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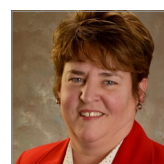
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former Deferred Compensation Director, City and County of San Francisco Retirement System



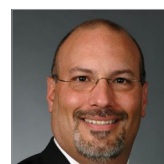
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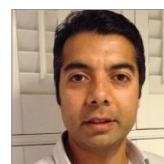
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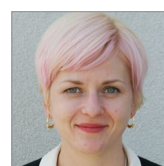
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SECTION 1

WILL DC PLANS EVER DELIVER LIKE A DB PLAN?

1.1 INTERVIEW

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1.3 WHITE PAPER

Understanding global retirement plans' best practices – learning from each other

1.1 INTERVIEW

Why are Defined Benefit ("DB") funds outperforming Defined Contribution ("DC") over time and how much is this related to the typically very retail nature of DC investment options?

Interviewer



David Grana
*Report Publisher, Clear
Path Analysis*

Interviewee



Tony Tomich
*Head of Pension
Investments, Farmers
Insurance*

David Grana: Over the last 15 years, Defined Benefit (DB) plans have outperformed Defined Contribution (DC) plans at least 75% of the time and by at least 39 basis points and on average, by 70 basis points. Why is that?

Tony Tomich: A DB plan has many structural features that aren't available in DC plans. One being that you have access to lower cost vehicles in a pension plan, such as separate accounts, which are fundamentally cheaper than mutual funds, which are the prevalent vehicle in a DC plan.

Mutual funds are much more expensive, you have to close them daily and work on marketing and regulatory work which you don't have to with a separate account.

When you see the migration of many bigger plans in the DC space to open architecture, one of the motivations is to move away from mutual funds because they are relatively expensive and if you are a big plan you don't have to use them.

Another issue is scale within the different pension plans and asset classes. With scale, you usually have lower fees.

In a pension, you have professional/institutional management which can't be understated. When you have professional management of assets you have a very thoughtful and diligent risk budgeting, strategic asset allocation that is identified and defined.

You also have disciplined re-balancing to stay in line with that strategic asset

allocation and so this ultimately leads to better outcomes.

On the other side of this, when you are dealing with retail investors they can display behavior that is very different. Sometimes they can chase returns at the top or can be fearful at the bottom of markets and so retail investing behaviors are very different to institutional behaviors.

David: Would you say education has a lot to do with this?

Tony: I don't know if I would pin education as you can have very well educated, smart people who behave in sub optimal ways in times of market volatility.

It is more about whether one is more seasoned and experienced rather than educated. If you have a seasoned, institutional investor, this person might behave differently than someone who might be very intelligent but who doesn't have the experience or expertise.

One of the main benefits of institutional investors is their patience and they understand that market volatility is a part of how the markets and the global economies work.

They know that in the long term, sticking to their strategic asset allocation is what creates optimal risk-adjusted returns.

In DB plans, you also have access to asset classes that you don't in a DC plan. You can look to collect different risk premia or illiquidity premia that

just isn't appropriate for some stand-alone DC fund options.

David: An employee working 60 hours a week may find it difficult to keep a close watch of their DC plan and re-balance according to their proposed strategy. Is there anything automatic in the market that investors can rely on to solve this issue?

Tony: Target date funds do this and that is why you have seen such a growth in this product. It does rebalance for you on a periodic basis, it sets a glide path and changes risk and asset allocation as time goes by.

It is also professionally re-balanced and that is why you have seen them grow so quickly, because they do it for a retail investor.

There are other services out there like managed accounts which will help someone create a strategic asset allocation (SAA) and maintain it to rebalance etc. but these cost money and may be confusing for some investors.

When we converted to open architecture, we had a number of focus groups and asked people simple questions like, did they know we had a 401(k), did they know what a stock or bond was etc. and the overall theme that came out from this was that people were confused and needed help.

This is why we have a belief that structures are very important and you have to put them in place to help use momentum in a good way instead of letting it work in a bad way.

The momentum of a DC plan is a very strong factor, as once people enroll they tend to not touch it, which is why having them consider a target date fund, or something that has a structure that allows for diversification, is really important.

This is one of the reasons we simplified our plan. We got rid of the myriad mutual funds that were very confusing.

David: How did you determine that these options were the right ones?

Tony: Before we converted, we had 3 tiers. And if you look at most DC plans out there, they tend to have 3 tiers. Tier 1 is a suite of target date funds where you can pick whatever date you anticipate you are going to retire. Tier 2 is all of the mutual funds or asset blocks, some have 20 others have 100, and it just depends on the plan. Tier 3 is the brokerage window.

We conducted focus groups and looked at guiding principles about how we thought about the conversion.

One element was that we wanted to ensure that cost efficiency was the most important factor that guided what we did. We know that 20 basis points expense over a lifetime savings is 6 to 7 years of income and is really important.

Another factor that was important was the ease of use, as we wanted people to be able to understand it and not be intimidated by it.

We focused on giving people 2 decisions to make and this was how we simplified things: one was active versus passive and the second was stocks versus bonds.

Back in the 80's, the style box came into the scene where you had large cap growth and small cap value, etc., which was a great way to create a lot of different products to get into the markets by the asset management companies.

"We focused on giving people 2 decisions to make and this was how we simplified things: one was active versus passive and the second was stocks versus bonds. "

You see most DC plans have 20 to 300 of these different mutual funds that fit into that style box and all around it but people often don't know how to optimize this so you see a lot of sub optimal behavior when you look at what your participants are doing.

They have what is called 1 over N which is where they have 25 options, don't know which one to choose so they put a 25th into each option and as most of the funds are equity you become overweighted to equity risk. Or they end up picking one or two, causing them to become over concentrated, which can be inappropriate based on their age.

We wanted to give our people just two decisions, passive or active, stocks or bonds. Our plan now has 4 tiers. Tier 1 has our target date funds in it. Tier 2 is passive, and you can choose a stock fund and a bond fund. Tier 3 is active and here they have 3 choices: stock, bond or stable value. And the 4th tier is the brokerage window.

We simplified to a pretty extreme degree and with these choices they become like pensions and are white labelled parent-child fund structures. We manage the parent-child structure ourselves like pensions so with the active stock fund, if you look underneath, the parent is Farmers active stock fund and then underneath you have all of these children-like options: small cap, international, EM and U.S. large cap, etc

We manage the SAA ourselves. We rebalance on a regular basis based on business rules we established. We also use separate account and co-

mingled trust accounts that are more cost efficient than mutual funds. And because of our size we were able to do this.

David: Have you done an analysis on what the cost structure was prior to the open architecture system versus what it is like now and how much it has been reduced?

Tony: Absolutely. It is much more cost efficient and our participants have much more diversified choices to pick from. Whereas before, they could have picked just one mutual fund and rode the rollercoaster, now they can pick the active stock fund and they are globally and sector diversified.

They are more cost efficient and have structures that give them the best chance for a positive retirement outcome.

David: Do you see one of the options being more popular versus the other in the selection from the employees?

Tony: This comes back to momentum and how your mapping or transition strategies work, as once people make a choice, they tend to stick with it.

David: Have you done a comparison of DB versus DC to see how they perform?

Tony: You can't compare the two as they have very different goals. We do have a quarterly investment committee meeting where the performance of both plans are presented to our governance, investment and pension committees.

In the pension we have a structure that has an Asset Liability Matching (ALM) concept. In the pension you have a liability that exists that is long duration that you have to try and match and also there is a growth component where you want to grow the asset as well.

You are addressing different risks in the pension than you are in the DC plan. You can compare single mandates (i.e., how does the equity sleeve in the pension look versus the stock fund), but even that is not really a fair comparison as the stock fund in the 401(k) is globally diversified as well as diversified from a sector stand point.

David: You mentioned that one of the advantages of a DB plan is the ability to invest in illiquid vehicles or alternative investments. Do you foresee that DC plans will start to introduce more illiquid types of investments? Do you feel that they should?

"When the crisis hit, many people turned unrealized losses into realized losses by moving their holdings, while many institutional investors just stayed patient."

Tony: I attend many conferences and adding alternatives to the DC world is a theme that is frequently talked about.

The challenge is that, with an alternative, they are not liquid and they don't get valued on a daily basis like a public security does in the fixed income or equity market.

At most every DC conference, typically one of the asset managers will be real estate orientated and will talk about how they are trying to get real estate into DC options.

This is all about liquidity because you have to have daily liquidity in any kind of DC plan because you have activity all of the time. Every two weeks you have payroll contributions coming in, you have loans that people take and there are many moving parts.

If you don't have assets that have daily liquidity or a liquidity sleeve they just don't work. You also have to be able to strike a daily Net Asset Value, or "NAV," for DC plans so that when people go to the websites of their plan record keepers, they can see the value of their DC plan on a daily basis.

Also, if they want to get in and out of it you have to strike a price to trade them in or out of the funds.

Alternatives like real estate, hedge funds or similar just don't lend themselves to that type of requirement. This doesn't mean that these people haven't tried to get into the DC space as this is where all the growth is going to be over the next 10 years. The alternative managers are working very hard to get into the DC space.

The issue is that there are just many structural challenges here.

David: Are there issues with employees cashing out of their DC plan if they are invested in an alternative fund?

Tony: This speaks again about daily liquidity. Hopefully within a plan the fund is big enough that you can deal with that daily transactional volume that you have. If I leave my job and want to convert my 401(k) over to a new plan or a rollover, the liquidity of the fund has to be able to deal with that daily transaction and it could be me or 100 of my coworkers who leave

on a particular day, depending on the size of the plan and company.

For real estate, whether you have a structure of 75% direct real estate and a 25% liquidity sleeve, a money market or something else, I am sure people will figure this out.

It is just hard because real estate is only appraised once a quarter or every 6 months and you have that inherent lack of daily NAV and liquidity, so it is challenging.

