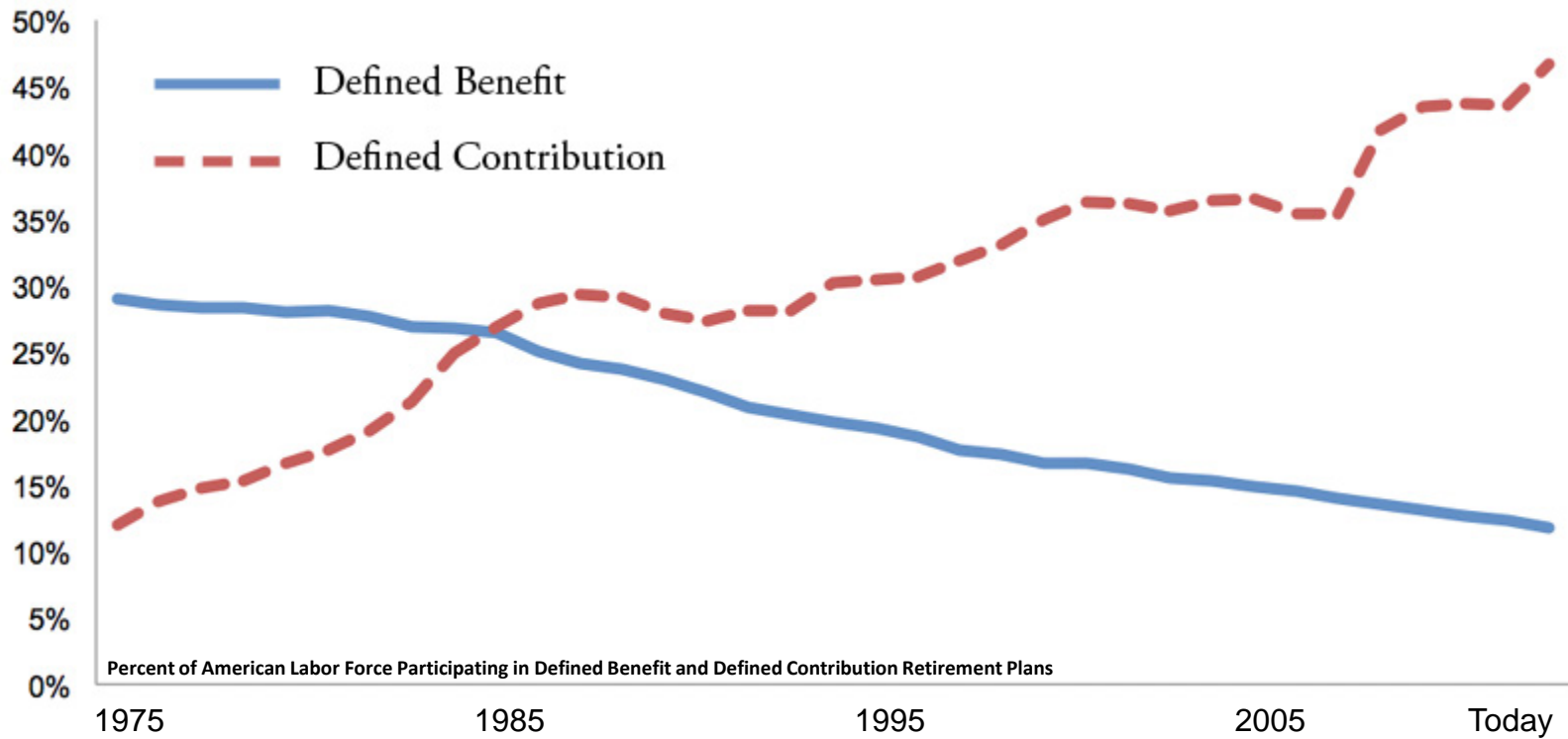


Public Sector Defined Contribution Plan Basics

Presented by:
John Thinnes, CFA, CAIA



Industry Trend



Trend in the Public Sector

- 90% of state & local gov't employees have access to retirement benefits
 - 84% have access to DB plan, 78% participating
 - 30% have access to DC plan, 17% participating
 - 43% of state workers, 26 % participation
 - 26% of local workers, 14% participation



