A Forum on Defined Contribution Plans

Offices of Arrowpoint Capital - Charlotte

April 25, 2013

Prepared by: Hubbell Consulting, LLC

Today's Agenda – April 25, 2013

- Introductions and Logistics
- Target Date Fund Approaches - Various Investment Managers
- Roth 401(k) Feature – a Second Wave
- Participant Outcomes Based Communication
- Wrap-up

Target Date Fund Approaches - Various Investment Managers

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Structure and Characteristics of Target-Date Funds

- A comprehensive single investment option that allows investors to hold a mix of asset classes that both rebalances periodically and shifts allocations over time.

- Invests more aggressively in the decades before retirement and shifts to a more conservative asset mix in the years immediately preceding retirement. This shift in assets is called the “glide path.”

- Not a uniform investment type. Depending on the glide-path philosophy, the sub-asset classes used, and the nature and quality of the underlying investments, target-date funds can display markedly different risk and return characteristics.

- Longer-dated funds are predominantly invested in equities, and the percentage of equities declines over time.

- While stocks and bonds may account for a large portion of these funds, target-date funds also allow for exposure to alternative asset classes.

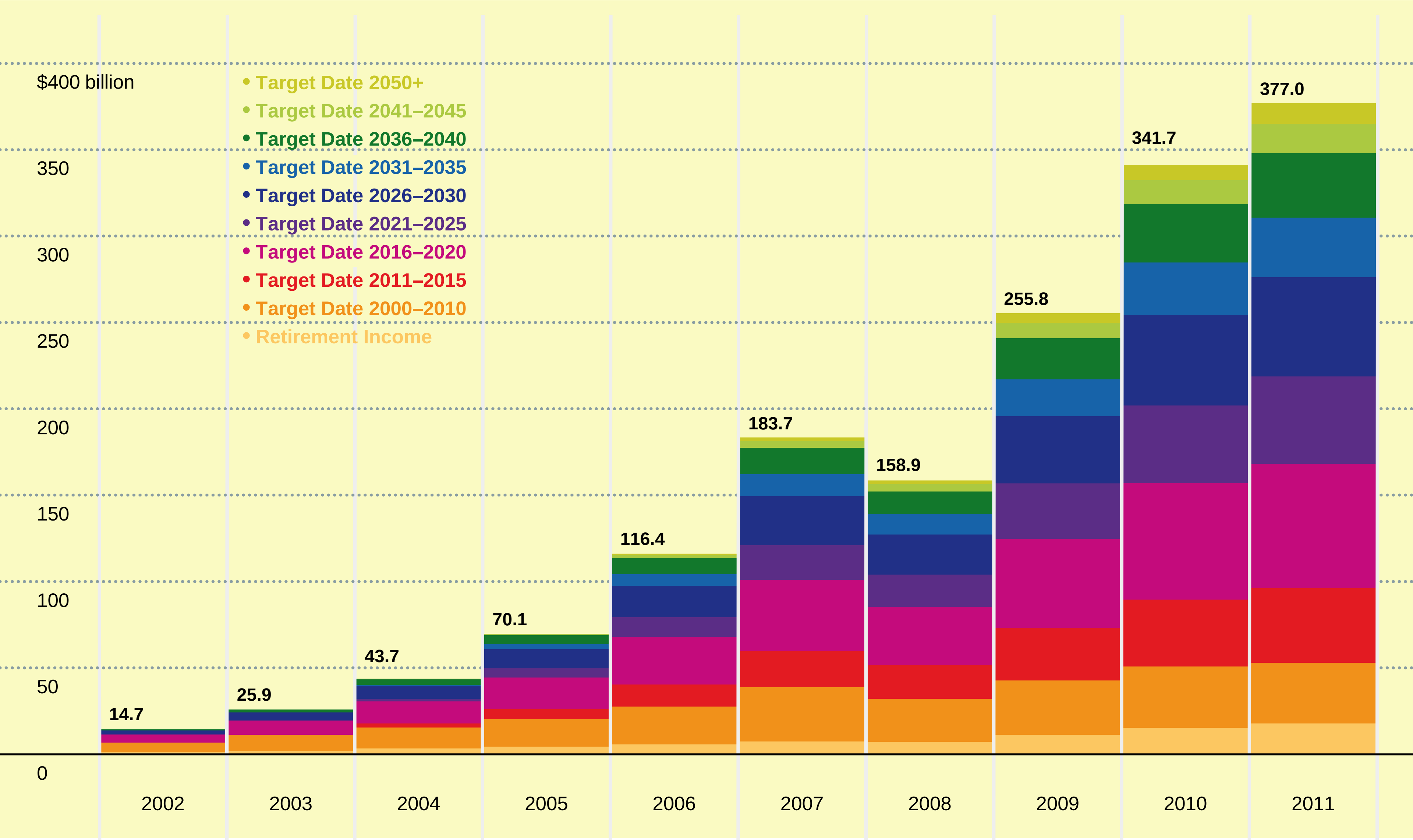
Three Mutual Fund Managers
Hold Over 65% of TDF "Mutual Fund" Assets