David: Is it safe to say that DB plans were better able to respond to the financial crisis of 2008 because they were able to shift their allocation much quicker than DC plans?

Tony: I would challenge the assertion you just made as it goes back to that retail behavior.

When the crisis hit, many people turned unrealized losses into realized losses by moving their holdings, while many institutional investors just stayed patient.

The truth is, you might have been better off to have just done nothing and turned off the TV. The markets are back even farther than they were during the crisis.

A big part of dealing with volatile markets is that, often, it is better to do nothing, to be patient and not hit the panic button. If you look at any chart from the early 2000's, you did see a big dip but then it came right back and you are now further ahead than you were before the crisis.

In times of market volatility this retail behavior and reaction to the news and to other people's concerns may lead to poor performance. Retirement savings and investing is about the long term and that has to be your mindset.

David: So was it this retail behavior that saved investors from losing a bit of their capital?

Why are Defined Benefit ("DB") funds outperforming Defined Contribution ("DC") over time and how much is this related to the typically very retail nature of DC investment options?

Tony: The retail behavior actually hurt those people as had they just done nothing they would have gone down but come back up.

The other consideration is that if you are in your 20's and 30's you can go up and down and it doesn't hurt you long term. However when you have people who are close to retirement, a big dip like this can really hurt because the timing of volatility is really important in retirement.

This speaks to how you have to de-risk as you get closer to retirement. For example, if you are close to retirement but you have a huge allocation to equity, that is probably not the appropriate risk allocation given the potential for short-term volatility when you need to start converting your savings to retirement income.

That is why with target date funds and other professionally managed funds they de-risk and take equity risk off the table and put you into other areas like fixed income vehicles, as you get closer to retirement.

David: So, patience, simple choices, and rebalancing according to your level of risk are all factors that will allow you to be able to have a decent pot for your retirement?

Tony: These are our guiding principles: efficiency, ease of use and structures that give folks the best chance of good retirement outcomes.

David: With all this being said, do we now have a formula that can get us pretty close to DB type returns or do we still have a way to go?

Tony: I am not sure that DC will ever get you the type of returns of a DB plan because they are managing to different objectives and are able to take different types of risks.

Not that Farmers does this but as a DB manager I could take much more risk and get into different vehicles in

order to get paid more. That plan could theoretically do things that might mean taking on more risk or be really different than what a DC manager could and should do because that DB plan might have access to different asset classes and patient capital.

As a pension manager, if I do something that backfires, the company has to then make more contributions to the pensions, whereas if I am a manager of a 401(k) plan, I am touching other people's money so the fiduciary duty here is a bit different.

You have to behave a little differently in a DC plan as you are a fiduciary for other people's funds.

David: Thank you very much for sharing your views on this topic.

"These are our guiding principles: efficiency, ease of use and structures that give folks the best chance of good retirement outcomes."

1.2 ROUNDTABLE

How to improve the use of DC plans as a vehicle overall for retirement savings

Moderator

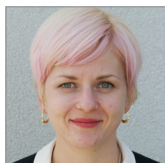


Hubert Danso
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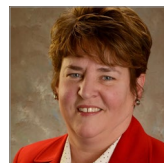
Panelists



Steve Toole
*Director Retirement
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Department of State
Treasurer*



Christine Bryan
*Benefits Manager,
TESSCO Technologies*



Cindy Cattin
*Managing Director –
Investment Operations
and Risk Management,
Exelon Corporation*

Hubert Danso: Is the Defined Contributions model of today falling short of what it should be doing?

Christine Bryan: I believe the model is falling short with respect to average balances and level of participation that I have seen at a couple of different employers.

In general, many don't have the amount saved up for retirement that they really need. There is also easy access to money in the form of loans and hardship withdrawals so the accounts are often seen more as a savings account rather than as a retirement vehicle.

Cindy Cattin: What it should be doing varies from plan to plan and when I think of Exelon and whether it is failing I would say no because we still have an open Defined Benefit (DB) plan where most of our participants continue to accrue a benefit there and so our Defined Contribution (DC) plan is viewed as supplemental.

We have 90%+ participation and healthy average balances so within the context of my company I don't see it as failing but that is because we are unique in what it should be doing and what it is intended to do for us.

Christine: I have worked in both non-profit and for-profit, both with a wide variety of employees with different

income levels and success within their retirement plans.

The hospitals where I worked before had frozen DB plans. There was one that had an active DB that was likely moving towards freezing to be replaced by DC safe harbor.

Where I am now there is no frozen DB but only DC 401k and the levels of participation are very unequal. At TESSCO we have an 85% participation rate with the 401k but that is likely due to automatic enrollment and automatic escalation and it would be much worse without that.

We have people at the top of the scale who are much better informed and who are participating and will be in much better shape than the people at the lower end of the pay scale. This is what I also saw at the hospitals.

The staff making 10 dollars an hour are the big concern; these individuals will be wholly dependent on programs like social security benefits versus the staff who are making a lot more and who will be just fine with their DC benefits.

Because the DC plans should meet the needs of everyone, if it is falling short for one group, it is not working as well as it should in general.

Hubert: You feel then that it works well for a certain class of contributor?

Christine: We certainly have quite a few people retiring who are very well prepared but the number of people I see who are ill prepared worries me.

Hubert: Steve, what are your thoughts?

Steve Toole: I don't feel it is falling short and the model is working the way it is supposed to.

The issue is, how are people taking advantage of the model and the key is plan design which is driven by employer decisions. Too many times they are leaving these plans up to participant selection who aren't thinking long term, which is a problem.

There are great examples where plan sponsors are taking advantage of "DB like" features in DC plans such as auto enrollment, auto contribution and escalation in order to drive participant outcomes but not enough.

If you look at the public sector participation, I have worked in the public sector for nearly 30 years and the rate of participation has been approximately 30% across the board and it hasn't changed so there is the issue that plan sponsors aren't doing enough to drive participant election.

In North Carolina (NC), we have 480,000 active public servants and our goal is that every one of them will be able

to replace 80% of their final annual income in retirement starting at age 62.

Each year, we issue an annual benefits statement that summarizes their DB, social security and their DC and we convert this to a monthly income projection. Since we are the DB administrator we know what their current income is and compare that to their current projected income at age 62 to determine if they are on track to replace 80% of their income in retirement. If they are short of the goal we offer ways to address the situation now before it's too late.

Currently over 60% of all active North Carolina public servants are on track to replace 80% of their income.

As we take a deeper dive into the numbers we learn some interesting results. 74.09% of our active public servants are exceeding 80% replacement income if they are participating in one of our state sponsored defined contribution plans. The number of members achieving 80% replacement income drops significantly if they are not participating in one of our defined contribution plans. In 2013, 60.37% were retirement ready, compared to 55.42% in 2014 and 50.16% in 2015. Participation in one of the state sponsored defined contribution plans makes all the difference in the world for North Carolina's public servants.

We don't currently have auto enrollment and auto escalation in North Carolina as it requires legislative change but we will pursue this again, legislatively in 2017.

Hubert: Will giving employees access to alternative investments improve their returns?

Cindy: It would depend on how you are giving them access as access through a target date fund could be beneficial but from a core menu perspective could be more problematic.

In the context of target date funds, alternatives are broad and can be defined in many ways so something like real estate is easy to slide into a target date fund and a relatively modest allocation can not only help with returns but also give some additional diversification.

If you consider assets like private equity, which could absolutely help you with your returns if it is the right fund, there is huge disparity between top tier private equity funds and middle or bottom tier funds.

It would be hard to get some of the top tier funds to want to participate in

“By using custom target date funds that are comprised of other funds already in the plan, an employer can easily switch out that single fund.”

the DC space as many of them tend to be over-subscribed as it is and there are many complexities that they would need to sort through to get that into a DC daily valuation space.

Christine: There are many ways to define this and no particular investment is going to guarantee an improvement in returns, as it is all about what the individual does with that investment and how it is utilised in the plan to begin with.

If an alternative investment was within a target date fund, it would make more sense. Personally, I am more a fan of the custom target date funds than the off-the-shelves, and it would be reasonable to build it into a custom target date fund.

However, for someone who doesn't know what they are doing and might be easily influenced by talk show investment advice, they may vastly decrease their returns by adding in alternative investments by trying to time the market and landing wrong.

Hubert: Why are you a fan of the custom target date rather than off-the-shelf solution?

Christine: Investment committees in my experience can be challenged by off-the-shelf target date funds, and often they are somewhat glossed over during the review process. Because they are composed of a large number of underlying investments that are under the control of the fund managers, an underperforming fund in a target date fund that would otherwise be switched if it existed as a standalone option in the retirement plan, has to stay put. Also, sometimes a particular fund (like the Target Date 2045 fund) is performing poorly, but unless the entire suite is changed, there is not much that can be done.

By using custom target date funds that are comprised of other funds already in the plan, an employer can easily switch out that single fund.

The fiduciary responsibility is easier to handle with the custom line up, because if there is one underlying fund that is underperforming, that one fund can be switched out as would be done with any other underperforming fund in the plan.

Steve: In North Carolina, we offer a customized asset allocation model and what I like about it is that it allows the board and staff to create a custom glide path based on the plan features, including the availability of a strong pension and social security.

All North Carolina public servants have access to a very strong pension fund which should influence the glide path very specifically and it does.

Typically, with the off-the-shelf solution, you are really trying to find something that best fits your needs.

A key significant difference between DB and DC is the active investment management by knowledgeable professionals, which includes a robust asset allocation model for the entire portfolio. On the DC side, most plan participants have access to a robust lineup but sometimes they are not leveraging proper asset allocation to reduce risk and maximize returns.

Plan sponsors have to be very mindful about how market swings can play havoc with participants. We have all heard the horror stories of participants buying high and selling low.

Plan sponsors have to think through the line up and provide value to participants but in an effective and risk controlled manner. Offering more riskier investments in the core menu where participants can elect to put 100% of their investments in is a very risky proposition and one that has to be thought through very carefully. Some exposure to alternative asset classes can certainly make some sense.

