companies responded that their disclosures were "Daily [because]—information [is] available on the website." These plans rely on participants to seek out disclosure information on plan and/or provider websites. One plan responded to the service fee disclosure questions with only a question mark (?) indicating that they either did not know about this process or did not know that they should disclose fees. Two other plans put marks of "X" or "Yes" in all of the areas indicating that they had disclosure but were not aware of the frequency.

Mandatory Plans versus Optional Plans

Mandatory plans and optional plans may be administered using different practices. In our sample, there are 33 mandatory plans[5] and 25 optional plans. The other plans (23) did not indicate whether their plans are mandatory or optional. According to the sample, mandatory plans are more likely to use external consultants as their plan administrators than optional plans. In comparison, optional plans tend to use external insurance companies as plan administrators. Table 6 presents the comparison of mandatory plans and optional plans from various aspects. There is no significant difference between optional plans and mandatory plans in the frequency of use of consultants to select service providers. Optional plans have lower contribution rates from either the employee or the employer. Many optional plans allow employees to put a certain percent of their payrolls in the DC plan, while employers provide a small amount of match if employees meet certain qualifications. Mandatory plans have slightly lower investment expense ratio (0.73 percent) than optional plans (0.96 percent), but the administrative expense ratio is higher for mandatory plans (0.90 percent) than the ratio for optional plans (0.62 percent).

5. These plans include multiple plans in one government.

TABLE 6
Mandatory Plans Versus Optional Plans (Valid Responses: 58 Plans, 72 Percent of the Total Respondents)

	Number of plans	Percentage of consultant use (5)	Average contribution rate (%)	Investment expense (median) (%)	Administrative expense (median) (%)
Mandatory plans	33	47	Employee—4.89 Employer—6	0.73	0.90
Optional plans	25	50	Employee—2.98 Employer—3.79	0.96	0.62

However, because many plans did not respond to the fee questions, and some plans do not know their fee levels, the medians of the expense ratios may not reflect the general difference.

Survey Results Summary

Most of the responding cities in Nebraska do not offer pension plans at all. Those that do are much more likely to use DC plans rather than DB plans. These plans are administered in a variety of ways, and about half use consultants to select service providers. Default investment options and asset allocation depend largely on the type of plan administrator. Disclosure and education are largely delegated to the service providers. Overall, there appears to be some lack of knowledge and systematic review of the plans, particularly relating to fees and investment performance; many respondents feel that monitoring is the role of the individual participants. This may explain why changes of service providers are very infrequent, and the amount of fees paid varies substantially. Mandatory plans and optional plans do not have significant differences in plan administration, although optional plans allow lower contribution rates.

CASE STUDIES

Six local governments were selected for more in-depth study, to represent variations in population, plan types, and plan administration (see Table 7). One is a county government and the other five are cities. The governments will be referred to as Sites 1–6, to maintain anonymity. Sites 1–3 are small cities, while Sites 4–6 are medium-sized cities/counties. All have at least one DC plan, and three also have DB plans.

Plan Administration: Role of the Plan Sponsor

Three views were expressed regarding the government's role in DC plan management. The first, held by Site 3, is that government should be fully involved in monitoring performance and

TABLE 7
Governments and Plan Type

Sites	Interviewee	Jurisdiction	Plan type
Site 1	Finance Director	City	Mandatory DC plans for the city administrator, civilian employees, and police and fire employees (EE: 6%, ER: 6%) Optional deferred compensation plan
Site 2	Finance Director	City	Mandatory police DC plan (ER: 6%, EE: 6%) Mandatory fire DC plan (EE: 6.5%, ER: 13%) Optional deferred compensation plan
Site 3	Finance Director	City	Optional civilian DC plan (EE: 6–10%, ER: 6%) Mandatory fire DC plan (EE: 6.5%, ER: 13%) Optional police hybrid plan (EE: 6%, ER: 6%)
Site 4	Personnel Department Manager	City	DB plan for police and fire DC plan for civilian employees (EE: 6%, ER: 3%, mandatory after 5 years of service or age 40)
Site 5	Fiscal Administrator	County	DB plan Optional deferred compensation plan
Site 6	Finance Director	City	Two DB plans (civilian, police, and fire) Optional deferred compensation plan

