Plan Design Trends in Higher Education

Work on the front allows participants to stop working at the end

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Agenda

- Compensation Model in Higher Education
- Defined Benefit to Defined Contribution Transition Impacts
- Defined Contribution Plan Lifecycle
- Plan Design
  - Young Savers
  - Accumulators
  - Pre-Retirees
- Plan Services
- Investment Structures
- Employee Education Needs
- 5 Steps to Creating a True Retirement Plan

Compensation Model in Higher Education

On average, 75% of the costs to run a college are related to personnel expenses

- A significant portion of that cost is attributable to benefits
  - Retirement
  - Health

Faculty salaries are especially expensive

- Business
- Engineering

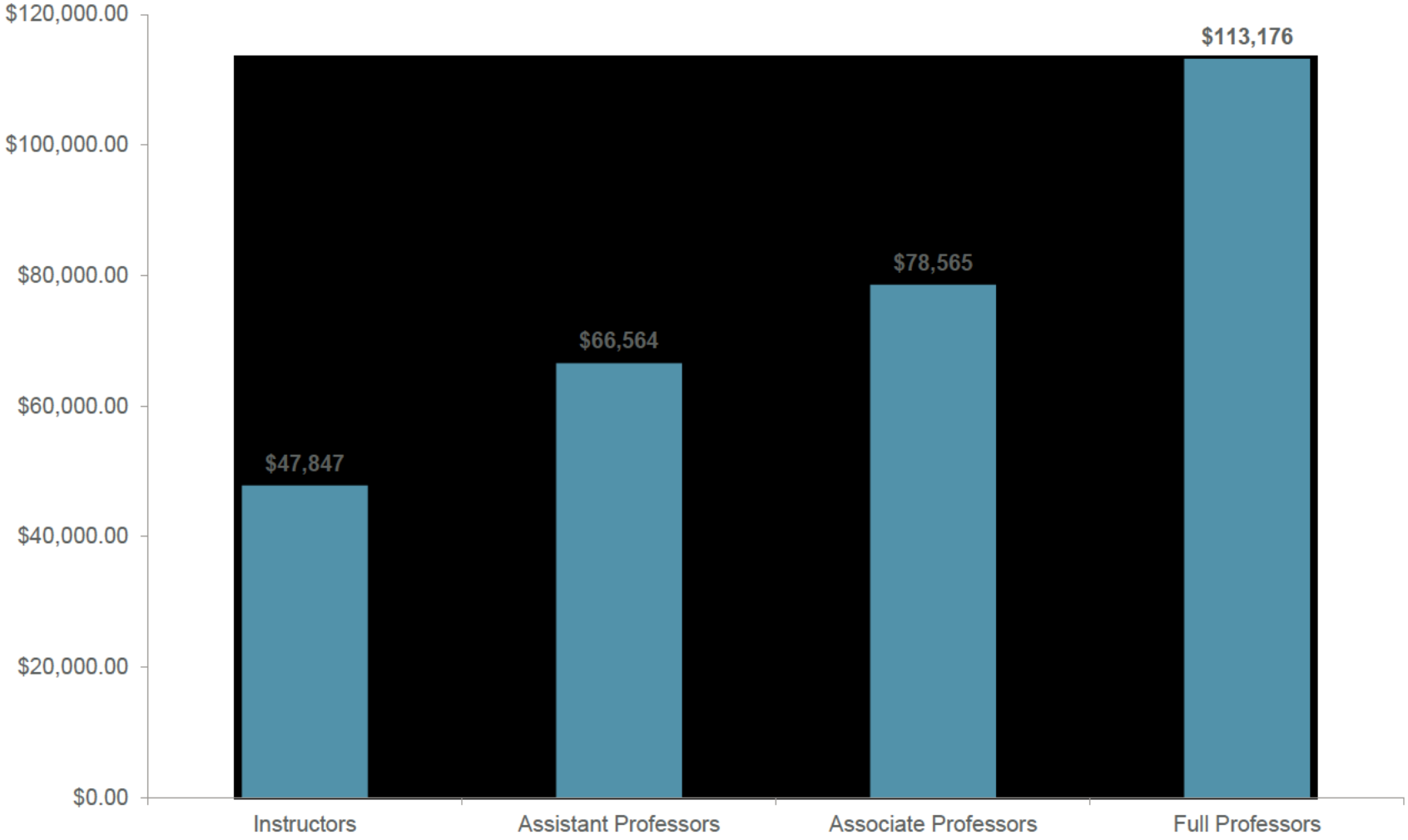
Costs go beyond direct compensation and benefits

- Paid time off for research
- Graduate assistants to support research
- Equipment and facilities to attract talent

Tenure

- Shifting faculty needs
- Increasing labor cost

Compensation Model in Higher Education



The American Association of University Professors. Salaries are adjusted to a nine-month work year. 2011-2012 academic year. Excludes cost of benefits and other non-compensation costs.

