

PERFORMANCE AUDIT REPORT

Reviewing the Kansas Public Employees' Deferred Compensation Program

Executive Summary

with Conclusions and Recommendations

**A Report to the Legislative Post Audit Committee
By the Legislative Division of Post Audit
State of Kansas
October 1996**



LEGISLATURE OF KANSAS
LEGISLATIVE DIVISION OF POST AUDIT

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To: Members of the Kansas Legislature

This executive summary contains the findings and conclusions from our completed performance audit, *Reviewing the Kansas Public Employees' Deferred Compensation Program*, together with a summary of the report's recommendations and the agency responses.

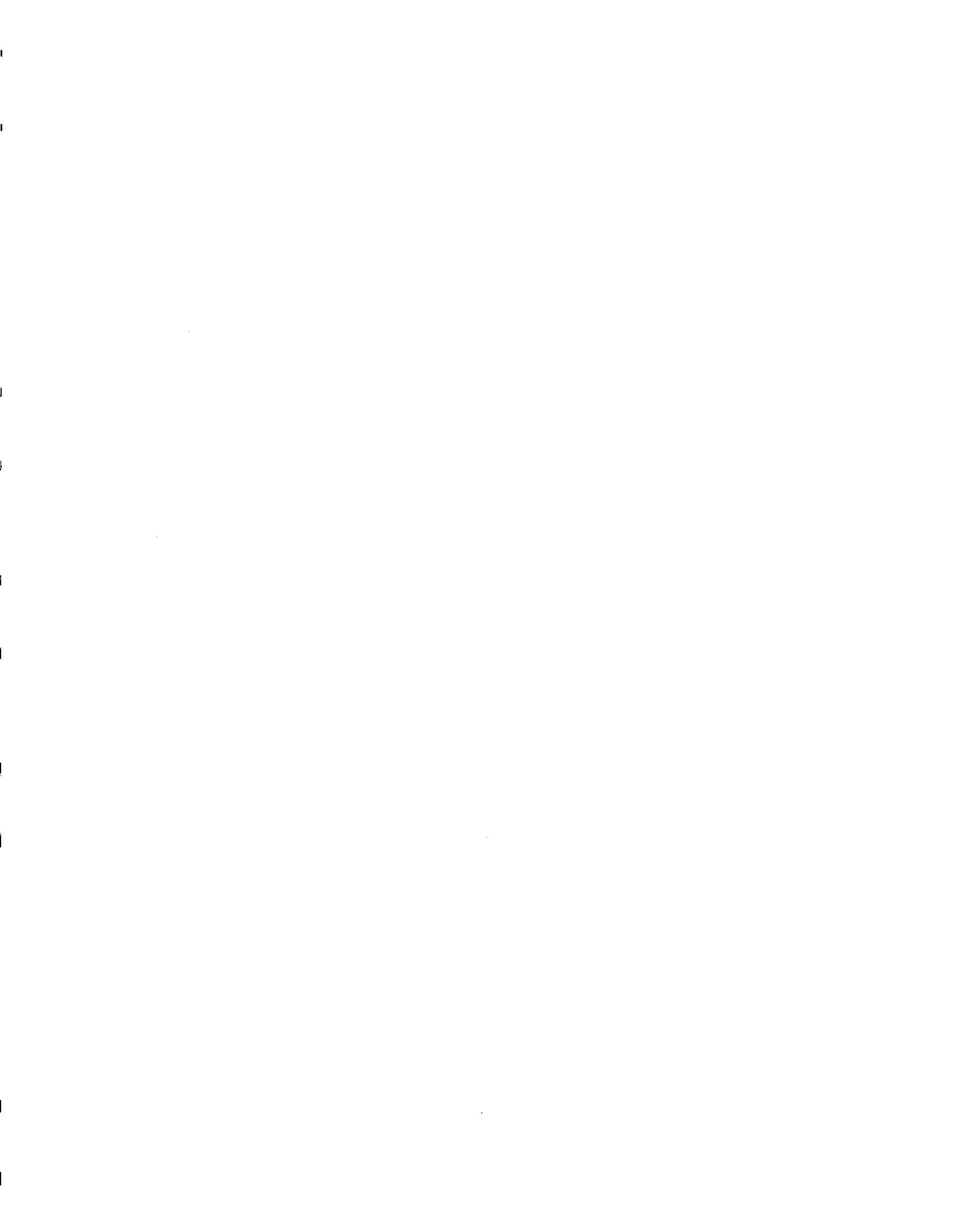
This report shows that the State exercises limited oversight of the Deferred Compensation Program, doing almost no monitoring of Aetna Investment Services. Our reviews showed that customer services were adequate, that investment performance was comparable to the general market, and that costs were comparable to other similar programs we reviewed. State employees we surveyed generally were satisfied with the services provided under the Program, but need more information about the Program's fees, limitations, and requirements. Finally, according to State law, the State isn't liable for any loss incurred by a participant in the Deferred Compensation Program, including losses from insolvency or mismanagement of funds. However, in our opinion, State law is unclear as to whether participants' moneys in fixed-return accounts are covered by the Kansas Life and Health Insurance Guaranty Association if Aetna were to become insolvent.