Note: EE, employee contribution rate; ER employer contribution rate.

helping participants manage their accounts. Site 3 has a pension committee that oversees the DC plan. The finance director stated that: "These people in the committee are committed to really take the fiduciary responsibilities and they feel it is important to keep track of it [the performance report]."

The second view, held by Site 5, considers the government role to be limited to design of the framework and general oversight of service providers for their 457 deferred compensation plan. This is done primarily by finance department staff. The finance director noted that: "We kind of look at it like the fiduciary duty to serve employees […] we run the oversight to make sure it is running OK […] We have a plan document that is approved by the county board by resolution. That lays the framework. Otherwise the account runs on its own."

The third view, held by the other four sites, sees a very limited role for government. Under this scenario, governments believe that once service providers are selected, participants should manage their own accounts and interact with service providers directly. For example: "I am not administering anything." (Site 1); "Once the money is in that plan, every dollar is theirs [participants'], so they are investing at their own risk." (Site 2); "It is their [participants'] job to monitor and make sure everything is doing what it says it will do…there is no way we could give them advice. So we are out of that." (Site 4); and "We don't do anything with the plans. The only thing we do is if they choose to participate, we will hold their money and remit it to [the providers]…." (Site 6). These sites have a mix of mandatory and optional plans, and two have both DB and DC plans, while two have only DC plans.

Provider Selection

Interviewees indicated that RFPs, analysis of proposals, presentations, and interviews are commonly used in the selection process, which is similar to the approach suggested in the best practice literature. Plan administrators also learn from their peers, and they include consultants and participants in the process. Site 3 has recently gone through a selection process, and Site 1 re-selected their service provider 9 years ago. The other four sites have used the current providers for a relatively long time.

Site 3 used an RFP developed by the pension committee. A consultant also assisted in the search, process design, and analysis. The Site 3 administrator stated: "The consultant was used to structure the process to make sure that we were interpreting the proposals correctly. Because the consultant knows where to go to find the answers to our questions in case they are not quite clear […] In some cases, they would give their opinions to the committee, but they didn't have a vote." There is some debate about whether to include employees' opinions in the process. Site 3 did so, but the plan administrator in Site 1 believes that employee opinions are not useful: "The employees don't see the service side as much as we did. Some of the problems we see. So we think we are pushing for the change."

Site 3 changed service providers recently because participants were not satisfied with their investment returns, felt that providers failed to warn people about the recent recession, and thought the fee level was too high. On the other hand, Site 4 has kept their provider for a long time, despite some concerns about fee levels: "I think they are probably a little high, but we have been with them so long. I look at other companies, and I would guess they are a little high. We got a lot of internal complaints about the fees."

Monitoring Service Providers

Interview results show that all the governments receive performance reports. However, governments review these reports with different levels of attention. We found three distinctive levels of service provider monitoring, with those with fewer investment options playing a more active role in reviewing performance (see Table 8).

In Site 3, the retirement committee meets monthly to review reports, analyze the performance of each investment fund and push for changes when necessary. Consultants train the committee members to help them evaluate the reports. The service provider offers about 20 investment options, the fewest number among the six cases. This government is highly involved in monitoring the DC plan.

In Site 5, the government establishes the framework for investment. After that, the government officials just generally look at the monthly reports and approve changes to the investment options menu suggested by the service providers. The two government officials who

TABLE 8
Role of Government, Number of Options, and Monitoring Methods

Interview sites	Role of the government	Number of options	Monitoring service providers
Site 3	Fully involved and play central role	20	Monthly review reports, analyze performance, and push for changes
Site 5	Design the framework and oversee the process	30–40	Regularly look at the report and review major changes
Sites 1, 2, 4, 6	Limited role	50–100	Yearly or less, non-regular

are responsible for managing the DC plan do not have time to regularly review each investment option and track performance.