Mutual Fund Family	Asset as of 12/31/2012 (billion)*
1. Fidelity Investments	$143.3
2. Vanguard	111.9
3. T. Rowe Price	74.8
Total (all mutual funds)	$484.8

* Source: Morningstar Direct

Target-Date Fund Assets Continue to Rise

Total net assets by category, 2002–2011*



Source: Morningstar, Inc.

DOL Initiatives - TDFs

Disclosures and Fiduciary Duties

- DOL Proposed Regulation “TDF Disclosure” – Nov 2010
  - Additional participant disclosure under ERISA 404(a)-5
    - Explain asset allocation, how it changes over time, the point the most conservative allocation is reached, including a “chart or graphic” illustration of these changes over time,
    - Explain that the age group TDF vintage is designed to be “retirement-as of date” and include any assumptions about participants contribution/withdrawal intentions ON or AFTER such date, ***and***
    - Clearly state that: participants may lose money, (including losses near and following retirement) and there is no guarantee the fund will provide adequate retirement income.

- DOL Tips for ERISA Plan Fiduciaries – Feb 2013
    - Establish process for comparing/selecting TDFs
    - Periodic review of selected TDFs
    - Understand investment of asset allocation, individual investments, changes over time
    - Review fees and expenses
    - Inquire whether “custom” or “non-proprietary” TDF is a better fit
    - Develop effective employee communications
    - Document your process (selection, review, decisions)