Shift in Risks

	Defined Benefit	Defined Contribution
Plan Investment Selection	Employer	Employer
Diversification / Asset Allocation	Employer	Employee
Determines Plan Expenses	Employer	Employer
Pay Plan Expenses	Employer	Employee
Funding (Plan Contributions)	Employer	Employee
Retirement Income	Employer	Employee



Retirement Plan Industry Trends

Current factors affecting the retirement plan industry:

- Continued pension reform and other political pressures
- Increased plan governance by formal plan committees
- Fee disclosure rules & public scrutiny have increased plan awareness
- Advances in recordkeeping technology continue to drive down cost
- Vendor consolidation
- Comprehensive participant education and retirement planning solutions



Types of Defined Contribution Plans

401(k)

- Corporate

403(b)

- University
- Hospital

457(b)

- Public

401(a)

- Public



Governmental Plans

401(a) Defined Contribution

- A retirement savings plan that allows dollars to accumulate on a tax-advantaged basis for retirement
- Contributions made by the employer, the participant, or both
- Employees typically select their investments from a menu designed by the employer and/or an advisor

457(b) Deferred Compensation

- A supplemental program that allows participants to make contributions on a pre-tax basis
- Taxes are deferred until your assets are withdrawn, usually during retirement
- Employees typically select their investments from a menu designed by the employer and/or an advisor

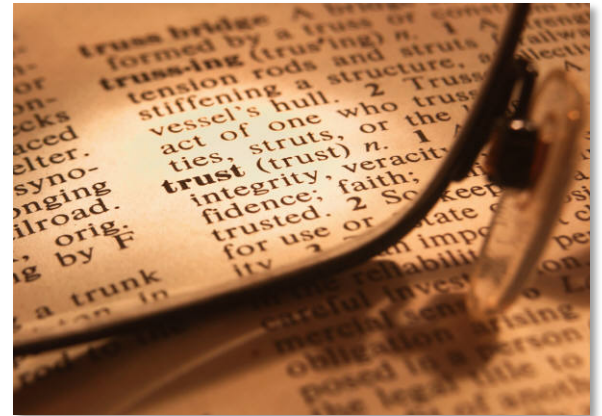


What is a Fiduciary?

fi·du·cia·ry | fə'dōōSHē,erē,-SHərē

Adjective

1. Pertaining to a position of Trust or confidence; confidential: a *fiduciary* relation, as that of an attorney, guardian, or trustee. 2. Unwavering; trustful; undoubting. 3. Relying on the confidence of the public as for paper currency or value. 4. Held in trust. ---- *n. pl. —aries* A person who holds a thing in trust; a trustee.



Role of a Fiduciary

- **ERISA** – Employee Retirement Income Security Act of 1974
 - regulates employer-sponsored retirement plans.
 - imposes specific duties on plan fiduciaries.
- **DOL** – Department of Labor
 - Enforces ERISA and ensures employers are making decisions in the best interest of plan participants



Am I a Fiduciary?

Do you...

- Have any discretionary authority or discretionary responsibility in the administration of the plan?
- Exercise any authority and/or control over the management or disposition of plan assets?
- Render investment advice to the plan and/or its participants for a fee or other compensation, whether direct or indirect?

Or do you...

- perform certain ministerial administrative functions within a framework of the plan's policies, practices and procedures?



Who is a Fiduciary?

