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Addressing Retirement Readiness

Making Defined Contribution Plans Work

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Prior to founding the Multnomah Group in 2003, Erik served as a Vice President of Retirement Services and led the Portland, OR practice of a national retirement services firm. In that position Erik was a founding member of the firm's national Investment Committee and had oversight for business development in the western United States.

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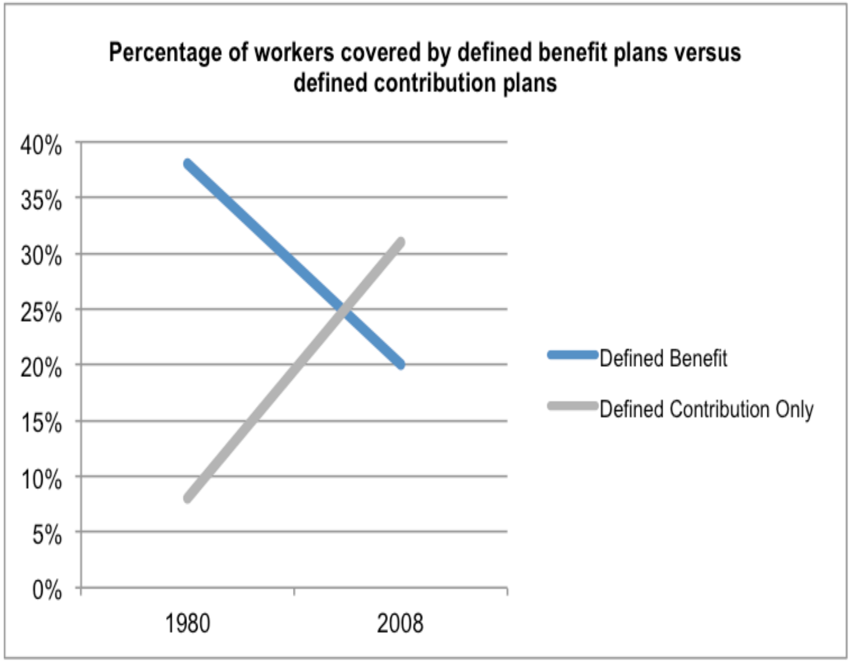
Agenda

- Introduction
- Retirement Readiness
- 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

The World has Changed

- Defined Benefit pension plans are rapidly becoming extinct
  - For-profit
  - 501(c)3
  - Governmental
- Causes
  - Portability
  - Accounting requirements
  - Actuarial standards
  - Funding volatility
- Consequences
  - Risk transfer



Source: U.S. Social Security Administration, Office of Retirement and Disability Policy, "The Disappearing Defined Benefit Pension and its Potential Impact on the Retirement Income of Baby Boomers."

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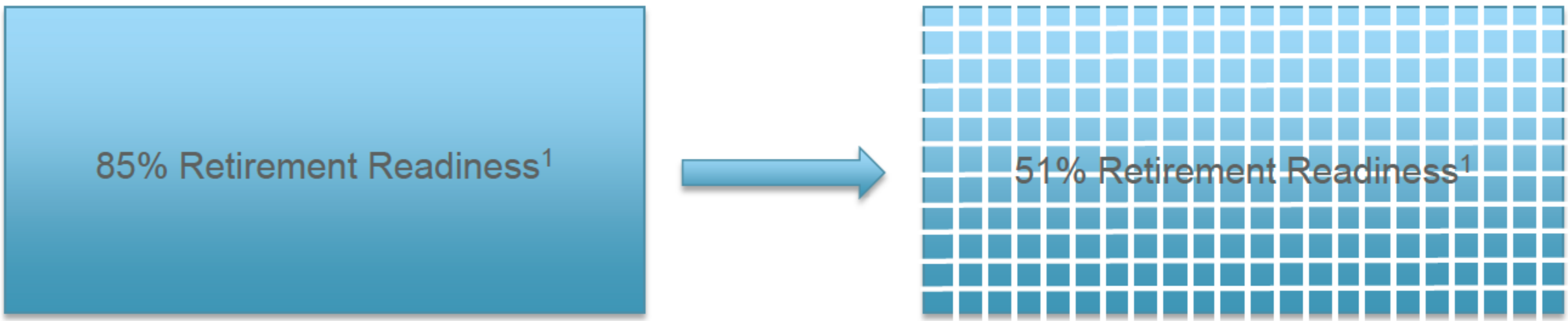
Change in Model for Retirement Savings