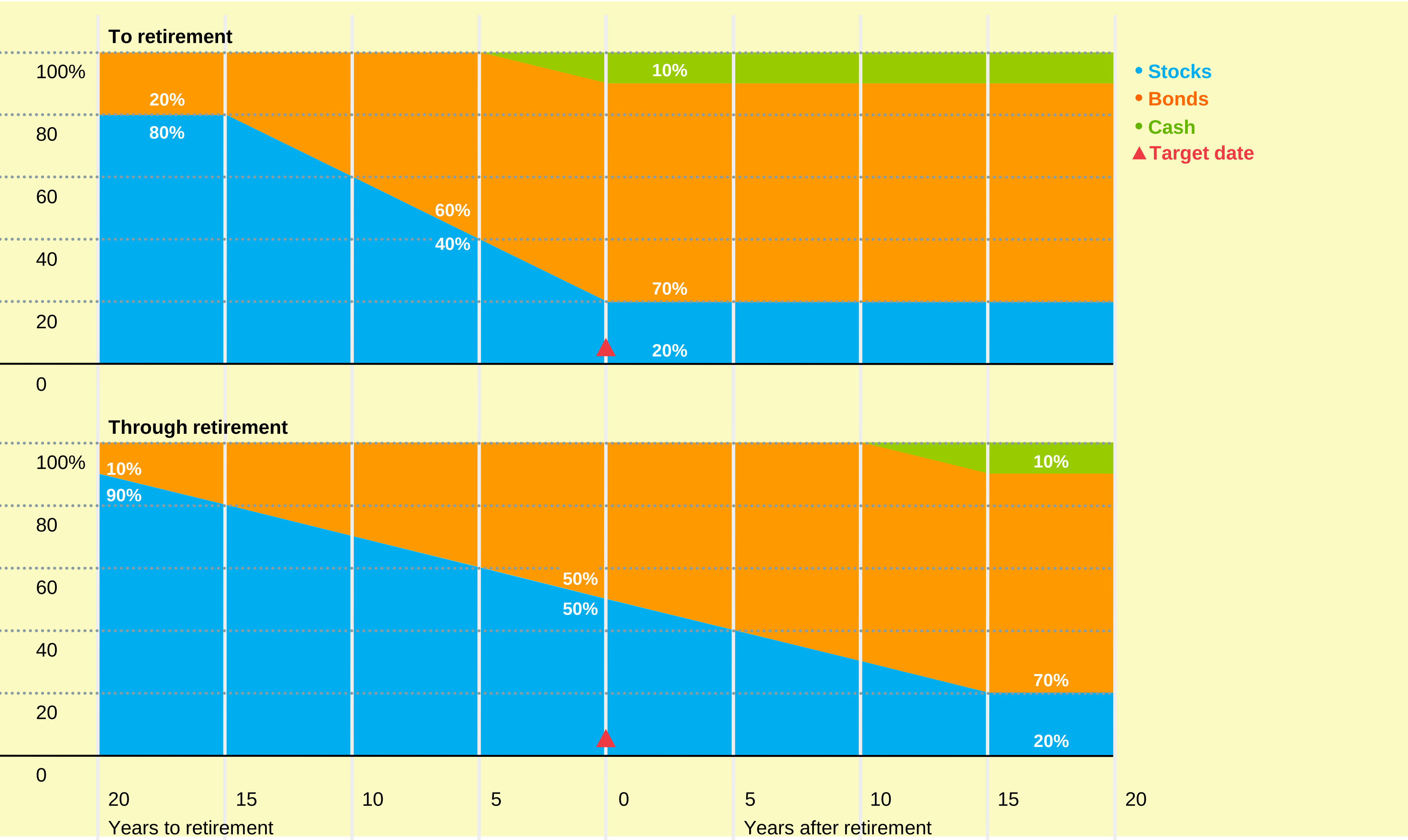
SEC – Recommendations

Investment Advisory Committee Study – April 2013

- Findings
  - TDFs total $485 billion end of 2012 (29% increase over 2011)
  - Well designed TDFs provide cost effective long term investment solution for many
  - Precipitous drop in values in 2008 of TDF vintage close to reaching “target date” brought attention to significant differences in risk levels among different funds with same vintage
  - Investors ill-equipped to identify risk disparities among similar seeming funds
  - Many pension consultants under-estimate the degree of risk among funds
  - 65% of TDF assets in 2012 held in mutual funds concentrated among three fund managers – Fidelity, Vanguard, and T. Rowe Price
- Recommendations to SEC
  - Develop “glide path” illustrations that include standardized measure of risk
  - Adopt standard methodology (or methodologies) for both risk-based and asset allocation glide path illustrations
  - Required TDF prospectus to disclose and clearly explain policies/assumptions to design/manage TDF vintages risk level over life of the fund
  - Supports SEC proposal to required TDF marketing material to include warning that fund is not guaranteed and losses are possible at or after the target date