Fiduciary

- Plan Sponsor
- Plan Trustee
- Plan Administrator
- Administrative and Investment Committees
- Investment Consultants

Not Typically a Fiduciary

- Directed Trustee
- Recordkeeper
- Attorney
- Accountant
- Actuary
- TPA

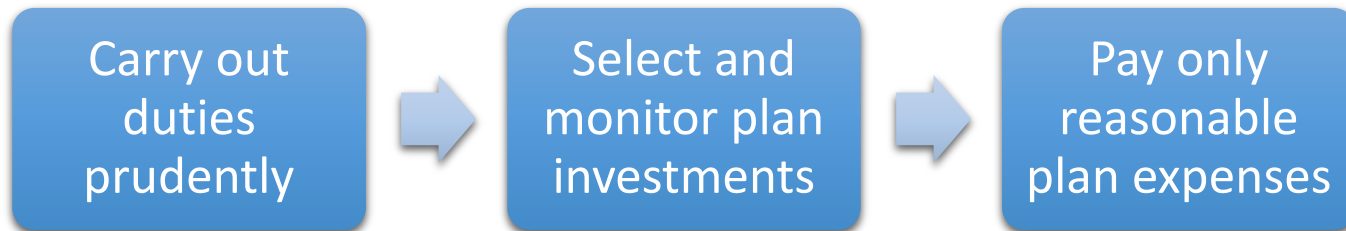
NOTE: FIDUCIARY IS A RESULT OF FUNCTION & DUTY, NOT TITLE



Roles of a Fiduciary

As outlined by the Government Finance Officers Association (GFOA):

*“In carrying out their responsibilities as fiduciaries, plan sponsors **make decisions in the best interests of the plan participants** and beneficiaries. In making these decisions, it is assumed that plan sponsors have knowledge about all fees and expenses charged to the plan and participants while ensuring that these costs are reasonable. It is also assumed that plan sponsors are disclosing to plan participants adequate and accurate information about the fees and expenses that affect their account balances.”*



Role of a Fiduciary

- ✓ **Duty of Loyalty** - a fiduciary must perform their duties solely in the interest of participants and beneficiaries. “exclusive benefit rule”
- ✓ **Duty to Act Prudently** - a fiduciary must act with the “care, skill, prudence, and diligence...that a prudent man acting in a like capacity and familiar with such matters would use...”
- ✓ **Duty of Diversification** - A fiduciary should strive to diversify investments so as to minimize the risk of large losses, unless, under the circumstances, it is clearly prudent not to do so.
- ✓ **Duty to Follow Plan Provisions** - a fiduciary must follow the terms of the governing documents for the plan



Fiduciary Responsibilities

General

- Document sound fiduciary processes
- Coordinate plan with other benefits
- Communicate effectively with participants
- Hire experts where it benefits the Trustees