One of the things we are doing in North Carolina is leveraging our record-keepers' custom portfolio models, GoalMaker, effectively in our plans. Currently, over 90% of all new enrollees and over 50% of all active participants use Prudential's proprietary product called GoalMaker.

The participant usage rate of our custom portfolio models is great and we find that participants do not make asset allocation changes as the markets shift. Our participants are staying the course. We are currently in discussions to alter our Glidepath and, ultimately, our asset allocation custom models to move from a "to retirement" to a "through retirement" and include non-traditional asset classes for improved asset allocation for the models only.

Hubert: The number of employers' matching contributions is decreasing year on year. What impact does this have on participation and accumulation?

Cindy: From a participation and accumulation perspective, with accumulation, obviously this is being far less contributed to because you are missing the match and with participation a lot of our employees participate strictly to get that match, so it can definitely have a negative consequence.

This is where some of the auto features come in and are really helpful as with auto enrollment and auto escalation, as long as you are getting people in the plan. A lot of times they will tend to not make many changes.

With those who we auto enroll into the plan, very few of them actually opt out once they are in so, while it obviously does have negative consequences, there are some tools we can use such as auto enrollment to mitigate this as much as possible.

Steve: Obviously, this will have a huge impact on the retirement readiness for those employees. Employers need to consider how attractive they are as an employer from a benefits perspective and if this may reduce the overall attractiveness of those employers

The biggest hurdle is to just get employees started on saving and investing on a routine basis. I worry that this action by employers is really sending the wrong message to the employees that it isn't that important to save now.

Christine: It is going to impact accumulation because you do have less money going in and it is a demotivator for participation, as many people look at the employer match to determine if and how much they will contribute to a retirement plan.

With auto enrollment you are still going to get people initially into the plan, but in some plans, including TESSCO's autoescalation, it's only applicable for those with deferral rates of 1% or more. This means that if a participant has stopped contributing altogether they won't benefit from the inertia of autoescalation, and getting them back into the plan can be challenging without the added sweetener of the employer match.

In terms of the match level, if you have a 50% match up to 6% then you will get a lot of people up to 6%. If you have 50% match up to 2% then you will get a bunch of people at 2% so setting a match is essentially setting a benchmark for what you feel is a reasonable amount for someone to start saving.

"Plan sponsors have to be very mindful about how market swings can play havoc with participants. We have all heard the horror stories of participants buying high and selling low."

to current and future employees, ultimately posing a potential retention and recruiting issue down the road in attracting talent.

The removal of the employer match creates the additional issue of not having vesting as a motivator for retention.

Hubert: Do you foresee that DC plans will ever be able to replicate the effectiveness of DB?

Steve: The single largest benefit of a DB plan is that the employer assumes the risk and not the employee and this will never be replicated in a DC.

Christine: I agree with adding lifetime income features to the plan as being a game changer.

I have had experience hand holding people through the retirement process and selecting their options under DB and DC plans. There is a noticeable difference in approach.

sum is offered versus an annuity we will typically see a lump sum as the predominant choice.

Hubert: What key message would you say on this topic?

Christine: Defined contribution plans are here to stay, but they are evolving. We haven't quite gotten to the point where they are working as well as defined benefit plans worked for our parents and grandparents, but we will get there.

“The more this can be done at the employer policy level, and less at the participant level, will improve retirement outcomes.”

Tremendous progress does continue to be made with DC in making them look and feel more like a DB plan. There are product features such as auto enrollment, auto escalation and there are more lifetime income products.

We have a unique product in North Carolina that we call the transfer benefit where we allow participants in our 457 and 401k to transfer assets back into their pension fund for a one-time fee of a hundred dollars and they get guaranteed lifetime income.

Plan sponsors continue to educate employees on the importance of long-term savings and not using DC accounts as a short-term investment vehicle. To that end, some plan sponsors are starting to remove the loan feature within their plans.

More does need to be done on DC plans but this has to be done at the employer level as they are the ones who have to make the tough decisions. The more that can be done at the employer policy level, and less at the participant level, will improve retirement outcomes.

The private sector is way ahead of the public sector on making these tough decisions and as an industry we need to catch up.

I see many people electing lump sum benefits on their DC despite heavy (but not specific) encouragement not to do so. Again, it is going to come down to getting people into the plan in the beginning and educating people on how best to use the money that they have accumulated.

There isn't any reason to go back to DB models because people don't stay with employers for 30 years anymore. The portability of a DC plan is good and necessary in the current world we live in, but it is about education, getting participants to utilize the plans correctly, getting the employers to design the plans correctly and then having a solution on the back end that is really going to make that money last for the rest of their lives.

Cindy: Automation definitely needs to play a role to drive participants in and encourage their behavior to become more DB like.

We need to address leakage so keep the money from coming out whether that is through loans, hardship withdrawals etc.

We also need to focus on the decumulation phase and educating participants around those choices as, similar to what Christine was saying, we typically see lump sums and even within our pension benefit, if a lump

Auto enrollment and escalation are big motivators to drive participation, but it is hugely important to educate participants on the importance of portability and how/why to roll over their funds when they are moving to the next employer. This all comes down to how employers communicate and get the message out to each and every one of their participants.

Figuring out how to get that message through is going to be the key that makes DC plans successful by helping all participants make their accumulated savings last them through retirement.

Cindy: It is about simplifying the experience for the participant, whether that is through the auto features or from an investment perspective, streamlining the menu and in so doing perhaps creating some custom multi manager funds that are going to increase diversification and help with the asset allocation decision or modelling to the extent that we can really simplify and help drive participants to do the right thing.

Steve: From a plan sponsor perspective, the North Carolina public employees don't have a choice to be part of the DB plan. Similarly, plan sponsors need to use plan design and make the tough decisions to make DC plans look and feel more like DB plans.

We are constantly encouraging our employees to enroll and increase their contributions in the DC plans. Often, I

hear from our retirees and they tell me thanks for encouraging me to get into the DC plans, or they will say thanks for encouraging me to increase my contributions, and sometimes they will say I wish I had listened to you and joined the DC plans.

No one has ever come up to me and said that I made them save too much for retirement and they wish they hadn't. I just don't believe it will ever happen. Plan sponsors have to step up, make the tough policy decisions and drive the right participant behaviors, which result in successful participant outcomes.

Hubert: Thank you all for sharing your views on this topic.

1.3 WHITE PAPER

Understanding global retirement plans' best practices – learning from each other



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Services Product
Management, Northern
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Retirement saving in the United States has come a long way since the Internal Revenue Service (IRS) adopted regulations ushering in defined contribution vehicles such as 401(k) plans. But we still have a lot of work ahead. By adopting the best features from other leading nations, we can move closer to a structure where U.S. workers put aside enough to fund their golden years.

A number of shortfalls in the American retirement structure need addressing. These are especially evident when you compare the U.S. system to other countries' retirement programs. The U.S. retirement system could vastly improve retirement outcomes for millions of contributors if we implemented a few key changes:

1. Make retirement saving or auto enrollment compulsory for U.S. workers.
2. Embed an annuitization process as a mandatory feature of these plans.
3. Work toward simplification of regulations governing retirement savings plans so employers more easily understand them and are less concerned about potential litigation that may arise from forcing participants to save and invest.
4. Implement federally sponsored educational efforts so that current and future workers understand retirement savings, investment and distribution choices.
5. Severely limit pre-retirement withdrawals and loans to staunch the "leaks" we typically see in retirement savings accounts that can significantly erode their ending values.

STILL NOT SAVING ENOUGH

The three-legged stool that underpins the U.S. worker's retirement savings doesn't provide the same level of support, financially or education-wise, as the multi-legged models other countries employ. With the continued decline of defined benefit (DB) plans, Americans typically rely on employer-based defined contribution (DC) programs such as

401(k) plans, as well as Social Security and their own personal savings.

Despite all the publicity about underfunded retirements, we continue to see data about the paucity of Americans' retirement savings. Astonishingly few U.S. workers nearing retirement have saved enough (or any) money for their retirement years. In fact, about half of U.S. households aged 55 and older have no retirement savings at all, according to the U.S. Government Accountability Office Retirement Security report issued in May 2015. And that figure includes any 401(k) or IRA savings. Of those people with some retirement savings, the median amount saved is \$104,000 for households age 55 to 64 and \$148,000 for those ages 65 to 74. That's equivalent to an inflation-protected lifetime annuity of just \$310 and \$649 per month, respectively. It's not much money to supplement Social Security – assuming the program survives the next decades – and any personal savings, which often include home equity.

That means too many U.S. workers are relying almost exclusively on the government to provide funds during retirement rather than saving on their own. Many others must continue working part-time after their "official" retirement just to get by. The reasons for this are legion, but foremost among them is the fact that the United States does not require its workers to save for retirement. In a heterogeneous, melting-pot culture where self-reliance and bold decision-making are held up as virtues, we do not hold our retirement funding structure up to that same social scrutiny. Many workers can and would save, if only we required it.

HOW OTHERS DO IT

That situation contrasts markedly in other developed countries with well-regarded retirement structures. One huge difference is that the United States does not make contributions to pension savings plans mandatory. Nor do we require workers to understand the financial investment they are making in their own futures.

In Denmark, for example, employees contribute one-third and employers contribute two-thirds to the mandatory DC program, which incentivizes annuities by removing the limit on contributions paid into it. The Danish program provides greater protection against fraud, mismanagement or provider insolvency of members' accrued benefits, and it uses investment professionals to handle the DC funds' asset allocation. Norway has offered a national public insurance program since 1997 and implemented an updated pension plan in 2011. It includes a mandatory occupational pension arranged by employers for employees. And in the Netherlands, there are a number of "hybrid" DB-DC plans where the employee also contributes to the DB-type employer-sponsored program.