Risk Level at Retirement

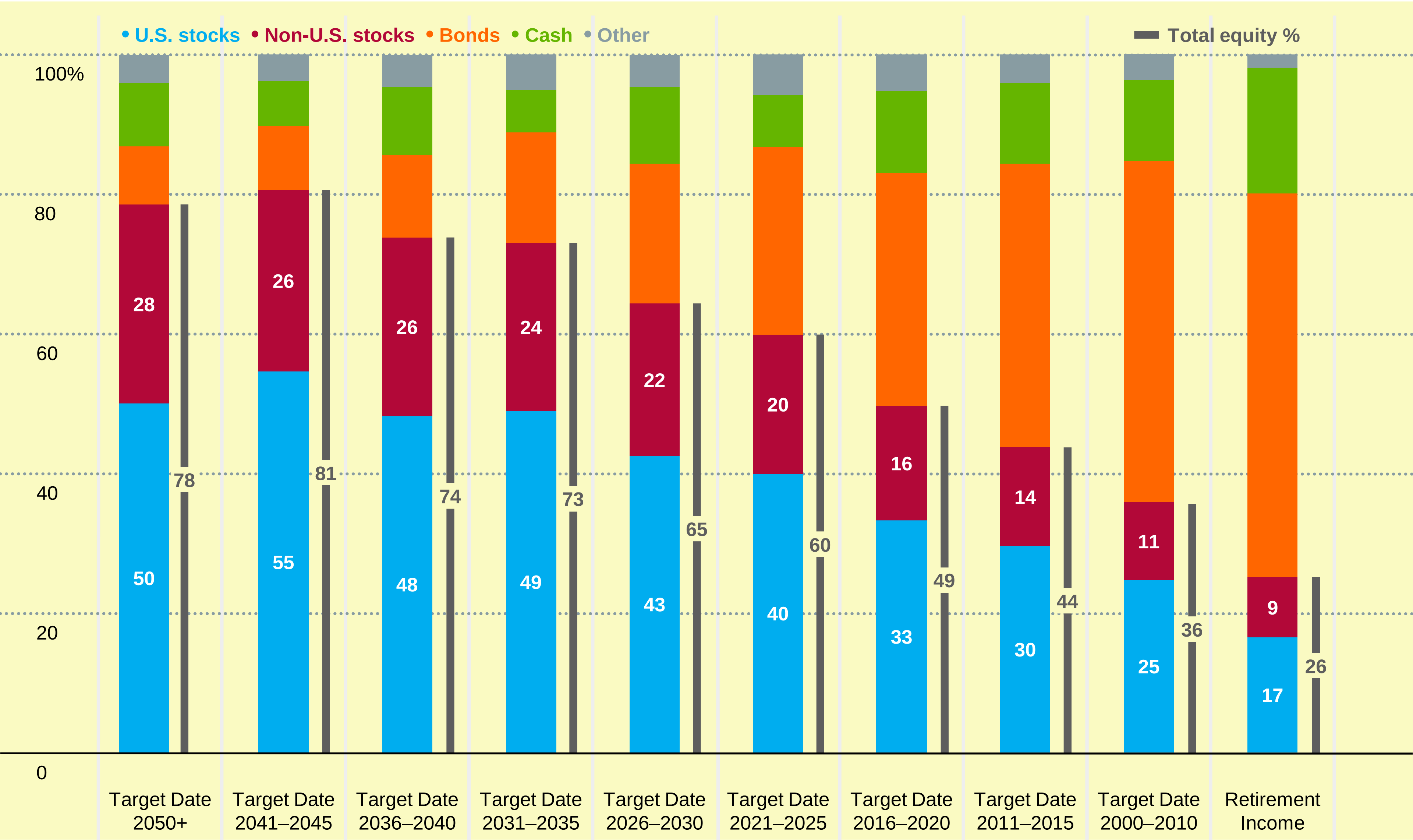
Comparison of “to” versus “through” funds



Source: Morningstar, Inc.