Fees

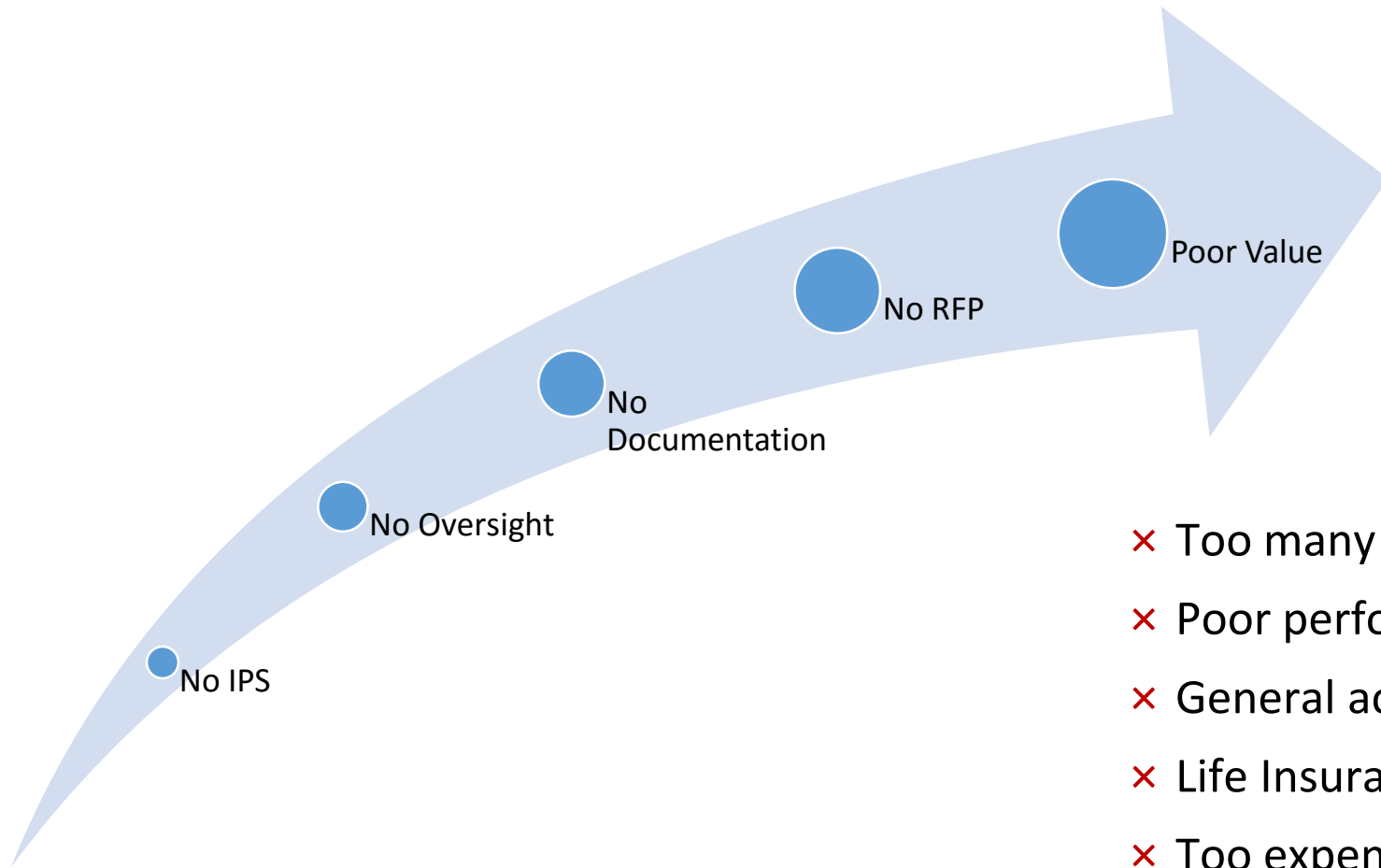
- Ensure fee transparency
- Understand who is receiving fees
- Benchmark services
- Monitor services that are provided
- Understand indirect revenue the plan may be generating

Investments

- Construct an all-inclusive Investment Policy Statement
- Create a simple, sensible menu
- Monitor lineup closely
- Provide tools for participants
- Measure employee engagement



Problem Areas



- ✗ Too many funds
- ✗ Poor performers
- ✗ General accounts
- ✗ Life Insurance
- ✗ Too expensive