In Hong Kong, the government set up a mandatory savings scheme in 2000 under which workers and employers each contribute 5% of their salaries. Now, some 85% of employees are covered by a pension plan, far above the roughly 30% of workers who had voluntary coverage before the government stepped in. Hong Kong also is implementing a default fund option for investments if the participant fails to choose a specific fund for his contribution.

The default option has a cap on the fee charges as well as an investment strategy that is to be standardized across all Mandatory Provident Fund (MPF) schemes. And although Hong Kong doesn't encourage individual savings by offering a tax advantage, it differs culturally in that there is much more family support for retired workers than in the United States.

For a couple of decades, Canada has operated a federal pension plan¹ funded by worker contributions that more closely resembles a tax instead of mandatory savings via payroll deduction. To provide additional retirement income, Canada culturally has always encouraged individuals to take personal responsibility for saving enough to retire. That voluntary approach, however, is slowly changing as provincial governments realize that the federal pension will not completely fund retirement for its growing and aging population. So a couple of provinces, Ontario and British Columbia, are exploring setting up mandatory regional plans that could involve compulsory payroll deductions that would supplement the federal program.

Among the most forward-looking and aggressive government retirement schemes is Australia, where the government requires employer minimum super guarantee contributions of 9.5% into a superannuation fund. That money is invested in the employer's fund or the employee's fund of choice. One key difference between the Australian

and U.S. systems is that contributions to Australian superannuation funds are taxed at entry and are tax-free when transferred out of superannuation into retirement accounts. However, the recent 2016-17 federal budget introduced a AUD 1.6 million cap on the amount that can be transferred tax-free at retirement.

UNIVERSAL CONCERNS

Other retirement funding issues cross all geographic borders. Foremost among them are concerns about increasing amounts of regulations and paperwork around pension plans and schemes. The lack of clarity about the rules governing the plans, as well as opacity around the rule-making process, hamstrings those who must abide by the rules. As some pension sponsors note, it's hard to play by the rules if you don't understand them!

In Canada, for example, the Ontario retirement pension plan recently introduced penalties of up to CD\$10,000 for employers failing to comply with its rules. The problem, however, is that many employers don't understand the proposed rules well enough to know whether they are toeing the line or crossing it. Sometimes, they fear they would figure it out only after they have been slapped with fines.

Also universal among complaints is the recognition of a dearth of solid education aimed at making employees and students – the future workers – savvy financial consumers. Although some nations, including Australia, are addressing this with government-sponsored efforts, others have little in the way of national programs.

In the United States, we face a woeful lack of education to help workers understand and evaluate their retirement income on an annual basis. And too much of the material that does exist comes from financial companies with a vested interest (i.e., commissions) in guiding those monies into their own branded funds and investments when white-labeled funds might perform better.

We also foster the impression that 401(k) plans are the worker's total end-all, be-all savings, so many do not squirrel away much money in addition to those DC contributions. And given the annual contribution caps in place, a 401(k) plan alone likely will not provide enough income in retirement for many employees. So there must be other money set aside for retirement.

The focus should be not only on calculating likely budgets during retirement but also on figuring how much money a worker will have each month or year during retirement.

¹ The Canada Pension Plan is for all provinces in Canada except Quebec, which has the Quebec Pension Plan.

Instead of honing in on the total nest egg he or she has accumulated, we should look at annuitizing that amount to compare to the worker's expected monthly retirement budget.

One way to better acclimate future workers into this holistic mindset would have the U.S. Department of Education implement widespread educational programs starting in elementary school. These could indoctrinate young students into the habit of thinking about saving for retirement as a natural part of the transition process when they graduate from an academic setting into the working world. And they would help erase the fear factor that can grow up around the math needed to figure out future finances.

Another key change that U.S. plans should make would be to eliminate the ability of U.S. 401(k) plans contributors to take money out entirely or take loans before age 59-1/2. Many employees like the idea of a flexible retirement account that they can access if they deem it necessary. But this practice causes "leaky" plans, where it's estimated that some 40% of money contributed flows out long before the employee retires.

This contrasts starkly with policies in Australia, Germany, Hong Kong, the United Kingdom and Canada, all of which limit withdrawals to hardships. But the catch is that some U.S. employers and plan sponsors fear the accusations and potential litigation from employees if you take away their ability to access their own money.

MORE WORK AHEAD

Many of the countries with the strongest retirement systems also have much less federal debt to service and much higher taxes overall that fund their healthcare and pension programs. It's clear that the United States would be hard-pressed politically and socially to suddenly raise taxes to the levels seen in France or Denmark in efforts to strengthen our social safety nets.

But we can take other smaller steps – closing some of the loopholes that allow for early withdrawals, making some level of pension contributions mandatory and stepping up our educational efforts. All these are less angst-causing moves that are doable across a broader swath of the current work force. And all are clearly aimed at making the financial possibility of a less-stressful retirement achievable for more American workers.

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SECTION 2

WILL DC PLANS EVER DELIVER LIKE A DB PLAN?

2.1 ROUNDTABLE

Can adding alternative assets improve the performance of DC plans?

2.2 INTERVIEW

The role that alternative assets and investment strategies play in a DC environment

2.1 ROUNDTABLE

Can adding alternative assets improve the performance of DC plans?

Moderator

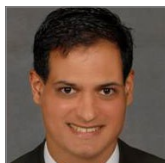


Hubert Danso
*Chief Executive Officer
and Vice Chairman,
Africa investor*

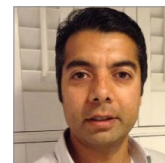
Panelists



Larry Powell
*former Deputy Director,
Utah Retirement System*



Ron Virtue
*Director, Investments,
JM Family Enterprises*



Jas Chumber
*Client Investment
Director, Unilever
Pension Investments*

Hubert Danso: How can alternative investments fit into DC plans?

Larry Powell: At Utah, we spent a fair amount of time looking into integrating alternatives into our DC options. We actually had a small allocation to liquid alternatives in one of more of our balanced options within our Defined Contribution (DC) plan.

I spent several weeks in Australia and as many of you know their entire superannuation scheme platform/ programs are structured as DC plans and most have illiquid alternatives in them.

There was one group I met while in Australia, with quite a bit of infrastructure in their DC plan. I really liked the structure of this particular plan and the limited number of options available to their participants. Their structure was really simple, they gave their participants 3 options as follows; cash, multi asset diversified or go somewhere else.

The problem many of the supers had in Australia during the great financial crisis is many of their participants pulled out of risky assets and into cash leaving the long term investors with all the illiquid assets.

In the end, everything worked out fine after the markets stabilized.

After I returned from Australia, we discussed in great lengths the differences between how the pensions are run in the U.S. vs Australia.

When it comes to resources expended to run the superannuation schemes and the human capital the Aussies allocate to run most of these plans is significantly less than they do here in the U.S. and pale in comparison to their Canadian counterparts. At the same time I thought in terms of structure, the Aussie plans which are almost 100% DC are way ahead of the curve than U.S. pension funds. U.S. pensions are moving in the same direction DC vs DB, however, we are a long ways from 100% DC.

In summary, in some ways the Aussies are way ahead of us and in others way behind.

Ron Virtue: Alternatives are best used as part of a bundled solution where they are in a balanced or life cycle type of fund or could be incorporated into a custom target date solution.

These investments can be difficult to understand for participants, and education is still needed even if they are part of another investment. But, it does create difficulty if people are choosing to move in and out of these investments on a daily basis because the real purpose of them is not as a stand alone option but rather that it is

in the correlation benefits that we see blending all of these different asset classes together.

We see the same benefits from many traditional strategies as well. So this could go for some alternative as well as traditional strategies which are best used, like emerging market equities, in a bundled solution.

Even on the traditional side, we believe that some asset classes and choices are best bundled with others in a life cycle type of fund.

Jas Chumber: We have over 80 funded pension plans in 45 countries so we see this challenge in many markets.

Our largest DC plan is in the U.S and is fairly sophisticated but we don't use many illiquid assets and are mainly liquid.

I am more focused on some of the European and Asian plans that we have. We prefer members to have limited but good quality choice with the default investment option being either through a target date or life cycle and in some markets we bundle or construct the funds ourselves.

We can take a number of the pieces and blend them together in a multiasset fund. Some of our multiasset funds do have illiquid assets like

emerging market debt, high yield and emerging market equity.

We haven't gone as far as to use private equity and this is where the big challenges would come. I do see challenges on use of some illiquid assets with fee caps on DC becoming prevalent in some of the European markets, particularly when these asset classes tend to be relatively expensive. In the UK there is a charge cap on DC retirement assets including member administrations of 0.75%. The risk is these charge caps will be lowered preventing investment in illiquid assets.

A lot of the DC plans in Europe tend to be smaller than in the U.S. as the U.S. mainly started this DC journey in 1974 following ERISA. Small DC plans are unable to benefit from economies of scale as much, and so is a challenge when it comes to cost and the ability to access illiquid asset classes in a cost efficient way.

Hubert: How are these investments structured differently for the DC market, as opposed to the way that they are structured for DB plans?

Ron: It can make sense to have a slightly different structure of the same investment type whether it is in DB or DC.

In a DC plan structure we could see a benefit from having a liquid portion in combination with an illiquid portfolio. So real estate could have a small component of public real estate combined with a larger component of private real estate, and the public component would provide that daily access to liquidity.

Or you could use a public vehicle that accesses the same alternative risk premia. One example could be to compare a global asset allocation fund to a global macro hedge fund. And, those might at times give you similar results in terms of risk and return, but

they are accessing different vehicles for their traits.

Another issue would be to look for non performance fee vehicles in the DC market, as the performance fee vehicle could be easier to implement in the DB plan.

Jas: They have to be structured in a multi asset fund as I don't feel that giving direct access to these illiquid assets to members would make sense.

We haven't looked at this in detail but this is something that we are thinking about and are carrying out research.

Hubert: What is inspiring you to do the research in this area?