This report includes recommendations for improving the State's level of oversight of the Program, improving information provided to participants about the Program's fees, restrictions, and limitations, clarifying State law as to whether participants' moneys in the fixed-return accounts are covered by the Guaranty Association, and incorporating new federal legislation into the State's Deferred Compensation Program.

If you would like a copy of the full audit report, please call our office and we will send you one right away. We would be happy to discuss these recommendations or any other items in the report with you at your convenience.

A handwritten signature in black ink that reads "Barbara J. Hinton". The signature is written in a cursive, flowing style.

Barbara J. Hinton
Legislative Post Auditor



**Reviewing the Kansas Public Employees'
Deferred Compensation Program**

**EXECUTIVE SUMMARY
Legislative Division of Post Audit**

**Question 1: Does the State Exercise Sufficient Oversight of The
Deferred Compensation Program To Ensure
That Its Employees Receive Good Quality Services
At a Reasonable Cost**

The State exercises very little oversight of the Deferred Compensation Program. page 10
State law makes the Director of Personnel Services responsible for overseeing the Program. However, we found that the Division provides limited oversight, with essentially no monitoring of Aetna Investment Services in the areas of customer service, investment performance, and Program costs.

Had the State monitored services offered under the Program, it would have found that services offered by Kansas' Program are similar to those offered by nearby states. page 13
Those services included conducting employee informational seminars, processing fund allocation transfers, handling complaints, and the like. We also found that the 30 investment options offered by Kansas' Program compared favorably with the average number of investment options offered by the six nearby states' programs.

Had the State monitored the Program's investment performance, it would have found that performance to be comparable to the general market during fiscal year 1996. page 13
The rates of return earned by the fixed-return funds were comparable to other conservative, lowrisk investments—such as government bonds—for the past fiscal year. The rates of return earned by the Program's variable-return funds also were comparable to those experienced by the market for that same time period.

Had the State monitored the Program's costs, it would have found Kansas' costs were comparable to program costs in other states we reviewed. page 16
The administration fees charged to Kansas employees with moneys in the Program's variable-return funds were lower than the fees of most other states we reviewed. In addition, management fees charged by funds in Kansas' Program compared favorably with similar fees for the other states' programs that provided comparable information. Finally, Kansas participants aren't charged a surrender fee for withdrawing their money when they quit the Program, like some participants in other states are charged.

Question 1 Conclusion: page 18
Kansas hasn't had significant oversight of its Deferred Compensation Program for the past one-and-one-half years, even though this increases the risk that the Program isn't meeting the State's goal of providing a good benefit to employees. We found that the State's Deferred Compensation Program, administered by Aetna, compares favorably in most aspects. Although we think oversight is

important, and that the State should consider re-evaluating its contractual relationship more frequently than once every 15 years, State employees haven't been harmed.

Companies involved in providing investment options for 457 deferred compensation plans appear to be competitive in the number and types of investment options offered. However, the question is whether the State wants to depend solely on market forces to ensure the quality and costs of its Deferred Compensation Program offered to employees.

We think that, with a minimal amount of effort, the Division of Personnel Services could provide the type and level of oversight that would give State officials greater assurance that the Program compares favorably with other such programs, and is meeting the needs and interests of State employees. Types of information State officials receive from these oversight efforts could guide decisions on whether or when to re-bid the contract, or request other changes or information that would benefit State employees.

Question 1 Recommendations: *We made recommendations to ensure that the oversight and administration responsibilities of the Divisions of Personnel Services and Accounts and Reports are clearly defined in statute. We also recommended that the Division of Personnel Services develop basic written policies and procedures regarding the oversight of the Deferred Compensation Program to ensure that the Program is providing good quality services at a reasonable cost. The Department of Administration concurred with our recommendations for written policies and procedures, and stated it's also planning to establish an oversight committee comprised of Department officials who will meet quarterly to oversee the Program and make recommendations.* page 19

Question 2: How Satisfied Are State Employees With The Services Provided Under The Deferred Compensation Program?

Participants generally were satisfied with the customer service aspects of the Program, although they need better information about moving their funds to other taxdeferred accounts. page 21
During this audit, we surveyed a total of 613 current Program participants. In all, 285 people responded (47%). The vast majority of respondents were happy with such things as how their complaints and questions were handled, the information they received about investment choices, and the ease of changing investment options. However, according to survey responses, there appears to be a misunderstanding about whether funds in the Program can be moved to other tax-deferred accounts after the employee quits the Program.