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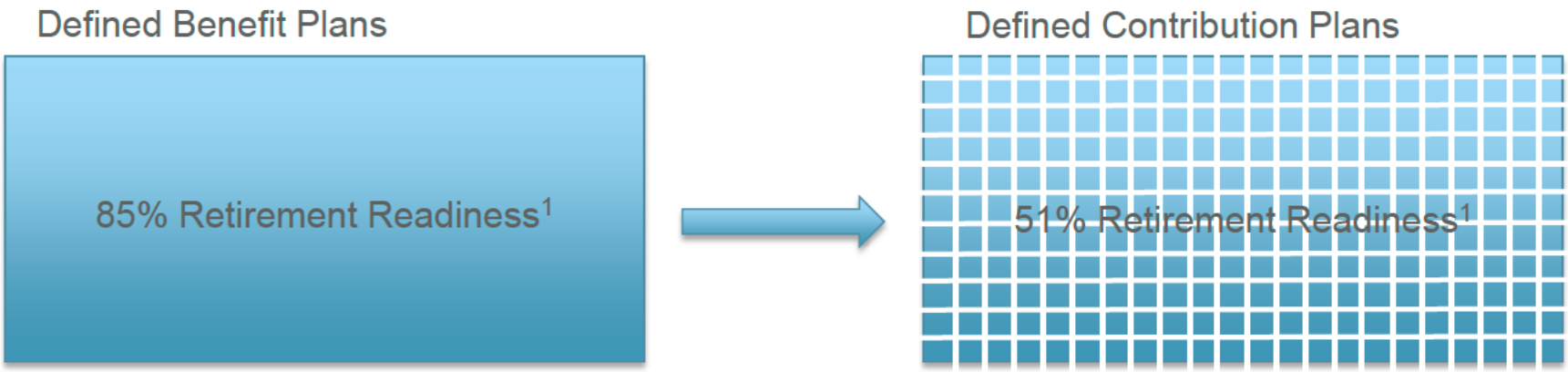
Change in Model for Retirement Savings



Primarily employer funded, with occasional required participant contributions	Funding	Mix of employer and employee contributions
Employer directed	Investment Strategy	Participant directed
Participants determine how much income they need to replace and work to the goal of achieving that level of benefit	Evaluation Metric	Participants focus on generating a sum of assets that will become the source of meeting retirement expenses
High	Plan Sponsor Volatility	Low
Participants are protected against investment and longevity risk	Participant "Safety"	Each participant must individually ensure their retirement preparedness

[1]National Institute on Retirement Security. *Retirement Readiness – What Difference Does a Pension Make?*

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Impact of the Transition

Employees whose primary retirement plan is a DC plan tend to retire one to two years later, than employees covered by a pension plan

Center for Retirement Research, “The Recent Trend Towards Later Retirement,” March 2007

Individuals covered only by a DB plan are 87% more likely to retire in any given year that individuals only covered by a DC plan.

Rui Yao and Eric Park, University of Missouri, “Do Market Returns Affect Retirement Timing?” 2011

A 1% increase in the S&P 500 Index in any given year increases the probability that the pre-retiree will retire by 2.5%

Rui Yao and Eric Park, University of Missouri, “Do Market Returns Affect Retirement Timing?” 2011

Delayed retirements may also increase employers’ healthcare costs. Healthcare costs for a 65-year-old worker are twice those of a worker between the ages of 45 and 54

U.S. Department of Health and Human Services, “National Health Care Expenditure Sheet.” Data as of 2004

The ability to retain young talent is impacted by the prospect of career and professional advancement

Lifecycle of a Defined Contribution Plan

1. Begin the retirement savings process
2. Reward engagement and patience
3. Affirm the commitment to beginning the savings process

1. Demonstrate the progress towards retirement readiness
2. Reduce the impact of leakage on retirement readiness
3. Begin educating on what retirement is

1. Provide extensive access to financial planning and advice
2. Focus on retirement plan as a tool for securing retirement rather than a wealth accumulation instrument
3. Identify opportunities to incent retirement