Diversifying Investments

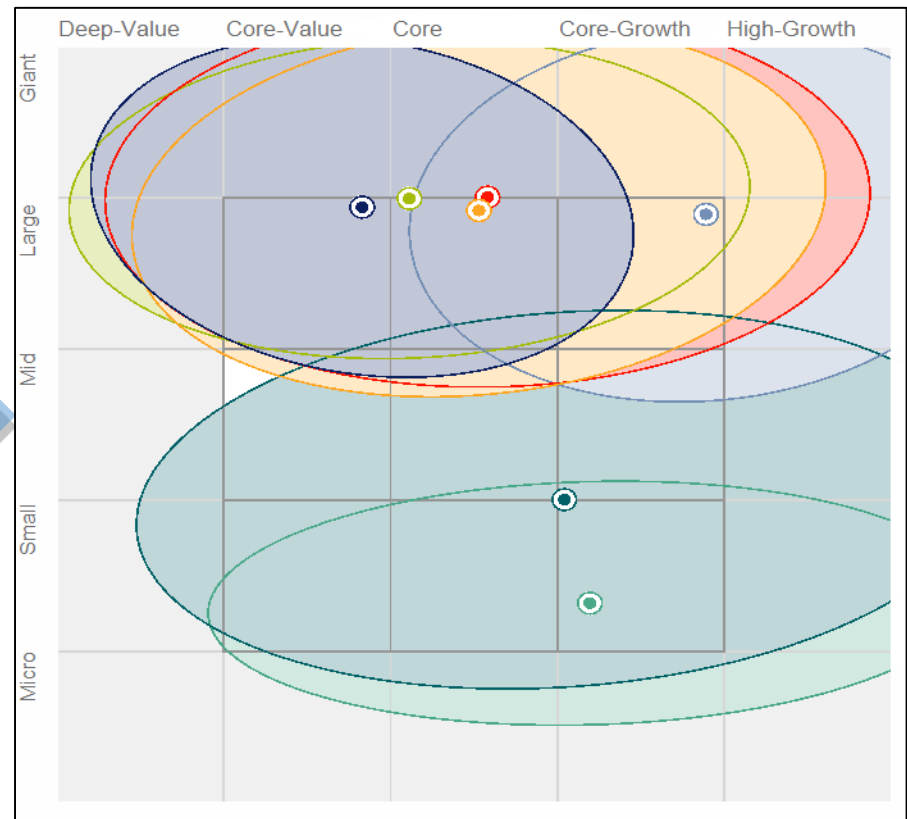
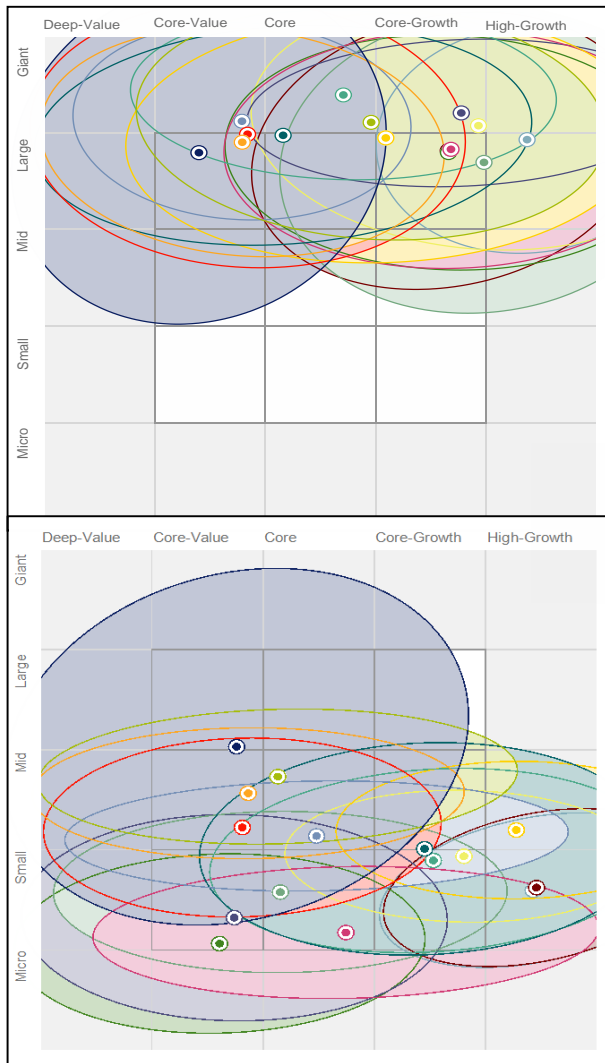
ERISA 404(c) Compliance