Defined Benefit Plans

Defined Contribution Plans



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?*

Retirement Readiness in a Defined Contribution World

	Contribution Rate	Investment Return	Time Horizon	Retirement Income Needs
Participant Approach	Employers determine the contributions they make into participant accounts, but for the vast majority of defined contribution plans, those contributions need to be augmented by employee deferrals and supplemental savings. A participant's supplemental contribution rate is a critical element in the rate of success in retirement savings.	Participants in defined contribution plans select investments that ultimately determine the rate of return achieved on their savings and any contributions made by their employer.	DC plans have very little control over when a participant elects to retire. Plans are structured to permit participants to continue saving on a tax-deferred basis until they elect to retire or are terminated by their employer. Some participants may be incented to continue working past age 70 ½ to avoid IRS Minimum Required Distributions.	The degree to which savers have managed expenses well in their accumulation phase will impact their ability and willingness to retire. Eligibility for health benefits and fixed mortgage costs are significant variables in determining a participants income needs.
Challenge	Current Moment Bias	Gambler's Fallacy	Status Quo Bias	Negativity Bias

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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

By 2020, 20% of the workforce is projected to be 65 and older. The only projected growth in the labor force for 2020 will be in employees 55 and older.

Bureau of Labor Statistics

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

Costs are Real

Workers' compensation claim duration is 25% longer and benefit payments are 56% higher.

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Disability premiums are 15 times higher and disability instances are 42% among workers ages 65 and older.

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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

Retirement Readiness

The state and/or degree of being ready for retirement. Retirement readiness typically refers to being financially prepared for retirement, or the degree to which an individual is on target to meet his or her retirement-income goals so that the standard of living enjoyed while working will be maintained after retirement.

- Viewing defined contribution through the prism of retirement income benefits
- Defined contribution retirement readiness is dramatically impacted by the steps employees have taken prior to their current employment

Lifecycle of a Defined Contribution Plan

Young Savers

- Young
- Lower income
- Direct competition for earned income

Accumulators

- Mid career
- Highly productive
- Financially secure

Pre-Retirees

- Accomplished
- Experienced
- Concluded costs of establishing a family / life

Young Savers

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

Accumulators

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

Pre-Retirees

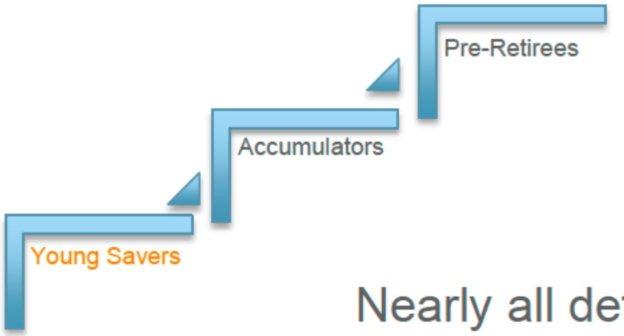
1. Provide extensive access to financial planning and advice
2. Focus on retirement plan as a tool for securing retirement rather than a wealth accumulation instrument
3. Identify opportunities to incent retirement