Target-Date Funds Alter Allocations Over Time

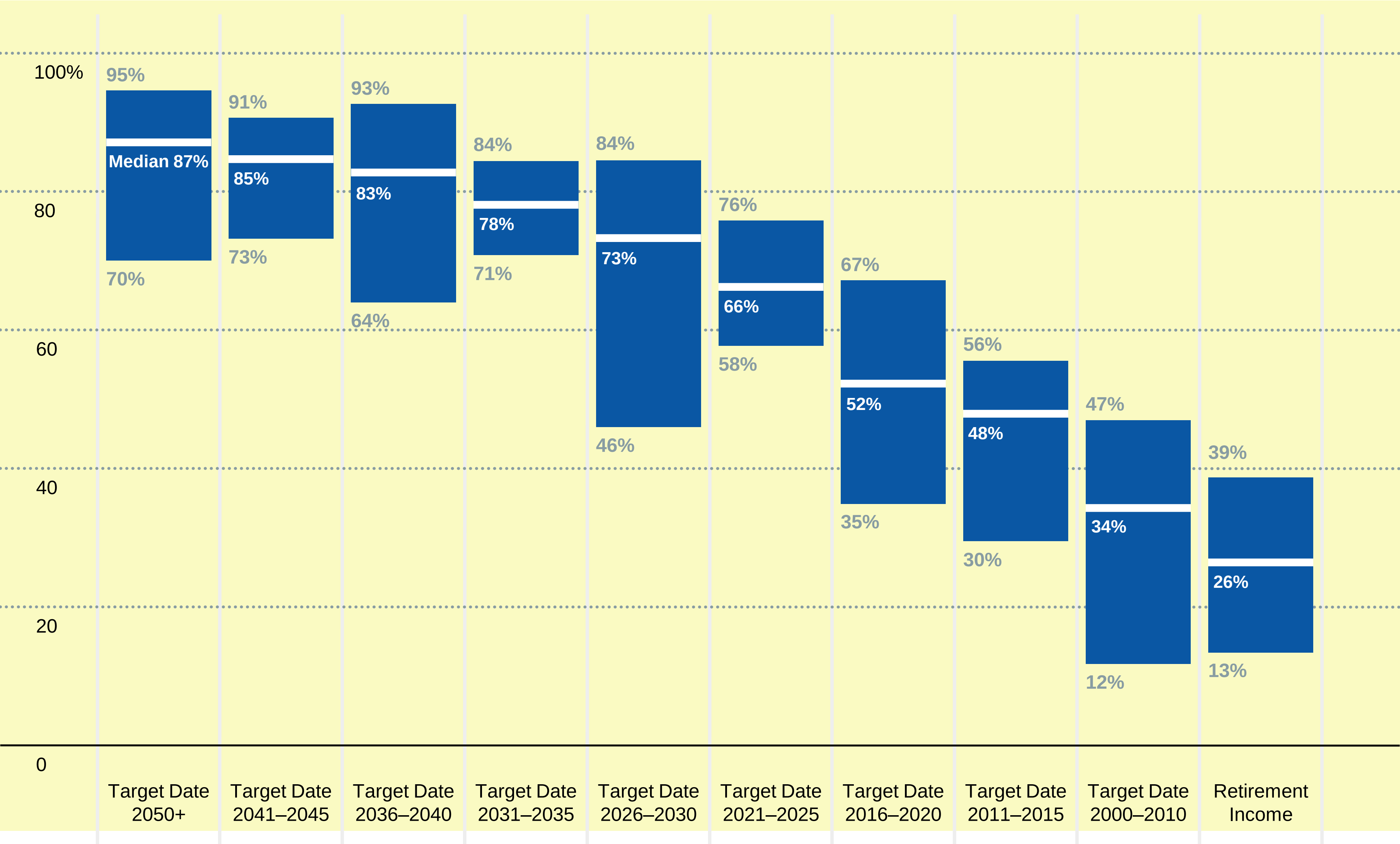
Average allocations to stocks, bonds, cash, and other investments



Source: Morningstar, Inc.