In the other four sites, where investment options range from 50 to 100, managers do not review performance reports, or do so rarely. Reports are provided directly to participants, and officials view it as the participants' responsibility to monitor performance. For example, one comment about reports was: "I don't evaluate them at all. Whether I should or not I have no idea. I feel that this is a voluntary contribution and each individual is responsible and they should monitor their own investment."

There is no obvious monitoring difference in our case study sites between mandatory plans and optional plans. Sites 5 and 6 both provide primary DB plans with optional 457 DC plans, but they have different monitoring practices. Sites 1, 2, and 3 all have mandatory DC plans, but only administrators in Site 3 are fully involved in monitoring service providers.

Education and Communication

Financial education and advice for participants are provided by the service providers. In Site 4, representatives from the company come to the government offices once or twice a month to talk to employees. In Sites 1 and 2, the representatives meet with new employees and provide onside educational programs from time to time, and employees can call the representative to schedule meetings. The Site 5 interviewee noted that representatives are always available and sometimes they even meet participants at their homes. In all six governments, the service providers offer contact numbers, websites, and booklets as information and educational sources for the participants.

The system of relying on service providers to offer financial education has both strengths and weaknesses. Providers are more familiar with investment options and performance, but reliance on the provider may not be adequate to uncover issues. Site 4 has considered hiring a consultant to provide financial education, but is concerned that a consultant may have their own biases and preferences.

Life-cycle funds and target-date funds are also provided to facilitate employees' investment decisions. Allocation categories in Site 3 are based on participant age. In Site 1, pie charts are used to demonstrate investment compositions based on a participant's risk tolerance. Site 4 has five to six life funds based on retirement date. Site 3's new service provider provides investment advice based on employees' answers to a questionnaire, which is more active and comprehensive than relying solely on age and risk factors.

Performance reports and account information are delivered periodically by service providers to participants via websites and/or mail. Interviewees expressed some dissatisfaction about service provider reports. The Site 3 interviewee said that the quarterly report "better be informative, easy to understand, and should be enough." The Site 4 interviewee complained that the reports make it hard for the investor to figure out the investment returns and the fee level.

Case Studies Summary

The interviewees in these six governments vary in their opinions regarding their role, and in management of their DC plans. Some see their role to be very limited, and rely on participants to monitor the performance of service providers. Others believe that the government has a responsibility to be actively involved in plan design and monitoring. Some regularly review performance and make changes in investment options, while others conduct little review and have maintained the same service providers for long periods without looking at alternatives. The range of investment options available to participants also varies widely across these jurisdictions, from 20 to 100. Service providers also play an important role in providing financial education and performance reports to participants. The service provider's representative appears to be a key actor in the perception of service; when asked about the quality of service providers, interview responses usually described relationships to the individual representative.

These officials do not appear to be fully aware of potential issues. For example, some were unable to answer questions related to plan fees or investment performance. Site 3 expressed concern with a service provider, but the provider was used for over 10 years before the government realized the fee level was much higher than their peers. Site 4 believes that their fees are probably high and provider performance reports are poor, but they have not taken steps to solicit possible new providers.

CONCLUSIONS

Survey and interview results give an overview of DC plan management in Nebraska local governments. Many governments in our sample have one or more DC plans as the primary or secondary retirement plan for their employees. Most of these plans are administered by third-party service providers, who offer investment options for participants, submit reports, and educate new employees. Within the governments, finance officers, human resource officers, or pension boards design the framework of the plans, discuss and approve major issues, select the service providers, and monitor the operation of the plan. We found that governments use different ways to select and monitor the service providers, as well as to educate and provide information to plan participants. Table 9 compares the best practices identified in the literature to actual practice from our findings.