Designing the Best Defined Contribution Plan

Plan Forward

1. Benefit Plan Design
2. Plan Provider Services
3. Investment Structures
4. Participant Education

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

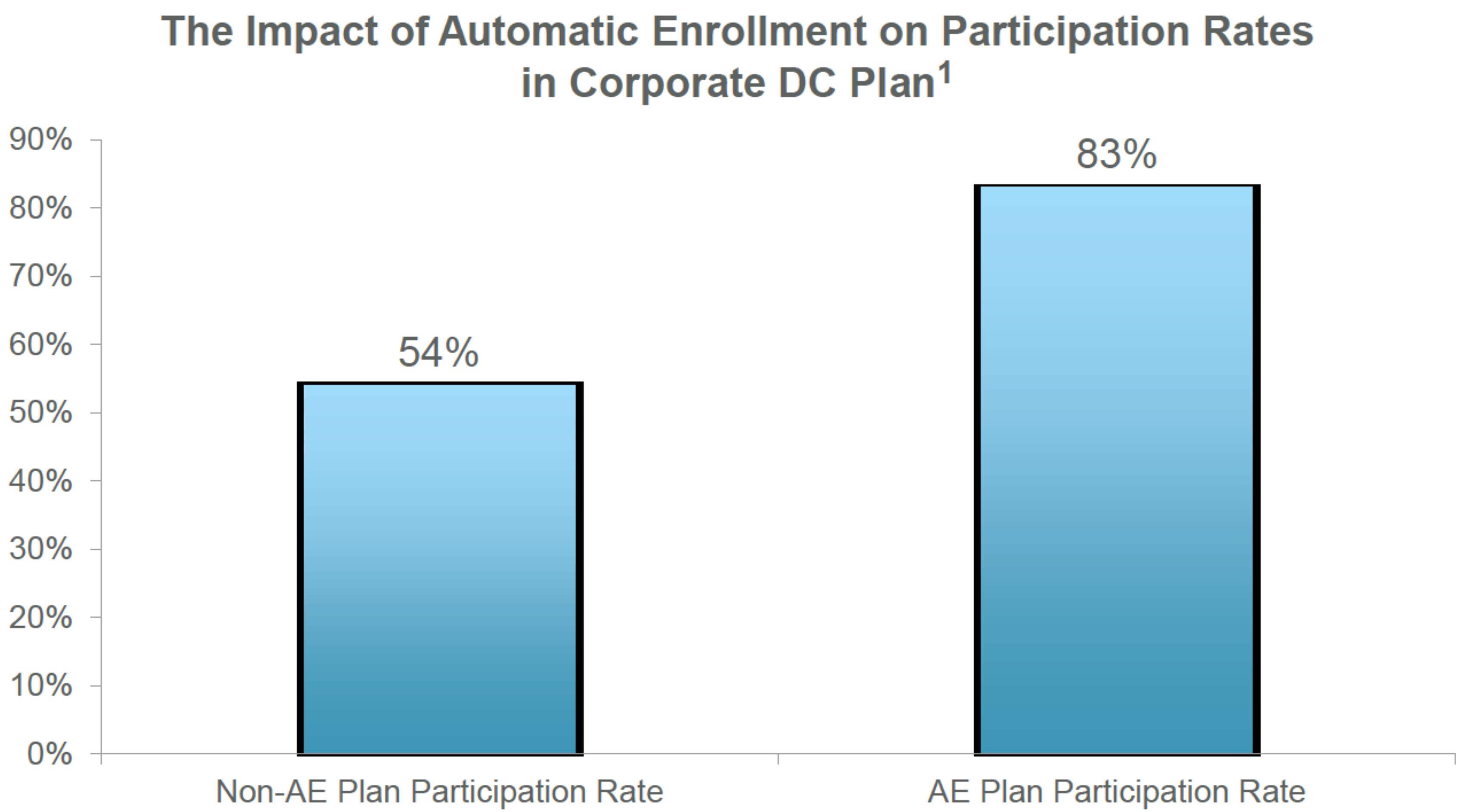
	Automatic Enrollment and Automatic Escalation	Adopting a Hybrid Match Formula
Pros	Fundamentally does not change the “contract” between participant and plan sponsor. Plan participants are provided an option to opt-out based on their needs, but many participants elect to remain automatically enrolled 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	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	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.