About two-thirds of participants were satisfied with the performance of their investments in the Program. page 22
Although respondents were less satisfied with this aspect of the Program than they were with customer services, this may reflect the performance of the individual investment options they selected. In such cases, the participant has the option of changing his or her investment options, or hoping for better future performance from his or her current chosen options.

About one-third of the participants responding to our survey agreed that Program fees are reasonable for the services provided. page 23
Participants were least satisfied with this aspect of the Program. Only 36% of survey respondents said they thought the fees charged for the Program were reasonable for the services provided.

Question 2 Conclusion: *From the survey responses we received, it appears that the majority of participants in the Kansas Public Employees' Deferred Compensation Program are satisfied with the customer services of the Program. Fewer participants reported that they were happy with the investment performance of their money in the Program. However, they can help resolve that issue by changing the funds in which they place their money.* page 23

Participants reported least satisfaction with the fees being charged by the Program in relation to the services offered. Many reported that they thought they weren't receiving adequate information about the fees associated with the Program. In addition, many participants thought that money in the Program could be moved to other tax-deferred accounts such as an IRA or a 401(k). Money in a 457 deferred compensation plan can't be moved to other tax-deferred accounts. This is a restriction imposed by the Internal Revenue Service. It appears that the State and Aetna need to improve the information provided to employees about fees and restrictions on the money in the Program.

Question 2 Recommendations: *We made recommendations to ensure that State employees participating in the Deferred Compensation Program are aware of the fees and restrictions related to the Program, and that participants are kept informed about the Program and any changes in Program fees or restrictions through ongoing information, either in their quarterly reports or a regular article in the Kansagram. The Department of Administration stated that its oversight committee will work with Aetna to develop more comprehensive and understandable information about fees.* page 24

Question 3: What Liability Does the State Have For Employees' Investments, Should Aetna Default or Mismanage Funds?

The State assumes no liability for losses incurred by Program participants in the event of insolvency or mismanagement of funds. page 25
According to Kansas law, the State isn't responsible for any loss incurred by an employee under the Program. However, we think State law is unclear as to whether participants' moneys in the Program's fixed-return accounts are covered by the Kansas Life and Health Insurance Guaranty Association if Aetna were to become insolvent.

Aetna operates in a highly regulated industry, and the controls now in place to monitor Aetna's overall operations should minimize the likelihood of insolvency or mismanagement. page 27
That monitoring includes reviews of Aetna's separate accounts, investment operations, and broker-dealer activities by such agencies as the Internal Revenue Service, the Securities and Exchange Commission, and the

National Association of Securities Dealers, Inc. Aetna's operations also are reviewed by several rating companies, which assess Aetna's ability to meet its long-term contractual obligations.

As a result of Aetna's internal precautionary measures, participants' money in the Program has some limited protection. page 29
Those measures include selecting investment managers from respected firms, carrying liability coverage on investment managers, and carrying corporate liability insurance for any fraudulent or dishonest acts committed by its officers or employees.

Recent changes in federal law also help protect participants' money from creditors in the event the State would ever become insolvent. page 29
Since the situation in Orange County, California, legislative changes have been made to prohibit access to moneys held in deferred compensation programs from the general creditors of the program sponsor. Beginning September 1996, federal law related to governmental deferred compensation plans required all moneys in such plans to be held in trust for the exclusive benefit of participants and their beneficiaries.

Question 3 Conclusion: *Since the State's Deferred Compensation Program began, thousands of State employees have invested millions of dollars in that Program. Although the Program's participants certainly understand that they may experience investment losses from their participation, they may not be as clear about their risk of other types of losses—from insolvency or mismanagement. Given how the Program is operated, the risk of such losses doesn't appear to be significant. Nevertheless, the State is responsible for evaluating these risks, addressing them where possible, and keeping participants appropriately informed.* page 30

Question 3 Recommendations: *We made recommendations to ensure that the State's Deferred Compensation Program is consistent with changes in federal law regarding governmental 457 deferred compensation plans, and that the Legislature clarify its intent in State law as to whether participants' moneys in the Program's fixed-return accounts are covered by the Kansas Life and Health Insurance Guaranty Association. The Department of Administration agrees that new federal legislation should be incorporated, and reports it will work with Aetna in this area. Representatives from Aetna said they thought State law was clear regarding Guaranty Association coverage for fixed-return accounts, but they agreed the Legislature should act to clarify the law if it thought such clarification were needed.* page 30

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This audit was conducted by Trish Pfannenstiel, Barbara Reed, and Cindy Crawley. If you need any additional information about the audit's findings, please contact Ms. Pfannenstiel at the Division's offices. Our address is: Legislative Division of Post Audit, 800 SW Jackson Street, Suite 1200, Topeka, Kansas 66612. You also may call (913) 296-3792, or contact us via the Internet at: LPA@PostAudit.ksleg.state.ks.us.