Jas: It is about the potential illiquidity premium that could be captured. Some of the DC plan assets could be more sticky than DB because, as in my experience, I see in Europe little trading between accounts by the majority of members and expect assets not to be consolidated for a very long time and in many cases left until retirement.

“The only viable way DC participants can participate in alternatives is through some kind of life cycle, target date or balanced portfolio.”

The reason we are analysing illiquid assets is some research suggesting that DB investment returns tend to be on average 1% per annum higher than DC, of which part is suggested due to the illiquidity premium.

It is about trying to capture that liquidity premium that looks interesting.

Larry: There is no doubt that you couldn't have private equity or infrastructure as a distinct option in a DC plan. The only viable way DC participants can participate in

alternatives is through some kind of life cycle, target date or balanced portfolio.

The scheme in Australia I mentioned before offers what is essentially a balanced or DB option. They are trying to replicate what we are all doing on the DB side which is managing one giant pool of capital allocated across multiple asset classes including but not limited to global equities, fixed income, hedge funds, private equity, real assets and offer that as an option.

Hubert: What do you feel the benefits are?

Larry: I don't believe one could have a DC option with alternatives with daily liquidity, it would have to be quarterly or annually.

A lot of people suggest using 40 Act funds for hedge fund exposure in a DC construct as a viable option. However, I totally disagree as these funds are very different than what you get when investing in a limited partnership. Hedge fund managers generate huge revenues from managing their

private partnerships wherein they levy management as well as incentive fees. It would be financial suicide for them to offer the same strategy in their 40 Act funds where they can't levy incentive fees. If they were actually running the same strategy in both structures, all their investors would pull their money from the higher fee option (unregistered) and reinvest in the lower fee option (1940 Act).

Hubert: Is having a NAV at the end of each trading day critical for DC investor participation, or could they feel comfortable with a totally illiquid

“It is really dependent on where you are in the world, and the regulatory requirements of a particular country, etc. Some jurisdictions and structures demand daily liquidity.”

investment locking up their capital for long periods of time?

Jas: Unfortunately a lot of the platform providers in Europe would only put funds on their platforms if it has a daily NAV and sometimes we have to play the game which is being dictated, which may or not be the right thing for members.

There are other funds where we strike the NAV twice a month so there are possibilities there. However, given the platforms, particularly from a UK perspective, typically want daily dealing funds this is the market norm.

A lot of investors are used to daily NAVs and trading on a daily basis and this may now be imbedded as market practice and expected; to take that away now may result in some pushback from members.

I don't personally feel it is critical to have a daily NAV but given the way platforms are set up in the UK and Europe this leads in practice to a daily NAV type of arrangement.

Larry: There is no simple answer to this question. It is really dependent on where you are in the world, and the regulatory requirements of a particular country, etc. Some jurisdictions and structures demand daily liquidity.

The solution is you have an option which is dedicated to be a DB like alternative and the investor elects to be part of this and in return they may not have daily liquidity. Even if they did have a daily NAV it wouldn't mean they could mark to market illiquid assets on a daily basis as it doesn't work and it's meaningless.

At Utah, we had nearly 50% of our assets in alternatives and we had issues on a quarterly and monthly basis trying to come up with a really accurate NAV of our total portfolio because of the illiquid pieces particularly real estate which was significantly difficult to value.

At Utah, which I am sure is no different than other state plans, as a general rule, 20% of the participants were creating 80% of the activity in our DC plan. Some of the bigger members with larger interests in the DC plan were making lots of trades.

Hubert: Can you think of a time when it would make sense? Which countries would be more favorable to it?

Larry: The only country I know of which is 100% DC is Australia.

At Utah, we spent 99% of our time on the DB as it is where the bulk of our assets were.

Hubert: Ron what are your thoughts?

Ron: I do understand that in the DC environment particularly for record keeping purposes that a NAV needs to be struck on a daily basis, but part of that is just process and it does not mean that the entire NAV or allocation needs to have a different NAV on a daily basis.

You can have up to a certain percentage in a balanced fund with a NAV that changes on a less regular basis like bi-weekly, monthly or quarterly. As long as it is not a huge percentage, it is still fine if you have it written in your documents the right way.

This percent will be valued on a less frequent basis, and we will just use the most recent value.

The time frame is long for most DB and DC investors, so there shouldn't be a big difference. If you think of the liability analysis that is performed by actuaries on DC investors, is it really different just because of a DC structure as the liability is effectively the same.

We have a short-term mindset when we are participating in a DC plan just because we feel like we are controlling the assets and should be actively involved, making trades and moves. But if we are in a life cycle or bundled fund, then we are in the same place as if we are invested in a pool together on another type of DB plan. Except it is not the plan sponsor's obligation to provide a certain balance at the end.

Hubert: Are alternative funds the answer to getting DC plans to perform more so like DB plans?

Larry: Yes, DB plans are so much different in the way they are structured in general compared to DC plans and the big difference is the DB plan's asset allocation to alternatives.

Ron: I don't know if there is a single answer, but if you want to improve investment outcomes you would rather have more access to different types of investments.

If a DB plan administrator is able to invest in a wider group of investment types including alternatives and illiquid and has chosen to do this there must be a good reason.

On the flip side, this means that we are restricting the universe too much if we are taking investments out of our choices in DC plans.

If we look at the muted returns that most experts are expecting for the next several years in traditional asset classes, where are people going to see those returns from? It doesn't look very good

“DC Governance is still in development in Europe where the funds generally are much smaller and the governance around some of the DC funds is not as well established compared to the large U.S. and Australian DC plans.”

if DB plans have a much better return than DC plans as it looks like the DC plan participants wouldn't be in a very good situation. So they could benefit from having access to the alternatives as part of their investment even if they aren't the core choices.

Jas: From a governance perspective there is probably a higher level of due diligence that needs to take place on alternative assets.

On DB funds the risk is taken by the employer but on DC it is by the member so there is a higher level of due diligence required and many governance groups may shy away from illiquid assets because of the higher governance required. In practice, DC having more assets, particularly in areas like hedge funds, could be a practical challenge.

DC Governance is still in development in Europe where the funds generally are much smaller and the governance around some of the DC funds is not as well established compared to the large U.S. and Australian DC plans.

In markets, particularly in Europe where there are charge caps, investing in alternatives is a real challenge and in some cases may be a show stopper if there is a certain charge cap that you need to be below. Typically, a lot of the DC plans would like to be below the minimum by a reasonable margin, particularly if they hold out their DC solution to be low cost relative to the market to attract members.

Hubert: Do you have any final thoughts on this topic?

Larry: I believe, given the proper mindset there would be a huge market for a DC option with alternatives.

At the end of the day, it would probably be the more sophisticated investors buying into it. As Ron mentioned there is a lot of education needed to be conducted by the DC sponsor in order to get investors comfortable with the risks and the returns of alternatives

The risks aren't just the market going down and things going sour. As we have seen from several institutions here in the U.S. who have DB-like options in their DC plan, having too heavy of an allocation to alternatives in a rising equity market, from an opportunity cost perspective, is huge.

There are quite a few factors to consider but it is a viable option and in the U.S. we are moving towards a DC environment. The tide is definitely moving in this direction and we need to be prepared for the inevitable.

Ron: As a plan sponsor who has included alternatives in their DC plan we believe that it is in the spirit of the Employee Retirement Income Security Act (ERISA) as a prudent fiduciary to look at different levers that we can use to improve outcomes for our participants and alternatives are part of the whole solution.

Jas: It is all about the member outcome and alternatives may have a role to play but there are challenges predominantly to do with governance and costs. If these can be overcome then alternatives can have a future.

Hubert: Thank you all for sharing your views on this topic.

2.2 INTERVIEW

The role that alternative assets and investment strategies play in a DC environment

Interviewer



David Grana
*Report Publisher, Clear
Path Analysis*

Interviewee



Jonathan Epstein
*President, Defined
Contribution
Alternatives Association*

David Grana: Typically, what types of alternative investments are found in DB plans?

Jonathan Epstein: Some of the more common alternatives that defined benefit plans invest in include hedge funds, private equity and debt, direct real estate, Real Estate Investment Trust (REITs), infrastructure, emerging market debt and commodities.

Each DB plan is unique in its governance structure and investment philosophy. This makes it difficult to point to a proxy for an alternatives allocation.

A recent study showed there were large differences amongst corporate DB plans when analysing their allocations to fixed income, equities and alternatives. This is due to some plans having implemented a liability driven investment approach and others being focused on maximizing returns.

What we do know is that it is very common for DB plans to use alternatives to hedge risks, lower volatility, and enhance returns. It's nothing new, non-traditional investments have been a value generator for both corporate and public pensions for decades.

David: Which are the more common types of alternatives available to DC plan members at the moment?

Jonathan: Alternatives are being utilized by plan sponsors here in the U.S. and even more so in DC plans outside of the U.S.

About 5 to 10% of U.S. DC sponsors offer some type of alternatives strategy to participants, excluding REITs. When we include real estate, the aggregate alternatives exposure jumps to about 25% to 30%. It is also difficult to capture aggregate market data for alternatives holdings where plan sponsors use collective investment trusts, like with custom target-date fund structures.

If we measure the usage of alternatives by assets invested, the majority are held by the larger DC plans- even though we see a larger uptake in the smaller plans segment. This concentration at the mega plan level is most likely the result of familiarity and financial savvy with non-traditional types of investments. Most of the larger DC plan sponsors have had the benefit of being exposed to alternatives via their counterpart DB plans.

Some of the more common alternatives used in DC plans include high yield bonds, emerging market debt, commodities, Treasury Inflation Protected Securities (TIPs), and REITs. We also see these being packaged together as strategies to help offset the risk of inflation and the swings in stocks and bonds.