Automatic Feature Implementation Frequency

	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



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

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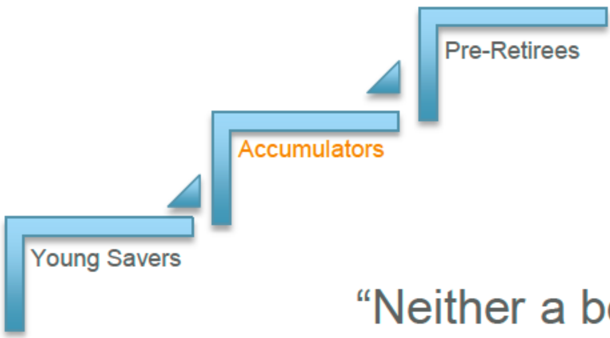
Benefit Plan Design – Accumulators



"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)

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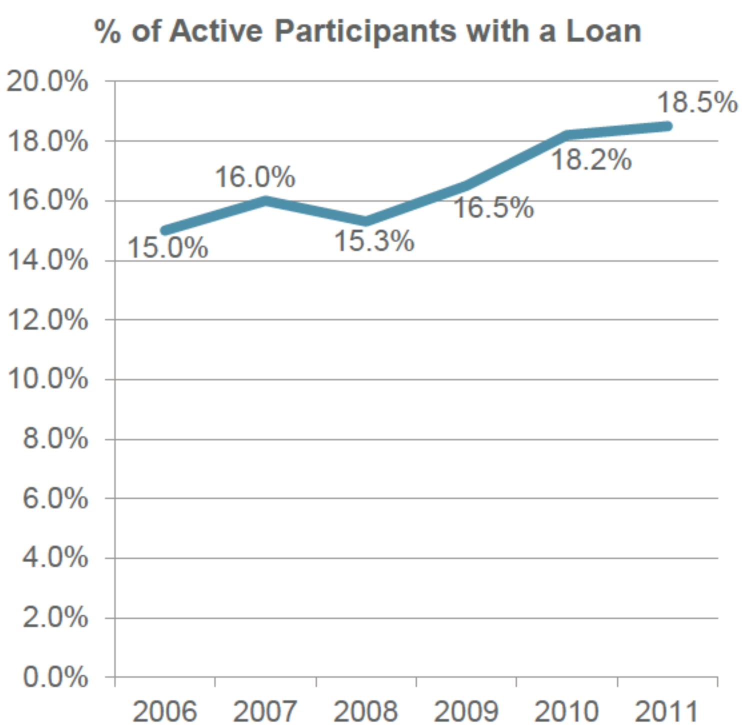
Defined Contribution Plan Participants' Activities

	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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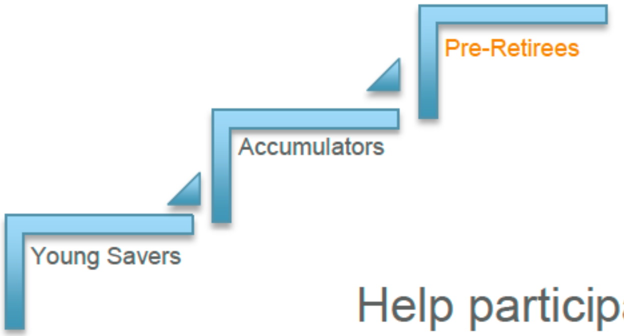
Benefit Plan Design – Pre-Retirees