1. Broad range of investments (at least 3)
 - Materially different risk/return characteristics
 - Equity, fixed income and principal preservation
2. Participant control and ability to diversify to minimize the risk of large losses
3. Sufficient and appropriate investment information is regularly provided



Simplifying Options

US Equities

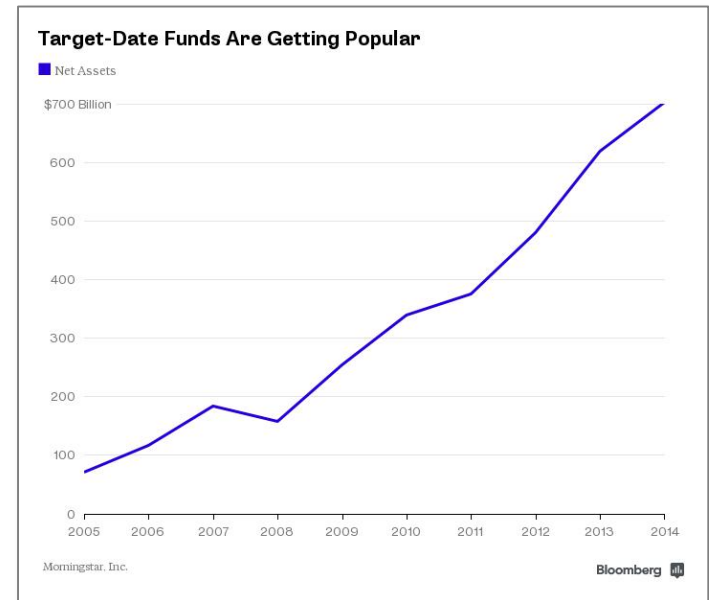


Growth of Target Date Funds

Target Date Funds (TDFs) are a single investment option that provide a diversified, professionally managed mix of investments designed to give participants a long term asset allocation strategy built around their anticipated retirement date. These investments automatically become more conservative over time as the duration of the participant's investment horizon decreases.

First introduced in the early 1990s, the popularity of TDFs has increased dramatically due to the auto-enrollment legislation established in the Pension Protection Act of 2006, which created the need for a safe-harbor Qualified Default Investment Alternative (QDIA) within 401(k) plans. The U.S. Dept. of Labor approved TDFs as one of three types of QDIAs.

- In 2015, over 50% of new contributions flowed into TDFs.¹
- TDFs now account for \$700 billion in retirement plans, more than four times the total at the end of 2008.¹
- By the end of 2019, it is estimated that TDFs will attract nearly 90% of new contributions.¹

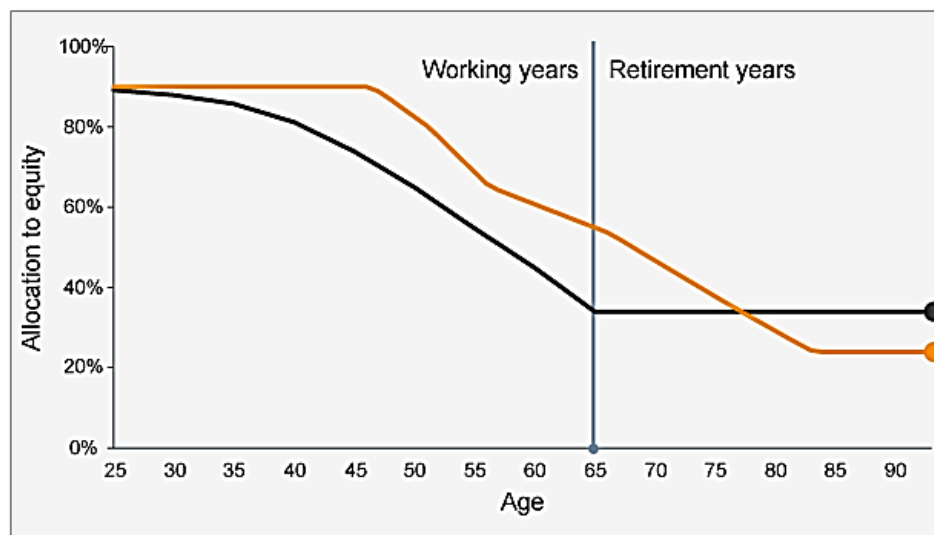


¹ "Retirement Markets 2014: Sizing Opportunities in Private and Public Retirement Plans" Cerulli Associates