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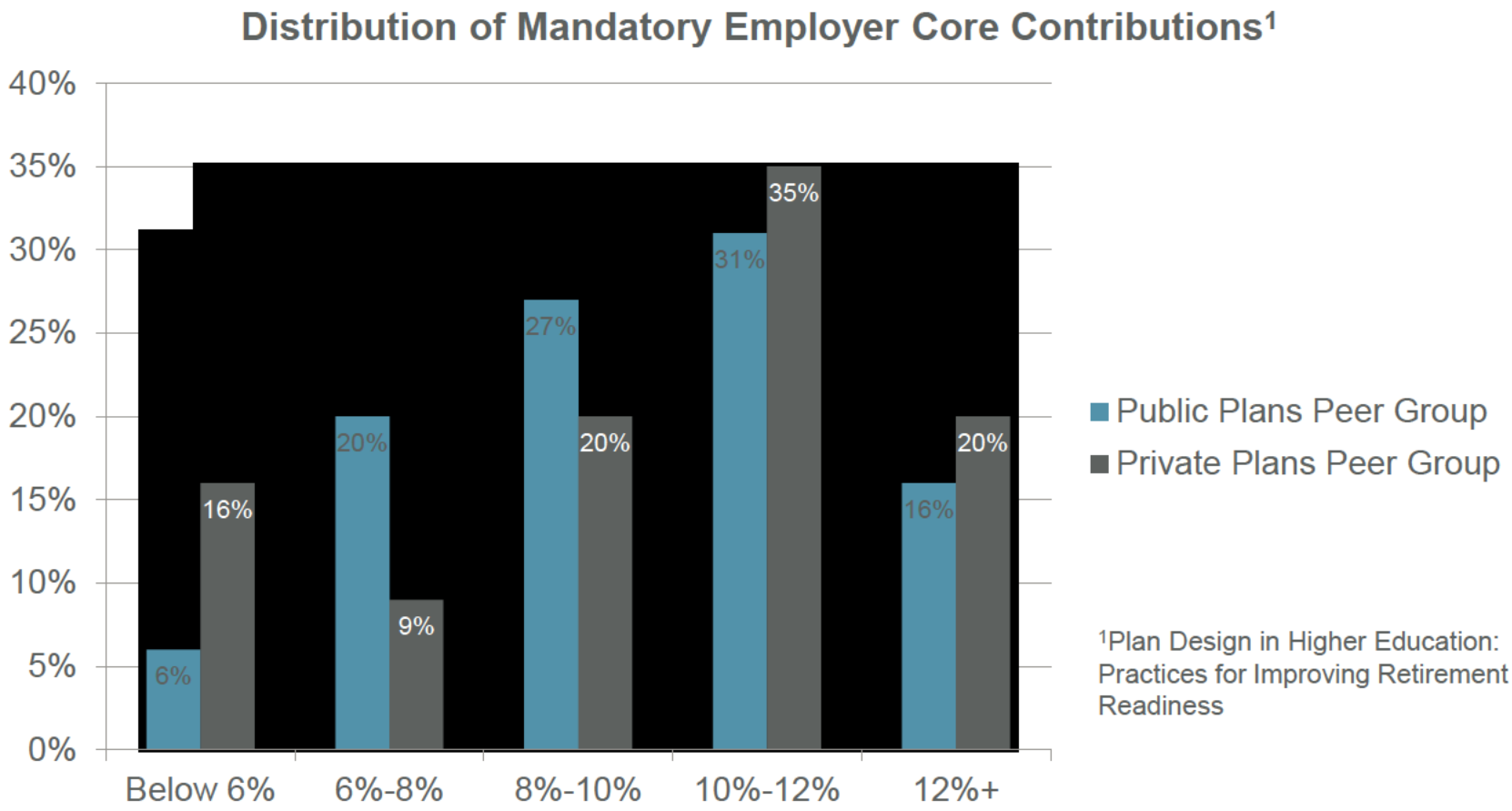
Designing the Best Defined Contribution Plan

Plan Forward

1. Benefit Plan Design
2. Plan Provider Services
3. Participant Education

Benefit Plan Design

Higher education is damaged by their high employer contribution rates to defined contribution plans



[1]Plan Design in Higher Education: Best Practices for Improving Retirement Readiness

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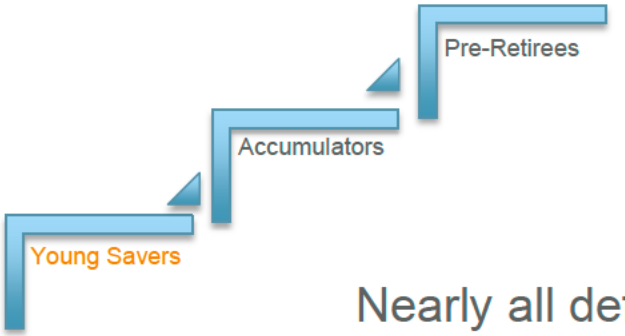
Benefit Plan Design – Young Savers



Nearly all defined contribution plans require an employee to defer salary to derive adequate retirement benefits

- A general rule of thumb is 10-15% total to generate adequate income replacement

1. Employee Mandatory Contributions
2. Automatic Enrollment and Automatic Escalation
3. Adopting a Hybrid Match Formula

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Benefit Plan Design – Young Savers