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

Plan Services

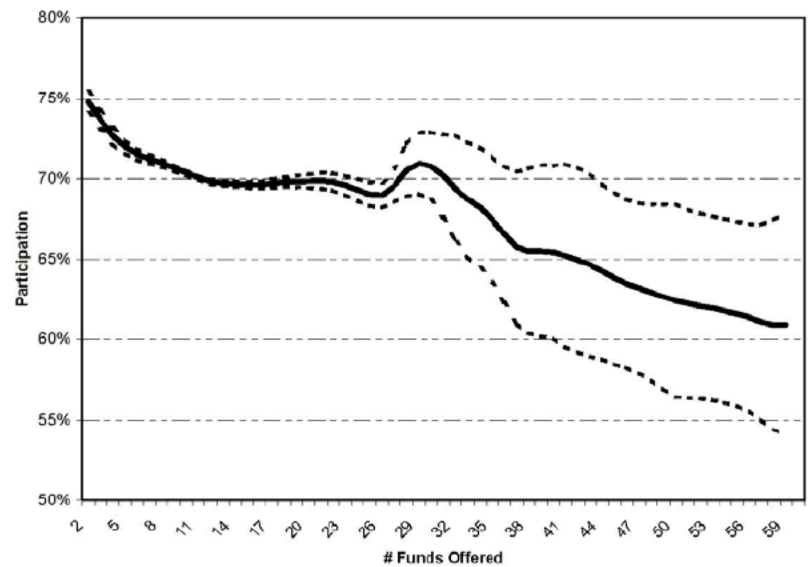
- K.I.S.S. your participants
  - Easy to enroll
  - Easy to allocate
  - Easy to use

- Sophisticates will optimize outcomes in any plan design

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

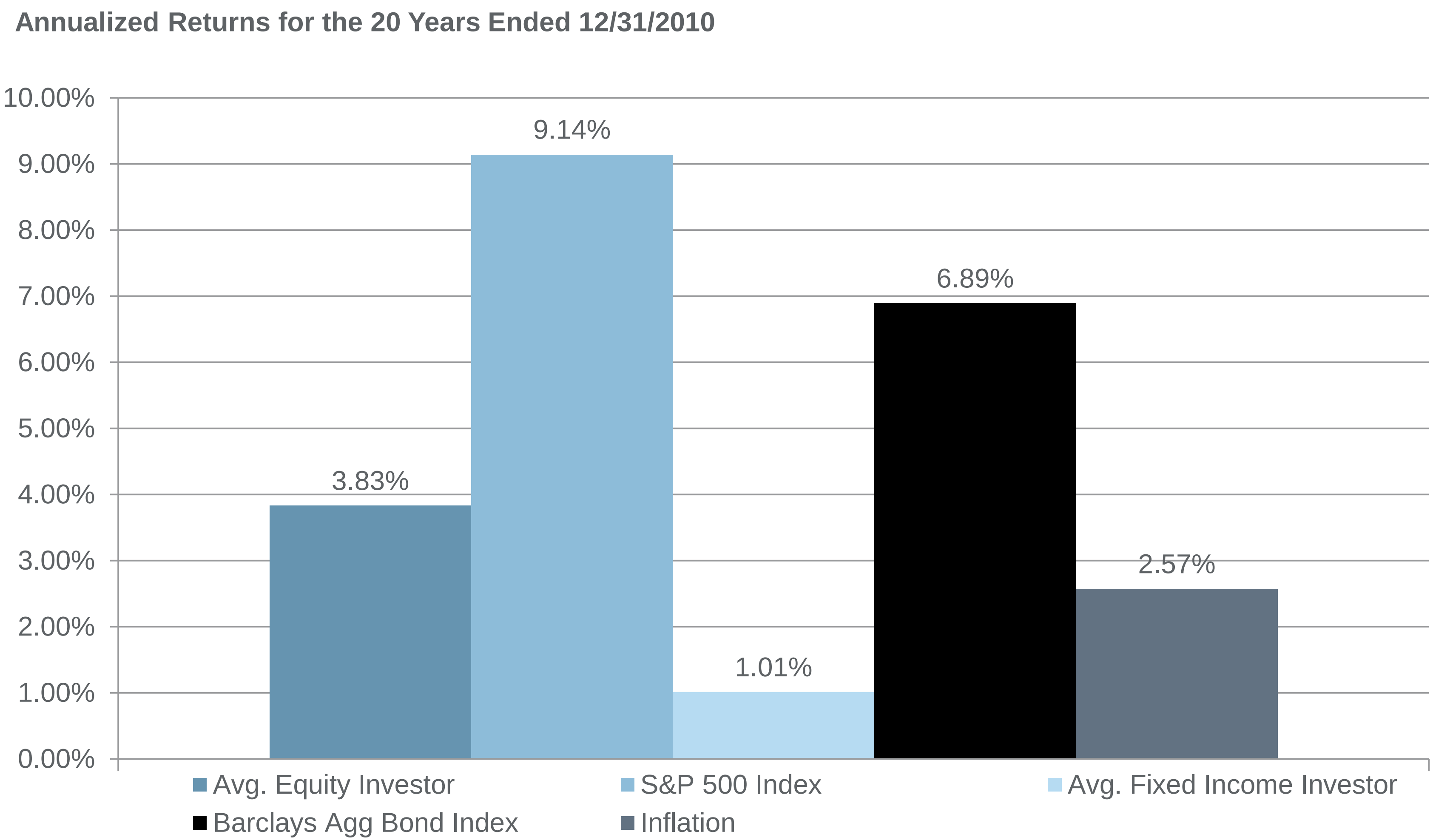
Source: J.P. Morgan Retirement Plan Services