Target-Date Funds Display Lack of Consistency in Allocations

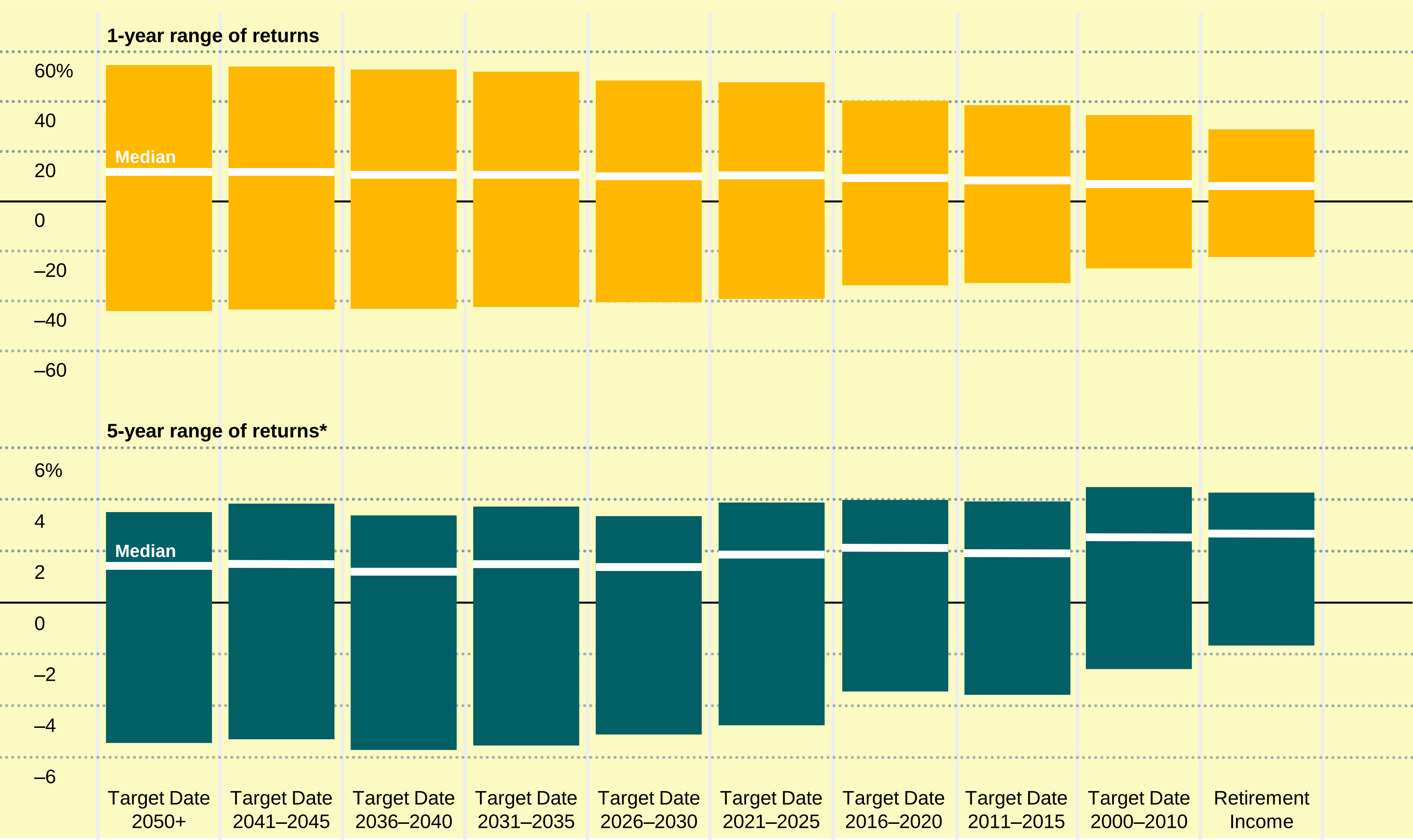
Range of allocations to equities as of November 2011



Source: Morningstar, Inc.

Risk Levels Differ by Target-Date Category

Rolling returns over 1- and 5-year periods, November 2003–December 2011



Source: Morningstar, Inc.

Plan Sponsor Questions – Evaluating TDFs

- What is the shape of the fund's glide path?
- How does the glide path compare to other funds in the same target-date category?
- What happens to the glide path at retirement?
- Is the fund intended to get investors "to" or "through" retirement?
- Is the fund diversified beyond stocks and bonds to include other alternative assets such as real estate, commodities, TIPS, etc.?
- What are the costs associated with the fund?
- Does the fund take a strategic or tactical asset allocation approach?
- What is the appropriate "benchmark" – Third party index provider? Custom index?

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Roth 401(k) Feature – a Second Wave

Carrie Teague - Principal (cteague@hubbell-llc.com)
Brian Hubbell – Principal (bhubbell@hubbell-llc.com)

American Tax Payer Relief Act of 2012 (“ATPR”)

Expanded “In-Plan” Roth Conversion Option

- Overview of ATPR Conversion Provisions
  - Plans covered – 401(k), 403(b), and 457(b). Plan sponsor choice to offer.
  - Participants may transfer “vested” amounts into existing Roth Account e.g. 401(k), Matching, Profit-Sharing balances plus earnings thereon
  - Effective for transfers post 12/31/2012
  - Participants subject to income tax in year of transfer on “taxable” amount
    - Not subject to 10% excise tax
    - Not subject to 20% to mandatory federal income tax withholding
  - Plan must provide for “Directed Roth” feature
  - Plan must add “In-Plan” Roth Conversion option
  - Converted amounts/earnings are tax free upon “qualified distribution”
    - If converted amount is withdrawn prior to 5 years from conversion or attainment of age 59 ½, such amount/earnings subject to 10% excise tax. New 5 year holding period applies to each conversion. The 5 year “starting clock” for contributing to “Directed Roth” account does not apply.