TABLE 9
Best Practices Versus Actual Practices

	Selecting service providers	Monitoring service providers	Investment options	Providing financial education	Communicating with participants
Best practice	Competitive bidding; use of consultants; involvement of participants' opinions	Quarterly reporting and continuous monitoring; government sponsors should monitor the service provider and make changes as necessary	A broad spectrum of investment choices with several passively managed options	Using multiple education tools; education should include a broad range of topics	Regularly disclosing plan information; hearing about participants' complaints
Actual practice in Nebraska	Competitive bidding is used in some plans; half of the plans use consultants; debates about whether to involve participants; providers are rarely changed	Service providers directly give reports to the participants; governments rarely look at the reports; governments are not aware of fee levels	20 to more than 100 investment options; target-date funds are provided; lack of international diversification; pattern of asset allocation is related to the type of administrator	Multiple education tools are used; education provided by reps from service providers	Information is disclosed regularly to participants; not enough channels to learn about participants' opinions

Practices are largely aligned in selecting service providers, although our findings show that consultants and participants' opinions were included to differing degrees. However, service providers are rarely changed in these DC plans. This could mean that performance is good, or else that officials are not aware of problems. When changes are made, it is due to unfavorable investment performance, limited investment options, lack of participants' education, high expenses, and/or participants' preferences. One-half of the survey respondents use consultants for service provider selection.

Not all governments appear to monitor service providers effectively. Many plans have no systematic process to review performance, but instead expect participants to track performance. According to the literature, this is not ideal because individual participants often lack sufficient knowledge to detect problems. Also, governments may not be fulfilling their fiduciary duty to act in the best interests of the employees. For example, many respondents were not aware of the fee levels and fee structures of their DC plans. This may lead to lower investment performance.

Investment options and asset allocation vary widely. Target date funds are often provided as an option for participants to simplify investment decisions. The survey results show that guaranteed funds, annuities, and money market funds are provided as default options. There is limited diversification of assets. One key finding is that the type of plan administrator appears to have an important effect on the options available. For example, a local insurance provider is likely to use insurance products.

Our results show that a variety of sources are used to provide participants with investment advice and education. However, governments largely rely on the service providers for these activities. Independent education sources are rarely used. According to the literature, this may not be sufficient. In addition, we found that there are limited channels to solicit participants' opinions about the services.

Multiple educational sources are used, but education is provided by the representatives from the service providers, which may be limited or biased. Finally, there is a regular disclosure of information, but there appear to be few opportunities for government sponsors to obtain feedback from participants about plan services.

Comparing mandatory plans with optional plans, we did not find significant difference between these two types of plans in terms of plan management and fee levels. However, we found that mandatory plans usually have higher contribution rates than optional plans.

These findings have implications for future study and practice of public DC plan management. Our study found that many governments are not clear about their roles in this area. We found three views about the government's role, but there are no clear criteria to decide which view is appropriate. Because the Employee Retirement Income Security Act does not apply to the public sector, the fiduciary duties in public DC plan management are not well defined. Plan administrators' time and effort spent on DC plan management vary among different organizations and different individuals, which can lead to potential problems.

This study did not evaluate plan performance comparing to relative benchmarks. Ours is an exploratory research study seeking to identify variations in the practice of DC plan management. We are also interested in how local officials perceive their roles in plan management. This study found that the actual practices in DC plans were not aligned with the best practices in certain aspects. We also found that administrators have different perspectives toward their roles in plan management. Future research could examine whether this deviation from the best practice, or the different patterns in plan management, would lead to different plan performance. For example, best practice suggests that the selection of service providers should be based on their qualification and the quality of service. By contrast, we found that DC plans in Nebraska tend to use local providers. Future research needs to examine these plans more in-depth about their fees, performance, and investment options.