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"

Investors Fail to Track the Market



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

"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 incorporate far more known data about a participant, such as wages, 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 more expensive 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.

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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"

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Decide Investment Menu Structure

- Tiered Methodologies are Preferable
- Simplifies Decision-Making
  - Employee communication is clearer
  - Decision-making is easier
- Offers Meaningful Choices to Participants
  - Acknowledges participants are different
  - No one-size-fits-all choice is available
  - Participants want different options

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Index Tier Option

- Ability to Build Globally Diversified Index Portfolio
- Low Cost
- Broad Diversification
- Style Specific Actively Managed Funds for Active Participants
- Optional Self-Directed Brokerage Account for Most Active Participants

Asset Allocation Funds (i.e. Target Maturity, Target Risk, etc.)

Core Index Funds

Active Style Funds

(Optional) Self-Directed Brokerage Account / Mutual Fund Window

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)

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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

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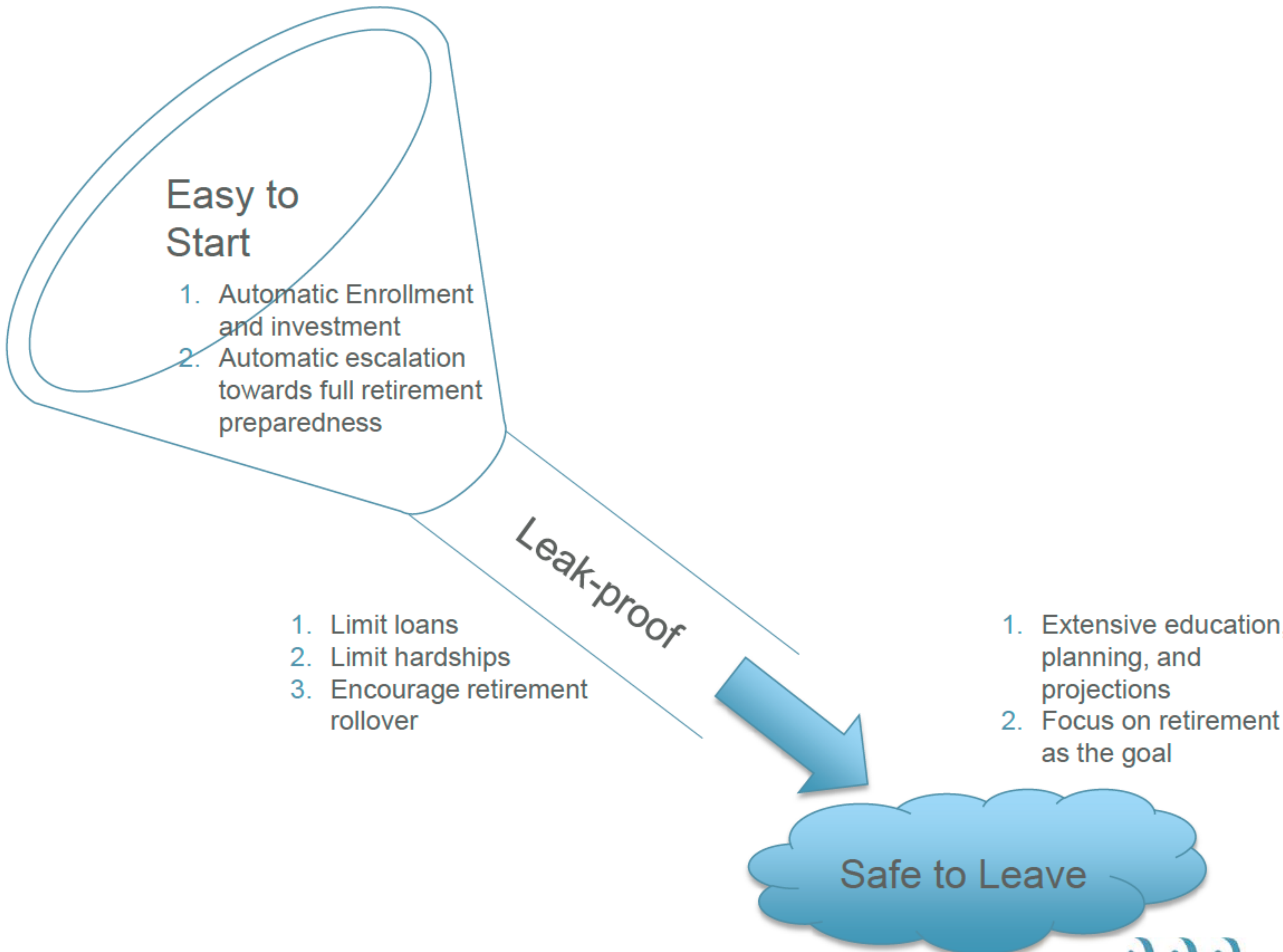
The Optimal Plan Design