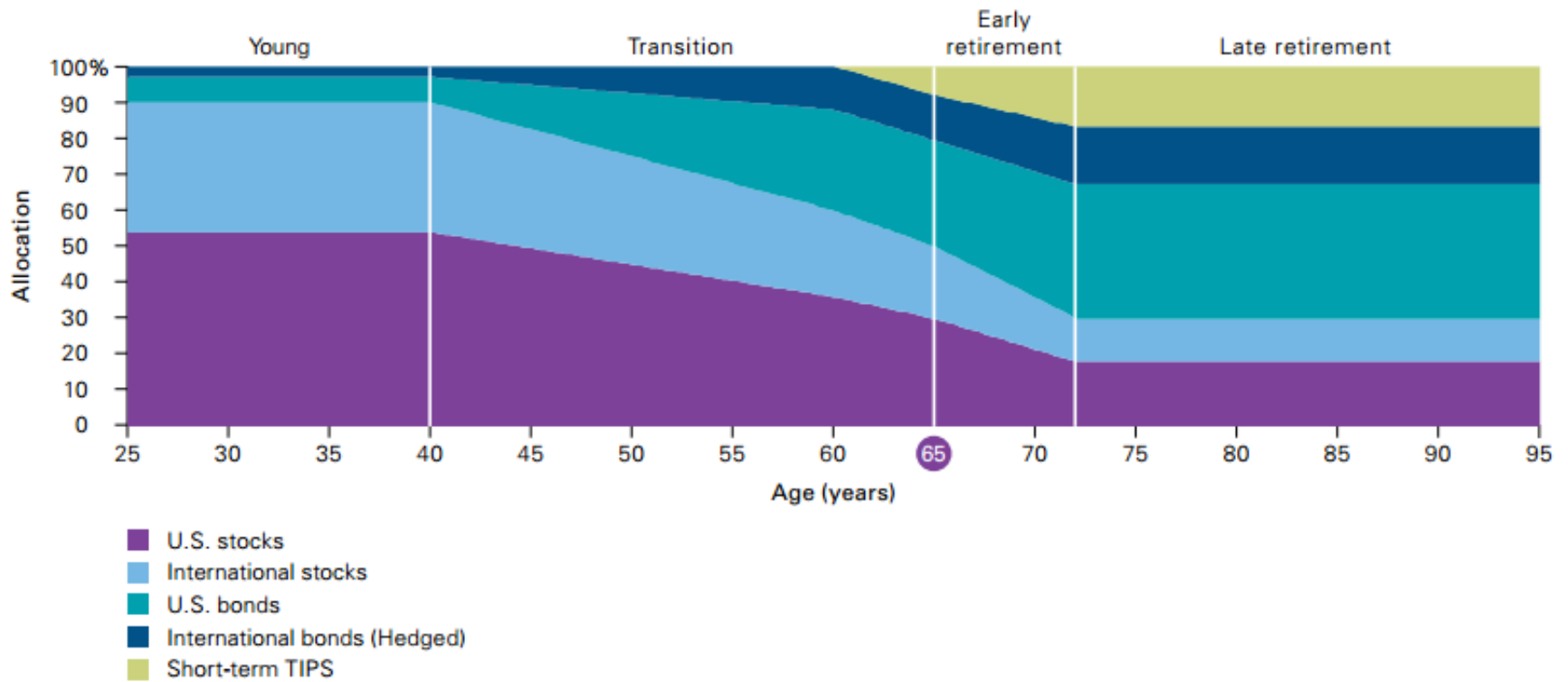


How Target Date Funds Work

- **Glide path** - A glide path represents the shift in asset allocation (becoming more conservative) as time passes. In general there are two distinct glide path strategies:
 - **To** - A 'to' approach reflects a target date fund whose asset allocation becomes most conservative at the target retirement date.
 - **Through** - A 'through' approach reflects a target date fund whose asset allocation typically contains a higher allocation to equities at target retirement date and continues reducing equity exposure until a future date during retirement.