In DC plans, participants are taking the risks and responsibilities in choosing investment options and managing the plan. Therefore, participants' knowledge and behaviors are also important for the performance of the plan. Our study did not address the perspective of the participants. We did find that many officials thought participants should take more responsibility to manage their own DC plans. Future studies could examine how successfully participants manage pension plans by themselves.

Most counties and school district employees in Nebraska participate in state-managed systems (either DC, cash balance, or DB plans). In contrast, municipalities are responsible for their own plans. This decentralization in plan management leads to a variety of different practices in local governments. Comparisons of options, participant decision making, and performance of the state-managed DC plans to the municipal plans could help in determining benefits and disadvantages to the current decentralization. Given some of our findings, particularly relating to the knowledge of the plan administrators, it may be more beneficial for states to manage DC plans for all local governments, particularly small ones that have limited resources and expertise in this area.

As state and local pension systems are considering adding more DC features to their current pension plans, this study suggests that there are some managerial issues to be considered. We suggest that plan administrators should be aware of the best practice in plan management. Additional study of existing practices, beyond this exploratory study in one state, is needed. Efforts should be expanded to train local government officials regarding best practices, and ways in which they can improve oversight of their DC plans.

ACKNOWLEDGMENTS

This research was funded through a grant from the University of Nebraska Foundation.

REFERENCES

Barr, Colin. 2009. "Pension Tension on the Rise: Underfunded Retirement Plans Are Shaping Up as Headache for Companies and Taxpayers alike." *CNN Money*, December 10.

Benartzi, Shlomo and Richard H. Thaler. 2001. "Naive Diversification Strategies in Defined Contribution Saving Plans." *American Economic Review.* 91 (1): 79–98.

Bonafede, Julia K., Steven J. Foresti, and Alexander Browning. 2009. *Wilshire Report on State Retirement Systems: Funding Levels and Asset Allocation*. Santa Monica, CA: Wilshire Consulting.

Cranch, Laurence E. and Danial A. Notto. 2008. "Evolving Fiduciary Duty Standards for Defined Contribution Plan Sponsors: The Impact of New Thinking About Employee Participation and Investment Selection." *Journal of Deferred Compensation.* 13 (4): 19–35.

Ferrera, Tess J. 2001. "Procedural Due Diligence in the Selection and Monitoring of Plan Service Providers." *Journal of Pension Benefits: Issues in Administration.* 9 (1): 39.

Fore, Douglas. 2001. "Going Private in the Public Sector: The Transition from Defined Benefit to Defined Contribution Pension Plans." In *Pension in the Public Sector*, edited by Olivia S. Mitchell and Edwin C. Hustead, 267–287. Philadelphia, PA: University of Pennsylvania Press.

Government Accountability Office, GAO. 2009. "Retirement Savings: Better Information and Sponsor Guidance Could Improve Oversight and Reduce Fees for Participants." Accessed June 3, 2013. http://www.gao.gov/new.items/d09641.pdf

Government Finance Officers Association, GFOA. 2009. "Best Practice: Asset Allocation Guidance for Defined Contribution Plans." Accessed June 3, 2013. http://www.gfoa.org/index.php?option=com_content&task=view&id=1606

Gordon, Catherine D. and Karin R. LaBarge. 2010. "Investment Committees: Vanguard's View of Best Practices." Accessed June 3, 2013. https://institutional.vanguard.com/iam/pdf/ICRIC.pdf

Hess, David. 2005. "Protecting and Politicizing Public Pension Fund Assets: Empirical Evidence on the Effects of Governance Structures and Practices." *University of California Davis Law Review.* 39: 187–224.

Holland, Joseph H., Doug Goodman, and Bethany Stich. 2008. "Defined Contribution Plans Emerging in the Public Sector: The Manifestation of Defined Contributions and the Effects of Workplace Financial Literacy Education." *Review of Public Personnel Administration.* 28 (4): 367–384.