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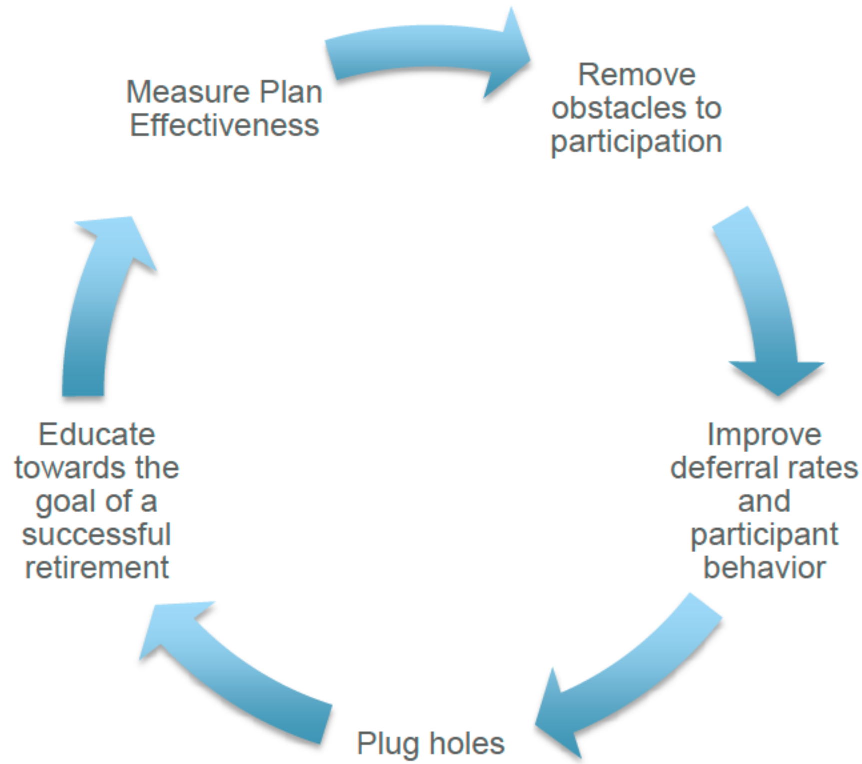
Five Steps to Improving Your Plan and Your Institution

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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