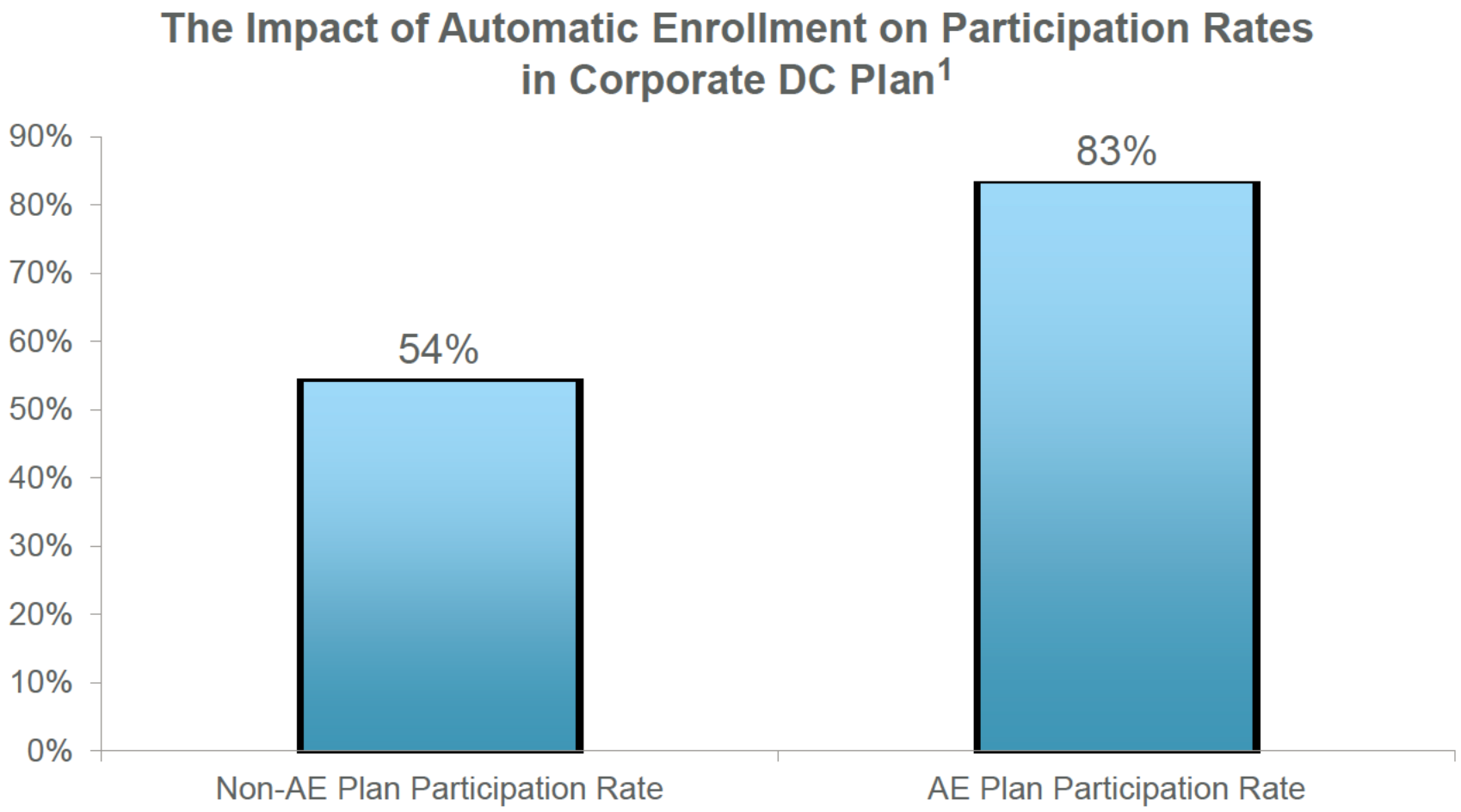
	Employee Mandatory Contributions	Automatic Enrollment and Automatic Escalation	Adopting a Hybrid Match Formula
Pros	100% adoption. Unlike nearly every other option, mandatory means mandatory and all participants (and the sponsor) benefit as a result.	Fundamentally does not change the "contract" between participant and plan sponsor. Plan participants are provided an option to opt-out based on their needs, but many participants elect to automatically enrolled and thereby become participants.	In some instances, a hybrid match formula may reduce the cost of contributions by the sponsor. Participants may be incented to "engage" in their retirement planning process.
Cons	Employees may eventually perceive employee mandatory contributions as an additional employer contribution thereby reducing the perceived value of their compensation verses peers.	While automatic enrollment can be instituted in such a way to address current employees who are not deferring, it is most typical to begin automatic enrollment prospectively thereby reducing its potential impact on current participants.	Impact of the change may not be as significant as the political cost of adopting. Further, the lowest paid employees will likely see their retirement preparedness decline, which may not meet the social justice policies of the sponsor.
Implementation	Very difficult. The perceived compensation takeaway will be considerable for most institutions.	Relatively easy. Employees surveyed generally support the implementation of automatic enrollment, especially when it does not impact them. Older payroll systems can be challenging to customize in a manner supportive of automatic increase and enrollment features.	Difficult. Taking current contributions made by the sponsor and making them contingent is seen as a takeaway; even in instances where the potential contribution grows.

Higher Education Lags Behind Other Industries in Usage of Automated Plan Features[1]

	Automatic Enrollment	Annual Increase Program
Higher Education	<5%	<5%
Not-for-Profit Healthcare	29%	49%
Corporate	22%	76%

[1]Plan Design in Higher Education: Best Practices for Improving Retirement Readiness

Automatic Enrollment Works



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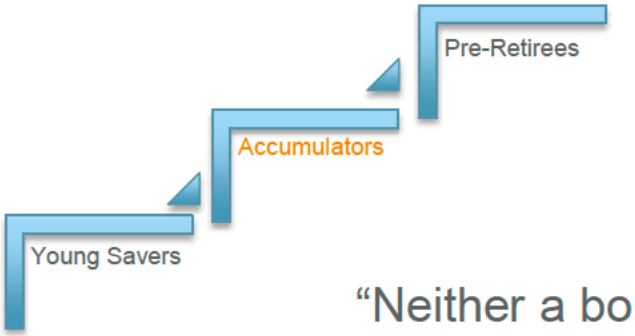
Benefit Plan Design – Accumulators