Other types of alternatives gaining traction include multi-strategy, fund of funds, and stand-alone strategies that may include managed futures, equity long/short, and risk parity. These can help reduce risk while others like global tactical asset allocation can help serve as an alpha generator. Due to its long track record of performance success, private equity is also being considered by plan sponsors as part of an overall

allocation strategy, like in custom target date funds or balanced funds.

David: We would then commonly see them in DC plans that currently have both DB and DC plans as opposed to just a DC plan?

Jonathan: At this juncture, I think common may be too strong a word. However, the types of conversations taking place among consultants, investment firms and decision-makers have evolved. The content being discussed is not so much on why use alternatives, but rather how and where to incorporate them.

David: Is there any type of data that shows the performance of DC funds that use alternatives opposed to those that don't? Is there a difference in the performance of one versus the other?

Jonathan: Yes there have been several studies by different firms analysing total returns and asset allocation differences between DB and DC.

The studies have shown DB plans have outperformed DC plans and by a range of 140 to 200 basis points. The studies also measured the differences over long periods of time.

Asset allocation is a key contributor to the differences. In addition, alternatives like private equity and real assets had outperformed other asset classes during the same time periods while not available in the DC plans being measured.

Another study looked at the performance of endowments and reasons why some consistently

outperformed others. This was over a 15 year time frame through mid-2014. The top 20 endowments had a 40% average allocation to alternatives and this contributed to their superior long term performance.

The enhanced alternatives exposure also provided added diversification when compared to both the typical portfolio of 60% U.S. equity and 40% bonds and to the average U.S. endowment fund.

The allocation to alternatives, in this particular case, included real estate, commodities and absolute return strategies.

The study also showed an average allocation to private equity at 19% and hedge funds and managed futures at 21%.

Comparing DB to DC plans directly can be quite difficult. DB plans have different governance structures, they are investment pooled with no participant self-direction, and are less reliant on daily cash flows. Basically, defined benefit plans reap the benefit of not having to accommodate for the same liquidity at the participant level which has an impact on the types of investments being taken advantage of.

That said, I feel strongly that DC plans have advantages when compared to DBs in that the industry gets to take only their best attributes and incorporate those into the DC model.

We have also seen the DC community collectively focus on enhancing participant outcomes. By investing in alternatives, plan sponsors can reduce risk, add diversification, and potentially achieve better returns.

Annuities found their way into DC plans to hedge against longevity risk. Now we are seeing more alternatives in DC plans to help hedge against other risks and enhance performance.

David: Are alternatives in the DC space a recent phenomenon?

Jonathan: In the DC space it isn't a recent phenomenon as there have been plans that have taken advantage of alternatives for quite some time. Over the last 5 years, we have seen incredible growth in real estate, commodities, and TIPs. There is also much discussion around liquid strategies due to the uncertainty of the markets, the interest rate environment, and the need to diversify equity risk within glide paths of TDFs.

It is hard to pinpoint an exact date when alternatives were first used in defined contribution plans because the term covers so many types of investments and strategies.

David: So, there is no question that it does benefit the portfolio and that it does increase returns?

Jonathan: If we look at private equity and specifically the Cambridge Associates U.S. Private Equity Index, it has generated 13.5% on a net basis and for twenty five years. Granted, this is outside of a qualified plan environment, but it shows the level of performance that can be generated for investors.

There are also different uses for alternatives. Hedge funds can be used to mitigate different types of risk, like inflation or downside risk and are typically considered either return enhancers or risk reducers. There is also implementation of hedge fund strategies within custom target date funds to help manage volatility and create a smoother ride for participants along a glide path. Basically, alternatives are used by plan sponsors because they can benefit portfolios and in different ways.

David: Are there limits as to how much of an individual's DC portfolio can be allocated to alternatives as a whole?

Jonathan: Typically no, plan level limitations are not imposed on a participant's ability to invest in alternatives within a participant directed plan.

However, this is one reason why the Pension Protection Act mandated target date funds, managed accounts and balanced funds as qualified default investment alternatives ("QDIA") with the exception of the stable value fund. These options have some type of built in methodology for asset allocation, taking the guesswork out of investing for a majority of the participants.

"There is also much discussion around liquid strategies due to the uncertainty of the markets, the interest rate environment, and the need to diversify equity risk within glide paths of TDFs."

This also doesn't mean that participants should invest all of their funds in a stand-alone alternatives option.

Alternatives are attractive because they can enhance risk adjusted returns, minimize downside risk and can protect against inflation.

David: Are what we are seeing in the market then a watered down or "light" version of alternatives, whereby, it is not purely investing in private equity or hedge funds but rather a version with added safeguards so that you are not completely exposed as much as in a DB fund?

Jonathan: This is the million dollar question of how you effectively present a more liquid form of an illiquid investment without diluting the underlying strategy. It really becomes a valuation, liquidity, and cash flow management discussion when using the illiquids as part of an overall strategy.

In a custom TDF, one strategy may be to incorporate an illiquid investment while keeping the investment intact. This can be done by effectively managing participant cash flows to bypass the illiquid investment. There

that uses REITs, commodities, direct real estate and TIPs.

There are also publicly listed private equity funds and private equity strategies that are available. Depending on the manager, the PE fund may have a built-in liquidity buffer to accommodate for capital calls and if used as part of an allocation strategy, participant cash flow needs can be managed at the vehicle level.

David: Then is it more of a multi asset strategy as opposed to a pure play?

fee while others view it as a profits interest that aligns managers with investors' goals.

Also, with sophistication comes cost. So, alternatives in general are more costly than your traditional equity or bond funds.

Outside of DC plans, hedge funds and private equity have traditionally taken a 2% investment management fee and a 20% profit performance share. However, those alternative strategies that are structured as open ended mutual funds are prohibited from charging a performance fee.

Many firms are starting to restructure their fees to be competitive in the DC space by conforming to regulatory requirements of the vehicle itself, providing greater transparency, and listening to plan sponsor needs.

David: It is likely that these investments have better performance, but that the overall returns are greatly reduced by the manager fees?

Jonathan: Cost is an important factor when considering an investment and it is a fiduciary duty to select and monitor them.

I cannot speak to the specific fees being charged by certain managers or their impact on net performance because the term alternatives encompasses so many types of strategies. However, the question is really about how much you are willing to pay for potential outperformance or to reduce risks. This is tied to the value being received for the cost being incurred.

DC plans and costs in general have been under a great deal of scrutiny. We see it with both litigation and the regulatory environment. Plan sponsors want to make sure their choices are protected or safeguarded. On the other hand, sponsors need to also weigh the benefits of including strategies that

“Outside of DC plans, hedge funds and private equity have traditionally taken a 2% investment management fee and a 20% profit performance share.”

would be no daily allocation to or from the illiquid investment and other asset classes would be used for the participant cash flows. The plan sponsor or their consultant would then have to manage the rebalancing around the cash gates or capital calls from the illiquid investment. This process will impact the allocation weights and has to be managed to also accommodate the overall glide path strategy.

Another method and used in Australia involves wrapping the illiquid investment with an ETF, mutual fund or index fund to meet daily liquidity needs and cash gates. This approach provides for liquidity at the option level and would receive daily cash flow allocations.

We are also seeing efficiency in the market to create strategies that take the best attributes of hedge funds and package them to be used as either a stand-alone strategy or as part of a multi-asset allocation fund. For example, an inflation hedge strategy

Jonathan: It depends. A plan sponsor may want to include a stand-alone inflation hedging strategy for participants. A stand-alone option could include an inflation hedging strategy using TIPs, Commodities, REITs and direct real estate. Whereas, a risk parity strategy may be added to a TDF glide path to help diversify equity risk while creating a less volatile ride for participants. It really depends on the type of alternative, where it makes sense, and what the needs are of the plan.

David: How do the fees compare to traditional equity or bond funds?

Jonathan: There are many reasons for cost variations amongst the different types of alternatives.

Investment and performance fees have been an ongoing concern due to transparency, consistency in calculations, and plain interpretation.

For example, some view carried interest in private equity as an added

can help provide their participants with better outcomes.

Measuring value for an investment may be to look at the performance being generated net of cost and net of the benchmark return. This can help plan sponsors when seeing these figures compared to similar investments and over time.

David: Someone would then have to look at past results and look to see if that does meet their criteria?

Jonathan: It is about what is reasonable, the value derived from the offering, and is it doing what it is intended to do. In addition, the DC market in and of itself is prompting many investment firms to make sure that they are charging reasonable fees.

Just yesterday I heard a hedge fund investment manager talking about how they are charging a 1% fee at the manager level and then because it is a fund of funds structure, different fees at the sub advisor level. This is off from the common 2 and 20 scenario.

It is hard to assess if the reduction in management fees is due to the compression in the DC environment or because of the vehicle used and its cost requirements. We are starting to see hedge funds enter and comply with the removal of the performance fee in order to use the open end 40 Act fund vehicle. As we see longer track records of performance for these funds, plan sponsors will have more intelligence on feasibility.

David: How liquid are alternative funds? Is it possible to liquidate before retirement, such as in instances where investors want to borrow against their 401(k), or to rollover their investment to another plan when they change employers?

Jonathan: Though daily liquidity is not a mandate of DC plans it is becoming more than just a bell or whistle and

“We are starting to see hedge funds enter and comply with the removal of the performance fee in order to use the open end 40 Act fund vehicle. As we see longer track records of performance for these funds, plan sponsors will have more intelligence on feasibility. ”

more of a standard in the U.S., whether you agree with it or not.

About 5% of plan sponsors do not allow plan participants to initiate daily transfers and still use monthly, quarterly or even longer timeframes.

In addition about 8% of DC plans are valued other than daily which most people may not know. There are liquid alternative funds that are daily valued and provide daily liquidity.

These can include combined hedge fund strategies as well as listed private equity. It is also the structure of the fund that may mandate the liquidity requirement, outside of plan sponsor and participant expectation.

The SEC requires daily liquidity when an open end 40 act fund is used but also allows for an up to 15% portion in illiquid investments.