Kilgour, John G. 2006. "Public Sector Pension Plans: Defined Benefit Versus Defined Contribution." *Compensation & Benefits Review.* 38 (1): 20–28.

Muller, Leslie A. 2003. "Investment Choice in Defined Contribution Plans: The Effects of Retirement Education on Asset Allocation." *Benefits Quarterly.* 19 (2): 76–94.

Munnell, Alicia H., Jean-Pierre Aubry, and Dan Muldoon. 2008a. "The Financial Crisis and State/Local Defined Benefit Plans." *Issues in Brief*. November 2008, Number 8–19. Center for Retirement Research at Boston College. Accessed June 3, 2013. http://crr.bc.edu/wp-content/uploads/2008/11/IB_8-19.pdf

Munnell, Alicia H., Alex Golub-Sass, Kelly Haverstick, Mauricio Soto, and Gregory Wiles. 2008b. "Why Have Some States Introduced Defined Contribution Plans?" *Issues in Brief*. January 2008, Number 3. Center for Retirement Research at Boston College. Accessed June 3, 2013. http://crr.bc.edu/briefs/why-have-some-states-introduced-defined-contribution-plans/

National Association of Government Defined Contribution Administrators, NAGDCA. 2008a. "NAGDCA 2008 Survey of Defined Contribution Plans." Accessed June 3, 2013. http://www.nagdca.org/content.cfm/id/2008_1

———. 2008b. "NAGDCA 2008 Survey of Defined Contribution Plans II." Accessed June 3, 2013. http://www.nagdca.org/content.cfm/id/2008_2

———. 2009. "NAGDCA 2009 Survey of Defined Contribution Plans II." Accessed June 3, 2013. http://www.nagdca.org/content.cfm/id/nagdca_2009_survey_of_defined_contribution_plans/

Nebraska Public Employees Retirement System, NPERS. 2013. "Annual Report to the Legislative Retirement Committee." Accessed June 3, 2013. http://npers.ne.gov/SelfService/public/howto/publications/LegisReports/AnnualReport2013.pdf

Ness, Andrew. 2006. "Preparing and Evaluating a Request for Proposals: How to Select a Vendor." NAGDCA Publication. Accessed June 3, 2013. http://www.nagdca.org/content.cfm/id/preparing_and_evaluating_a_request_for_proposals

Peng, Jun. 2009. *State and Local Pension Fund Management*. Boca Raton, FL: Auerbach Publications.

Plan Sponsor Council of America, PSCA. 2012. "2012 403(b) Plan Survey: Highlights. Accessed June 3, 2013. http://www.psca.org/2012-403b-survey/

Rugh, Jacob. 2003. “Participant Contribution and Asset Allocations During the Recent Bull and Bear Market: Evidence from TIAA-CREF.” *Benefits Quarterly.* 19 (4): 55–67.
SigRist, Kevin W. and Steward L. Brown. 2000. “Design Considerations for Large Public Sector Defined Contribution Plans.” *Financial Services Review.* 9: 197–218.
Snell, Ronald K. 2012. “State Defined Contribution and Hybrid Retirement Plans.” Accessed June 3, 2013. http://www.ncsl.org/issues-research/labor/state-defined-contribution-hybrid-retirement-plans.aspx
Stone, Donald. 2010. “Investment Selection and Monitoring: A Practical Approach to Best Practices.” Accessed June 3, 2013. http://www.401khelpcenter.com/401k/stone_investment_selection.html
The Pew Center on the States. 2010. “The Trillion Dollar Gap: Underfunded State Retirement Systems and the Roads to Reform.” Accessed June 3, 2013. http://www.pewstates.org/research/reports/the-trillion-dollar-gap-85899371867
———. 2012. “The Widening Gap Update.” Accessed June 3, 2013. http://www.pewtrusts.org/our_work_report_detail.aspx?id=85899398866