"Neither a borrower or a lender be"

1. Plan Rollovers
2. Retirement Plan Loans
3. Hardship Withdrawals

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Retirement Leakage

Only 20% of employees who take a lump-sum distribution roll proceeds into a tax-qualified IRA or retirement plan account

GAO

Participants age 35-45 are more likely to borrow – and when they do, are more likely to take the maximum – as compared to their younger and older counterparts

Borrowing from Yourself: The Determinants of 401(k) Loan Patterns

Estimated participant loan default rate from July 2011 – May 2012 was 17.4%

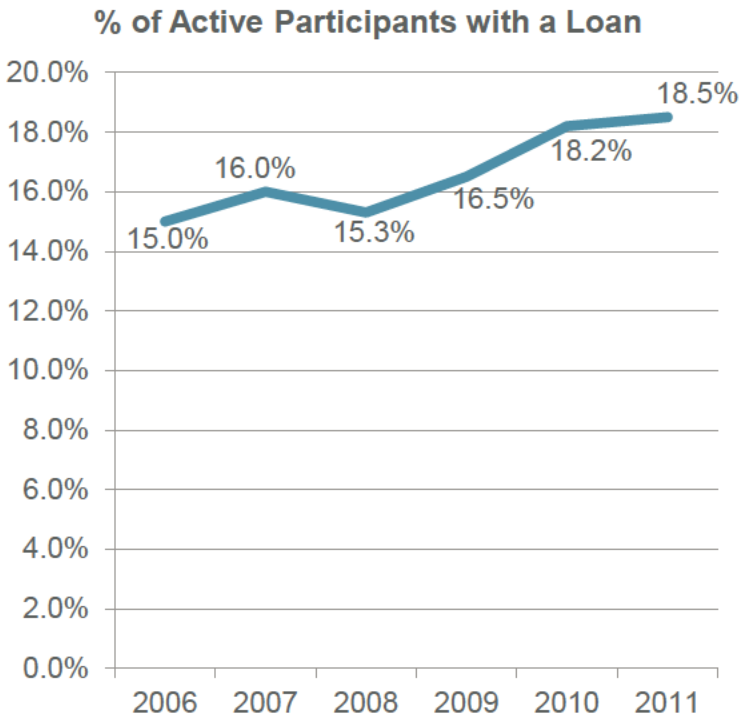
Navigant Economics

Prevailing plan interest rate is tied to Prime (3.25%)

Hardship distributions are much less prevalent (typically less than 2% annually)

Defined Contribution Plan Participants' Activities (2006-11)

	2006	2007	2008	2009	2010	2011
% of Active Participants with a Loan	15.0%	16.0%	15.3%	16.5%	18.2%	18.5%
US Retirement Assets in Defined Contribution Plans ($trillion)	$4.1	$4.4	$3.4	$4.0	$4.5	$4.6



Investment Company Institute, Defined Contribution Plan Participants' Activities 2011, April 2012

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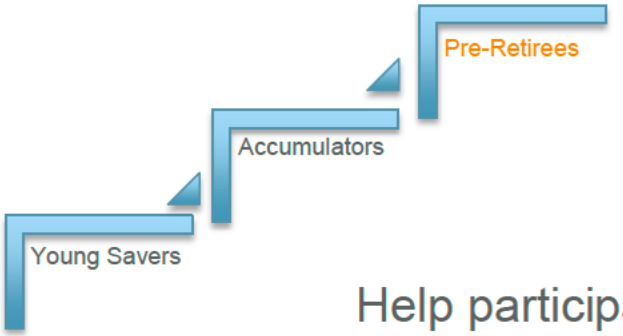
Benefit Plan Design – Pre-Retirees



Help participants keep their eyes on the prize

1. In-service plan distributions
2. Early retirement windows

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In-Service Plan Distributions

Plans routinely provide older employees (59 ½ - 65) the ability to begin taking distributions from their retirement plan

1. Maintain a focus on retirement
2. In-service distributions should ideally be tied to phased retirement programs with committed dates of retirement

403(b) plans are flexible in allowing employers to make post-severance contributions to a retirement plan. Plan sponsors should be judicious with the utilization of these features

1. Early retirement needs to be highly targeted
2. Utilization of early retirement may shape expectations about future availability and alter normal plan behavior