Fund Diversification



Guidelines for Selection and Review

- ☐ Establish a process for comparing and selecting that considers employee demographics and complies with the Investment Policy Statement
- ☐ Establish a process for the periodic review
- ☐ Understand the fund's investments – the allocation in different asset classes (stocks, bonds, cash), individual investments, and how these will change over time
- ☐ Review the fund's fees and investment expenses
- ☐ Inquire about whether a custom or non-proprietary target date fund would be a better fit for your plan
- ☐ Develop effective employee communications
- ☐ Take advantage of available sources of information to evaluate the fund recommendations you received regarding the selection process
- ☐ Document the process





HORRIFYING





MORE HORRIFYING



Types of Fees

Plan Administration

- Recordkeeping
- Participant education

Investments

- Explicit - Fund expenses
- “Hidden” - 12b-1, subTA, Proprietary fees

Other

- Investment Advisor / Consultant
- Attorney

The collage consists of three documents:

- Window Sticker (Top Right):** For a 2008 Ford Motor Credit Company vehicle, model 9BA01490 NB. It lists the standard vehicle price as \$36,555.00 and includes a list of optional equipment such as leather, navigation, and a sunroof.
- EPA Fuel Economy Estimates (Bottom Center):** A form showing estimated annual fuel costs. For a city driver, the cost is \$2,335 (16 MPG). For a highway driver, the cost is \$2,225 (22 MPG). It also includes a combined fuel economy estimate of 18 MPG.
- Government Safety Ratings (Bottom Right):** A form showing the vehicle's safety ratings. The overall MSRP is \$43,875.00. The ratings are: Frontal crash (To Be Rated), Side crash (To Be Rated), Rollover (To Be Rated), and Rear crash (To Be Rated).



Explaining Expenses

ERISA requires fees for service to be reasonable, and DOL guidance requires a rational, prudent basis for the method chosen for allocating fees. It is critical to develop a rational basis for the Plan's fee structure, and weight the impact of various fee structures to determine what method is most prudent for the Plan.

Types of Expenses	Expense Details	How Fees are Paid
Investment	<ul style="list-style-type: none"> Includes management fee, revenue sharing, Sub-TA Multiple share classes available 	<ul style="list-style-type: none"> Fees are embedded in the NAV, or share price of the investment
'Plan Level' Administration	<ul style="list-style-type: none"> Covers core administration services, including statements, call center, participant education, web site, etc. Fees may or may not be visible on statements or website, depending on the fee model in use 	<ul style="list-style-type: none"> Can be allocated based on account balances ("asset-based") OR as a fixed \$ amount fee per participant Fees can be paid from revenue sharing, withdrawn from participant accounts or paid by plan sponsor
'Participant Level' Transactions	<ul style="list-style-type: none"> Loans, withdrawals and distributions 	<ul style="list-style-type: none"> Based on specific activity, withdrawn from account Fee is charged to the specific participant (only)



Fiduciary Best Practice

- ✓ Create a plan committee
- ✓ Hold regular committee meetings that include a review of:
 - Investments
 - Recordkeeper(s)
 - Other professionals
- ✓ Document these meetings and any decisions or relevant discussions
- ✓ Implement and regularly review an Investment Policy Statement
- ✓ Hire an investment professional to help, when appropriate



If you only remember one thing...

Prudence is a process...

but only if you can prove it!

- ✓ Have a process
- ✓ Follow that process
- ✓ Document, document, document