This requirement in and of itself fits better with hedge fund strategies whose underlying investments use more liquid securities like equities or traded derivatives.

There are trade-offs for investment firms when deciding on the most effective vehicles to use when structuring a fund.

Some alternatives have other protection mechanisms like hedge funds and direct real estate. These funds typically see redemptions on a monthly or quarterly basis.

They may also use cash gates or a max percent that can be moved in a set time period and used to temper large redemptions within typical hedge fund investments.

They may also apply lock ups which then sets the time periods. With that said, these mechanisms are designed to protect both investors and the integrity of the underlying investments.

There is also no standard on how to make funds liquid, as this is borne from the underlying investment itself, valuation methodology, system capabilities and third party validation.

Regarding liquidity at the participant level based on the U.S. DC system, it is unfortunate that the DC environment makes it too easy for participants to access their funds.

Participants can access their funds prior to retirement while they are still employed via hardship distribution. This is used for things like purchasing a primary residence, for medical bills or even education.

Around 90% of the plans allow for this option and there is also an in service distribution which is permitted in about 80% of plans.

Also, when a participant separates from service they can withdraw their funds, roll it to an IRA or to a future plan, or keep it with their former employer. Certain rules apply for each of these options.

Basically, plan leakage is a primary concern here in the US and our system happens to be one of the most liquid and to a fault.

David: Is it common to see a NAV on many of these funds or is there still that quarterly or monthly withdrawal period that they outline?

Jonathan: Some common alternatives deriving a daily NAV can include emerging market debt/equity and high yield bonds. For valuations of private investments like direct real estate or private equity, they are usually done on a monthly or quarterly basis outside of the defined contribution plan framework.

These investments are utilizing different practices to help provide transparency around the methodology used to create the daily value, which can vary not only by asset but by firm.

Some firms and sponsors use indexation to help value their illiquid alternatives like direct real estate or infrastructure. They use a public index to serve as a proxy for the underlying pricing methodology.

Changes made in a public index can then serve as a basis for any changes to the actual investments.

To be successful, proper protocols need to be adhered to and governance in place to continually monitor data and adjust the pricing accordingly.

David: Is there ever any doubt as to whether these indexes are more or less accurate?

Jonathan: With private equity, there are firms that have composed indexes that can be used as a proxy to help with valuations. As far as accuracy, I would think that with time comes more data that can then be used to study lags and external impacts effecting valuations.

David: With these investments, what is the degree of uptake amongst DC plan holders?

Jonathan: I see growth with the liquid alternatives which includes your multi strategy and fund of funds.

There has been an uptake in these areas just based on the retail markets as assets have grown from 70 billion in 2009 to about 400 billion now. If we use that momentum as a proxy for DC plans, it represents a favorable outlook.

“These investments are utilizing different practices to help provide transparency around the methodology used to create the daily value, which can vary not only by asset but by firm.”

This is supported by a 5% uptake in the micro market as well as a similar figure for the mega plans.

I predict growth for illiquid alternatives like private equity, direct real estate and infrastructure and seeing them incorporated within the custom allocation strategies like TDFs.

We are also experiencing strong growth with target date funds. It is predicted that in 2019 target date funds will comprise 35% of all DC assets.

In addition, TDFs will receive about 88% of total DC contributions. If we pair that growth with the growth of collective investment trusts, this creates a healthy environment for

risk reduction and return enhancing strategies.

David: Will the TDFs surpass the traditional long only equity and bond funds that most investors have their pension asset allocated towards?

Jonathan: We are experiencing the structure of TDFs looking more like DB plan allocations. TDFs are evolving and starting to use sophisticated strategies and techniques within their design to better enhance participant outcomes.

If you delve into where TDF assets are invested, the majority sit with the mutual fund providers. We would have to see those firms incorporate alternative strategies to see larger impacts in the uptake.

The low interest rate environment and uncertainty in the markets is prompting plan sponsors to contemplate strategies that help with diversification and reduce risks. This fosters the use of alternative investments to help accommodate those decisions.

David: Do you foresee that there will be alternatives in many more DC plan offerings in the future?

Jonathan: Yes, I see incremental growth for multiple types of alternatives because they are being discussed at both the institutional and retail levels.

In terms of the drivers of growth, from the regulatory environment the Department of Labor just came out with a new fiduciary rule. They have taken a positive step forward from their earlier rendition by removing a list of asset classes that would have fallen under the best interest contract exemption in their final rule.

The removal of the list means that certain asset classes are not restricted from the exemption. We are also seeing more open viewpoints about alternatives in general.

“Education is paramount and supported by required disclosures and greater transparency. The use of more automated features in DC plan design helps to make positive decisions on behalf of plan participants.”

Some sponsors are also making it easier on participant choice by narrowing the number of core options made available. By reducing the number of core options, this simultaneously broadens the scope of the underlying investment styles and strategies that can be used. This is another opportunity for plan sponsors to engage alternatives.

As mentioned, the growth of both CITs and TDFs will serve as drivers of alternatives usage. In addition, plan sponsors are concerned with mitigating risks for participants at or nearing retirement.

There was a recent study that found that retirement confidence amongst the baby boomer generation was at a historic low and 24% of boomers were not confident that their savings would last them through retirement. The boomers are the 52 to 70 year olds. These figures serve as the basis of why plan sponsors, investment firms, and consultants are working together to create strategies that help participant outcomes.

David: At some stage we will then see more uptake from plan sponsors. Hopefully it will become a more common place investment to make like private equity, commodities, hedge funds etc.?

Jonathan: As plan sponsors start to learn more about the different types and benefits of alternatives, we will naturally see greater usage. It becomes a prudent choice for sponsors to want to listen to what can help their participants.

David: What about getting that information across to the employees, who themselves are making the decisions to allocate towards one fund over the other?

Jonathan: Education is paramount and supported by required disclosures and greater transparency. The use of more automated features in DC plan design helps to make positive decisions on behalf of plan participants. In other words, a participant should not have to become an investment expert to select a target date fund. Plan sponsors then have to collaborate with their service providers to develop an effective plan of action for participant education.

DCALTA was created to enhance participant outcomes by educating the DC community on the benefits of including alternatives within a defined contribution plan framework.

David: At my next 401k orientation I may then see a DCALTA representative or some related material educating me on what my alternative investment options are?

Jonathan: Hope so.

David: Thank you for sharing your time with me today on this subject.

SECTION 3

HOW TARGET DATE FUNDS HAVE CHANGED THE LANDSCAPE

3.1 INTERVIEW

A look at how target date maturity funds can be a route to the DB-ing of the DC investment plans

3.2 WHITE PAPER

Target date funds: Finding the right solution for participants

3.1 INTERVIEW

A look at how target date maturity funds can be a route to the DB-ing of the DC investment plans

Interviewer



David Grana
*Report Publisher, Clear
Path Analysis*

Interviewee



Julia Durand
*former Deferred
Compensation Director,
City and County of San
Francisco Retirement
System*

David Grana: Do target date funds make investing for retirement easier?

Julia Durand: If the point of a target date fund is to make investing for retirement simpler, then yes, absolutely they do that. Although, it has evolved into something bigger as it went from an idea of “set it and forget it” to participants having to select it, identify what type of investor they are, when they want to retire and how much money they would need for retirement. Target date funds were such a great idea in concept that they became the default investment choice for many plans. But with this, came an unrealistic expectation that these funds were going to be the panacea for financial planning when many of the plan sponsors’ appeal towards target date funds was the ease of getting non-participants started.

David: Are target date funds a one-size fits all solution?

Julia: There isn't and can't be a one size fits all for target date funds. One of the things that drove the target date funds for the 403(b) plan that I managed at CalSTRS was the realization that just because participants share the same birthdate, doesn't mean they have the same risk tolerance. We then designed the funds based upon age at the time of retirement and risk tolerance and that worked well for our participants. We had 3 different plans for someone who was retiring at, say, age 62, which were aggressive, moderate or conservative. Even if they had the same pay check and birthdate, people retiring at the same time could still have a different risk tolerance.

David: Have you seen many other employers offering the option based on risk tolerance?

Julia: We were the first and I didn't see many others using this type of target date option. Even in San Francisco (Deferred Compensation Plan) we didn't offer this type of investment option.

David: Would additional education about target dates funds be helpful for investors?

Julia: When the IRS and Department of Labor get involved and they attempt to establish rules designed to protect investors and guide those who are hired to help investors, (such as the 403(b) regulations that required disclosure), the unintended consequences of the most sweeping changes to 403(b) regulations in almost 50 years required plan sponsors to create books with all required disclosures, which a participant just isn't going to read. Participants barely read 30 seconds worth of information. Education has made things scarier. All of the small footnotes are a complete distraction and deters some participants from reading and learning more about their investments. I'm not sure that education solely is the answer.

David: Do you think investors understand the unique rebalancing element about target date funds?

Julia: I am not sure that there is adequate understanding of rebalancing. Not only by participants but even as plan sponsors. It would often create paralysis in the decision

making process of participants if they had to understand rebalancing. When I first started in this industry in 1998, when investments were doing really well, we had to explain how when one portion of a portfolio had a higher return, that you then needed to sell off some of the shares to get the balance back. It was a very tough sale. The question is whether it is more important for us to get someone in the plan or to try to educate them.

David: Do target date funds protect investors from market downturns, such as during 2008?

Julia: My initial thought is, “why are we trying to protect investors from such perils?” Paternalism is what gets participants into trouble in that some, not all, participants have an unrealistic expectation that they can invest and avoid loss. It was a healthy time to go through that loss, since that was when investors found out that they were aggressively invested. Everyone is aggressive when the market is up. I saw a lot of investors learn from that experience.

David: Can target date funds get DC plans to emulate the returns of DBs?