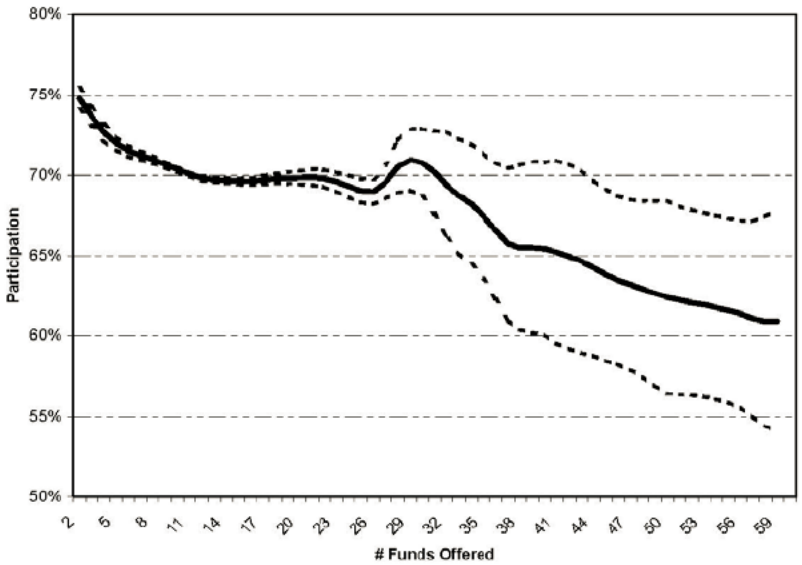
Plan Services

- K.I.S.S. your participants
  - Easy to enroll
  - Easy to allocate
  - Easy to use
- Sophisticates will optimize outcomes in a any plan design

Participant Type	How Participants Self-Identify
Delegators	69%
Do-It-Yourselfers	30%
Self-Directed Sophisticates	1%

Source: J.P. Morgan Retirement Plan Services

Impact of Choice on Participation Rates



Source: Iyengar, Sheena S.; Jiang, Wei; Huberman, Gur "How Much Choice is Too Much?: Contributions to 401(k) Retirement Plans"

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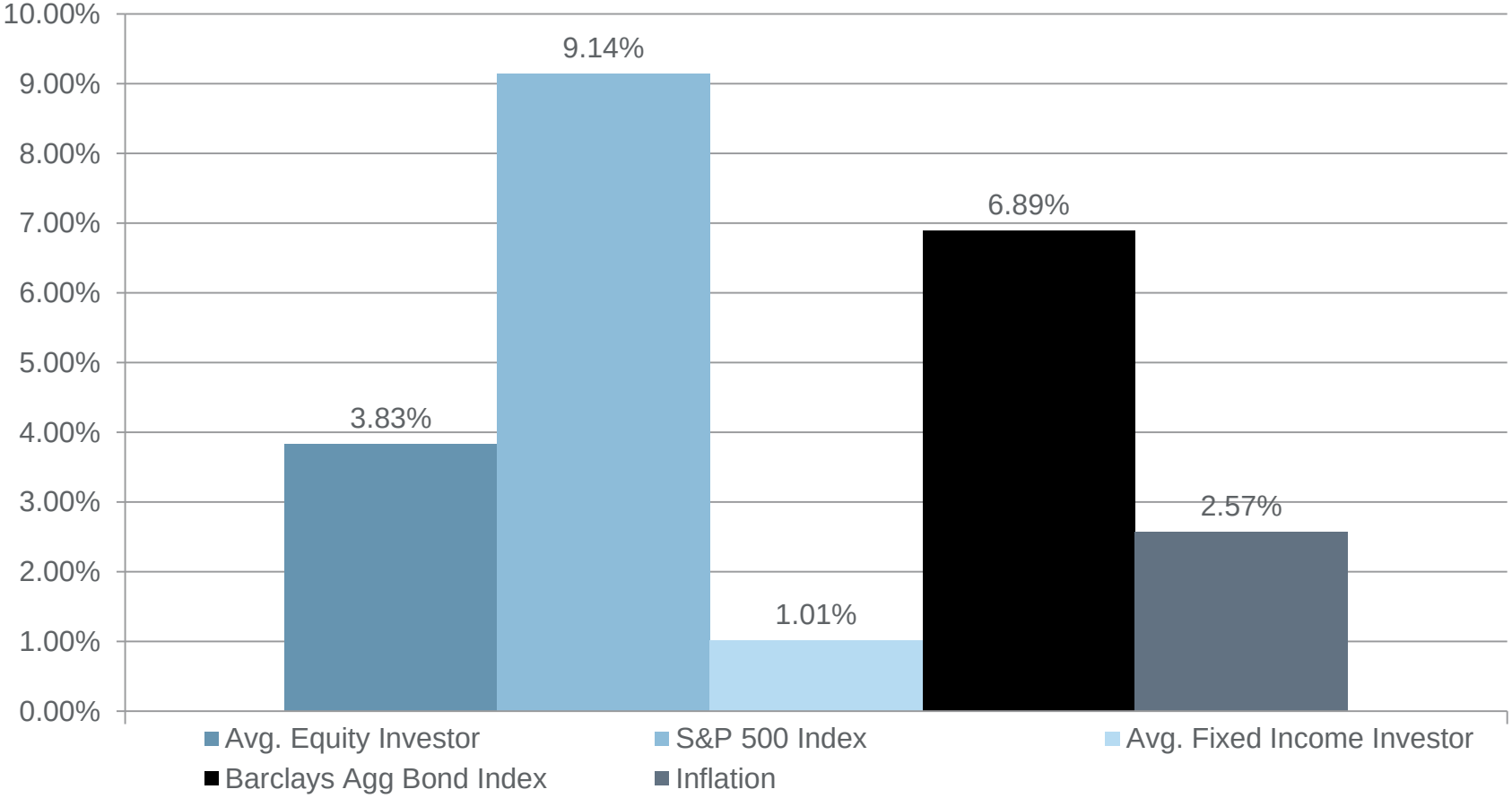
Investors Fail to Track the Market

Annualized Returns for the 20 Years Ended 12/31/2010



Source: Dalbar, Inc. 2011 Quantitative Analysis of Investor Behavior

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“Easy” Investment Structures

	Managed Account	Target Maturity	Target Risk
Structure	Managed account structures typically use an array of underlying products and allocate to them based on information known about the participant. There are a finite number of portfolios a participant may be invested in based on the data known.	Participants are invested in a single fund with a predetermined glidepath that becomes more conservative as a participant nears a specified age (typically 65).	Target risk defaults are typically a single balanced fund that allocates between stocks and bonds in a manner consistent with its prospectus.
Pros	Managed account solutions carry far more known data about a participant, such as wage which has a material impact on investment allocation strategy. Some managed account solutions also allow customization of the analytics to incorporate known data about the population being served, such as turnover.	Provides some customization for participants with only a date-of-birth variable. Typically is a lower cost alternative to other default investment structures.	A balanced fund is the simplest of the default investment structures, a single investment product for any participant who fails to make an election or wishes to delegate investment allocation and monitoring.
Cons	Can be a more expensive total cost of ownership as investment product costs are compounded by a managed account fee.	Age is an important factor in driving asset allocation strategy, but not the exclusive factor. Additionally, target date funds are typically closed solutions.	Target risk solutions invariable provide too much volatility for older works and too little equity exposure for younger workers.

Investment Returns Cannot Fix Savings Problems

5 Year Annualized Returns (Period Ending 12/31/2010)

Percentile	Single Target-Date Fund	Managed Account	All Other Participants
Mean	3.93%	3.65%	3.76%
5th	3.62%	2.20%	-0.02%
25th	3.62%	3.08%	2.66%
50th	3.90%	3.66%	3.80%
75th	3.90%	4.22%	4.64%
95th	4.65%	5.06%	8.09%

Source: Vanguard 2011 "Participants During the Financial Crisis: Total Returns 2005-2010"

Education has Limits

"…policy makers should be very concerned that retirement education does not increase the likelihood that financially vulnerable groups – women, persons without a college degree, and particularly persons with lower incomes – will save their distributions"

U.S. Social Security Administration Office of Policy. *"Does Retirement Education Teach People to Save Pension Distributions?"*

Peer behavior may be as or more impactful on participant savings behavior than employee education

E. Duflo, E. Saez / Journal of Public Economics 85 (2002)

Employee Education Tips

During Enrollment

1. Focus education on financial literacy and savings behaviors
2. Deemphasize the importance of investment selection on retirement plan participation
3. Do not require education as a predecessor to participation
4. Appreciate the importance of peer group behavior and leadership in furthering retirement plan performance

During Accumulation

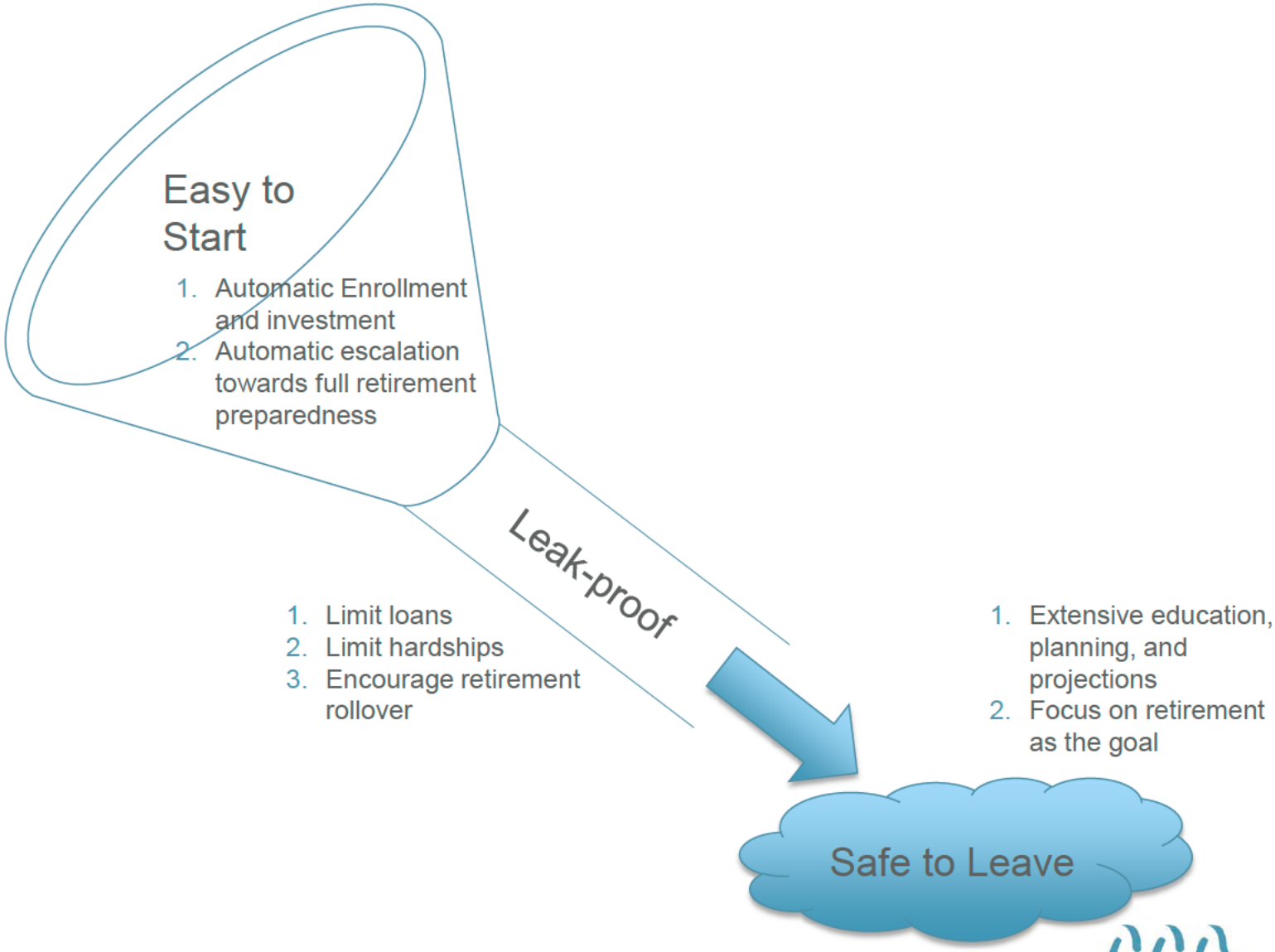
1. Begin educating on external factors on retirement (healthcare, insurance, social security, etc.)
2. Highlight the effectiveness of current behaviors and the culture of savings and participation
3. Provide access to additional personal education resources to validate savings goals and structure