Julia: I see there is a race to the bottom where we want to get rid of the DB, when in actuality, we should be supplementing it with DC, not making DC the sole source of income in retirement. I do believe that DC plans are trying to mimic the results of the DB plans, but DB plans are run in such a different way. DB plans are evergreen and they have to invest as if everyone in it is a perpetual 70 year old. Whereas, in a DC plan, participants

are only worried about themselves and spending their last dollar on the last day that they are alive.

David: With target date funds, can investors “set it and forget it”, much like with a DB plan?

Julia: With a DB plan, none of us ever questions the investments - the board may - but the average pensioner doesn't question how often the DB plan is rebalanced. On the DC side we can't advertise the target date fund as set it and forget it. Why? Because we don't have enough historical data to say how things will eventually turn out with target date funds. With DB plans, we didn't have this either. Maybe the target date funds do pan out and 30 years from now we'll find out we did alright.

David: What options do target date funds offer for people who have not saved throughout their careers?

Julia: I don't feel that a target date fund would be appropriate for an investor who needs to make up for lost time. But more importantly I would redirect the focus on expectations and outcomes. A huge dose of reality needs to be administered to these individuals. If they haven't saved for retirement and are looking to be an investor who doubles their investments frequently, they would need to be shown a true example of what it takes to get there and, once you do this, most investors say that they aren't that aggressive.

David: Do some target date funds include alternative investments?

Julia: Yes. We used REITs back in 2007. They were small but did start growing. You factor in that in San Francisco, with the ones that we chose, they didn't move the needle on the returns quite like we had hoped they would. Selection is everything, so when we introduced these alternatives within our target date fund to our plan line up, if they didn't do well, it turned everyone away. Providers have to be

very careful as to which alternative investments they put forward in their plans. They have to be aware that if they don't work out, it sets a precedent and everyone backs away.

David: Are target date funds excessively risky?

Julia: No. Target date funds are a quick and easy way to get participants involved in saving for retirement. However, investors should research and study individual investment options so that they can diversify their portfolios once they learn what type of investor they are.

David: Do the fees differ greatly from other types of funds?

Julia: They tend to be in line with passive investments and sometimes lower.

David: Because a minimal amount of management is required?

Julia: Right.

David: As the target date fund reaches its retirement target date and rebalances to less risky and lower return assets, should investors expect fees to get lower?

target retirement age. If it goes into a non-active fund where 60% is in fixed income, the fees are already known because you are graduating into another plan. When someone reaches the target date they are actually put into the retired portfolio where it is not going to be rebalanced any longer. It is not inactive, but rather managed at a level where somebody is ready to take a withdrawal. And that brings up the topic of funds that are managed “to” versus “through”.

David: Can you please explain the difference between the two?

Julia: So the question is whether the target date is being managed to that date or through a date after that. Do they just stop once the target date is reached or is it continuing to be managed? The reason to stop at or after the retirement date involves many variables, such as that the person could take a lump sum, or they could take out monthly installments or periodic withdrawals.

David: What are the reasons for choosing one over the other?

Julia: The reason for choosing “to” is so the investor can dictate how to use the money after retirement. So if

“A huge dose of reality needs to be administered to these individuals. If they haven't saved for retirement and are looking to be an investor who doubles their investments frequently, they would need to be shown a true example of what it takes to get there and, once you do this, most investors say that they aren't that aggressive. ”

Julia: Not necessarily. I don't have an expectation that fees would get lower after rebalancing or reaching

the investor is, say, planning to buy a retirement home and will need a large amount of money in order to make

“We as plan sponsors often do things to redirect participants, such as a re-enrollment, because inertia sets in. Most of our problems are from participants staying invested in a stable value fund and never moving.”

the purchase, they can draw down the funds. If that isn't the plan and they would rather use it to supplement their income, but not immediately, then they will choose a “through” fund.

David: What happens if the fund has nearly reached its target date and it experiences another 2008 type crash?

Julia: Most of our participants would either panic and call to move their money and lock in their permanent loss or they would forget about it and leave it there. We as plan sponsors often do things to redirect participants, such as a re-enrollment, because inertia sets in. Most of our problems are from participants staying invested in a stable value fund and never moving. We had over 30% of our participants who were in stable value, which was atrocious. But we could not get them to move because of what had happened in 2008.

David: Do you see target date funds becoming part of the mainstream in DC plans?

Julia: They will become more mainstream but there is still a way to go.

David: Is the target date fund the solution that DC plans have been needing all these years?

Julia: It eliminates participant paralysis. Plan participants are so overwhelmed by the terms “investing” and “money”. If you have a target date fund, it makes investing easy by asking a couple of questions like how old you are, when you want to retire and then

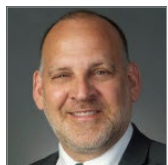
shows what fund to start off with.

But once a participant is invested, the next step is getting them to review their investment selection at regular intervals and even consider looking at the other plan investment options.

David: Thank you for sharing your views on this topic.

3.2 WHITE PAPER

Target date funds: Finding the right solution for participants



Tom Lauer
*Defined Contributions
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Trust*

As defined contribution plans increasingly replace defined benefit plans as the primary vehicle for employee retirement savings, responsibility for retirement readiness has shifted from employer to employee. Participants shoulder responsibility for investment decision and associated market risk. The average worker, who is not an investment professional, is expected to understand not only what to do with his or her retirement assets, but also what not to do.

The industry has taken steps to ensure these plans are on course to provide meaningful income streams for employees. For example, automatic enrollment has significantly increased plan participation. Additionally, automatic escalation provides a method for passively increasing the savings to meaningful amounts as employees progress toward retirement. Ultimately though, investment discretion is left firmly in the participant's hands. The industry is rife with stories of participants making the wrong investment decisions at the wrong times (for example, pulling out of equity after a market drop, only returning after the market has recovered). In an effort to ensure proper investment of retirement assets, is it time to take a stronger stance over how participants act?

To help participants better manage the long-term nature of retirement assets, target date funds (TDFs) were created. They offer a set mix of asset classes with a predetermined maturity date. Allocations in the fund automatically rebalance to more-conservative investments as the employee nears retirement. Participants select the fund and leave the rest to a predetermined glidepath. However, even these funds leave room for participant discretion. Participants can elect to invest in as many TDFs as their employer provides, and movement in and out of the funds is not restricted. This can create opportunities for less-than-ideal decisions, including market timing issues.

Take, for example, a large corporation's participant-directed activity during a significant market dip in 2016. For the first time since 2008, participant-directed transfers reflected a net negative position for their aggregated TDFs. Participant activity in other plans showed similar patterns. The movements out of the funds appeared to correspond to downturns in the equity markets. TDFs, with the inclusion of professional asset management, are intended to deter such participant-directed activity. Indeed, part of the design and advantage of these funds is to relieve participants of that

management burden. However, with nothing restricting movements out of the TDFs, a large number of participants reacted to the market downturn and transferred their money out in favor of fixed income funds.

Though TDFs are intended to help participants manage long term investing, is this happening? In reviewing transfer activity for a \$2 billion corporate DC plan, the following was observed:

- Of the plan's 18,500 employees, only 27% had a balance in at least one TDF.
- Of the approximately 5,000 participants invested in a TDF, nearly 95% invested in only one TDF. However, of the remaining 5%, nearly half invest in three or more vintage options, including a dozen participants who invest in 12 different vintages.
- Of those 5,000 participants, 70% used at least one other fund in the menu.
- Despite 27% of the participants having some money in the TDF suite, only 5% of the plan's assets were invested in those funds.

Some participants invest in multiple TDFs in an effort to further customize to their own target retirement date. However, in doing this, participants have unnecessarily diversified their assets. A TDF, by definition, is designed for a group of participants based on an approximate retirement date. It is already diversified, so investing in multiple TDFs is not necessary.

We believe it is time to restrict the use of TDFs in an effort to force participants to use them as intended. Here are some suggestions to consider:

- Plans should only offer vintages with 5 year increments, and participants should be restricted to invest in only one TDF. This is not suggesting they can only invest in a single plan option, but rather they can only use one TDF. For example, 50% to a 2025 Fund and 50% to the other non-TDF options is allowable, while 30% to the 2025 Fund, 20% to the 2030 Fund, and 50% to the non-TDF options is not.
- If plan participants want to "customize" their allocations, they could achieve that goal by using non-TDF options.

This would give participants an easier- to-calculate method than trying to meld different glidepaths.

- Transfers in and out of the TDFs should be partially restricted. By electing to invest in a TDF, a participant signs on to professional money management that has a defined investment strategy over a determined length of time. For example, a certain TDF may have a greater allocation to non-U.S. assets in an effort to increase diversification. Such a strategy may underperform in a strong U.S. equity market such as 2011-2014, but the horizon should be longer. Participants therefore should not move in and out in an effort to better the short term result.
- All participants who do not make an election should be automatically enrolled in TDFs. In addition, any participant who did not make an election in the past should retroactively be enrolled in a TDF. Participants can opt out if they desire, but the goal is to capture those who have never elected or are uncomfortable doing so. Though it may be operationally challenging to transfer funds out of stable value funds or culturally challenging to transfer out of company stock options, this is in the best interest of the participants. Both stable value funds and company stock are the options that tend to be the most misused investments and those most frequently in need of realignment.
- Re-enrollment should become a periodic event that occurs every 5 years. This process would serve as verification that participants are aware and approve of their investment choices.

These changes would move TDFs in the direction to more closely mirror defined benefit plan management: having a long term eye to the future with a goal of providing a meaningful income stream at retirement. That doesn't necessarily translate into accumulating as much money as possible, but rather accumulating enough money. Defined contribution investment shouldn't be viewed as way to get rich, but rather as a way to provide enough income to maintain a lifestyle. The dollars in these plans should be viewed as money participants must have at retirement, and should not be risked in efforts to accumulate more. This is where professional oversight is needed as participants may not understand that having either too much or too little risk can be harmful. Well-run target date funds combined with proper participant usage would best serve DC plan participants in the quest for a meaningful retirement income stream.

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*But you are stirred by the
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