Pre-Retiree Needs

Viewing the participant as a whole

1. Bringing retirement plan projections to a fine point
   - External assets
   - Spousal income
   - Spending needs
   - Healthcare costs/resources
   - Understanding federal and state resources
2. Advice for participants on how to secure and protect accumulated savings
   - Asset allocation
   - Liquidity constraints
   - Comprehensive retirement planning
3. Transitioning accumulations to income
   - Annuity options
   - Income planning

The Optimal Higher Education Plan Design



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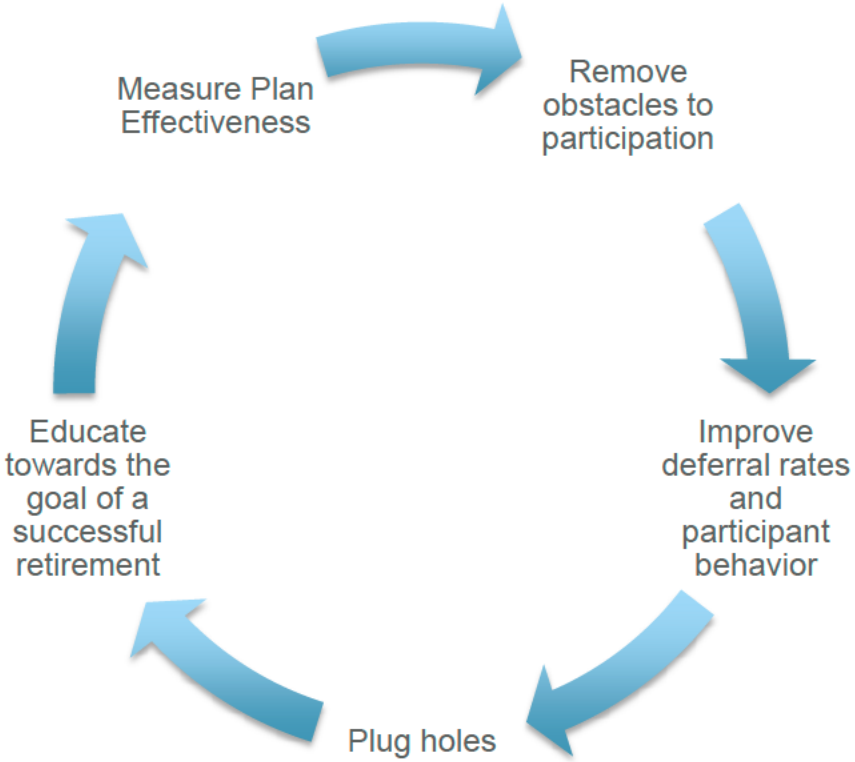
Five Steps to Improving Your Plan and Your Institution

1. Evaluate the Current Retirement Readiness of Your Institution as a Benchmark
2. Determine Obstacles to New Hire Participation
3. Develop Mechanisms to Move New Hires Towards Adequate Income Replacement
4. Plug the Holes
   - Current loan demographics
   - Hardship withdrawal impact
5. Build the Communication Plan to Support the Objective
   - Develop and Education Policy Statement
   - Early emphasis on savings
   - High-touch participant advice and financial planning for pre-retirees



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