In-Plan Roth Conversion
Participant Advantages/Considerations

- Participant Advantages (if withdrawn as a "qualified distribution")
  - Eliminates concerns of future tax rates – all earnings "tax fee"
  - Diversifies "taxable" vs. "non-taxable" accumulations at retirement
  - May change "risk profile" of long term investing
  - Stage conversions over several plan years

- Participant Considerations
  - Expect their tax rate to be the same or higher in the future?
  - Can pay the conversion taxes out of nonretirement money?
  - Plan to keep the money invested for the long term?

- Qualified Distribution (requirements)
  - Designated Roth "established" for 5 years (first tax year deposit made)
  - AND – and attainment of age 59 ½, or upon death or disability

In-Plan Roth Conversion

Plan Sponsor Evaluation/Questions

- Is this a feature participants will find attractive?
- May a plan limit the conversion election e.g. frequency, amount?
- Is your plan recordkeeper able to handle recordkeeping e.g. tracking 5 year holding requirement on ***each*** conversion?
- Effective employee communication critically important
- Legal matters to consult your ERISA attorney:
  - Plan amendment(s)
  - Impact on annual "safe harbor plan" notices, if any
  - Drafting "conversion election" forms (is 402(f) notice required?)
  - Can option be removed from the plan (anti-cutback rules?)

Participant Outcomes Based Communication

Carrie Teague - Principal (cteague@hubbell-llc.com)
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Participant Outcomes Based Communication
– What does this mean?

- 401(k) Plans exist for a reason
  - Attract, Retain and Reward Employees
  - Plans which are not used miss the key purpose
  - Plans which are used are correlated with better retention
  - Engaged participants are engaged employees

- Plan sponsors should look back from the Participants’ Lens
  - Help me understand why I should contribute?
  - Make it easier for me to determine a good path forward
  - Keep me from making a dumb decision
  - Inform me where you can to make me a better investor
  - Don’t confuse me with too many and too much

If a plan sponsor knows most of his/ her employees do not have enough basic knowledge to be successful and decides to forego communication, is that decision in the best interest of participants?

Dennis Ackley, CEO of Ackley Associates, Missouri

Help me understand why I should contribute?
– Some context per EBRI

- Retirement savings may be taking a back seat to more immediate financial concerns, as follows:
  - Job uncertainty is more pressing – 30%
  - Making ends meets is next – 12%
  - Saving and planning for retirement trails – 2%

- Cost of living and day-to-day expenses head the list of reasons why workers do not contribute (or contribute more) to their employer's plan - 41%

- Debt may be another factor standing in the way:
  - Workers having problem with debt – 55%
  - Could you come up with $2,000 for an emergency – 50%

Help me understand why I should contribute?
– Change the focus

- Many employees see the big numbers and don't think they can get there
  - Show the short and long term aspects of savings
  - Improve financial security in case something happens
  - Reiterate this is your money – you can take it to your next job
  - State the obvious – you will retire someday, so you better save now

- More savings now means much more later
  - Power of compounding is very powerful (don't undersell it)
  - Financial pros say 17% of pay now, but 31% if start at age 45

- Don't throw money away – match, match, match
  - If you have a match, play that up and play it up a lot
  - Show their payroll contributions, but total assets at 1, 2 , 5, 10, 20 years
  - Men love to compete, so personalize how can get left behind

Doing nothing is improper education. The state of financial literacy today is so low that almost anything helps. Of course, plan sponsors should aspire to more than that.

Duane Thompson, Sr. Policy Analyst fi360, Pennsylvania

Make it easier for me to determine a good path forward

- Auto enroll will leverage inertia
  - Auto enrolling companies see much-improved participation
  - Employees are consumed with choices, so they fail to act
  - Do not make auto enrollment too aggressive, as it will cause more changes than if a reasonable goal is set
- Auto escalation is more rare, but is a good tool
  - Some view it as more Big Brother-ish, even sponsors
  - Communicate why you are doing it
  - Communicate it up front, communicate when changed and for a period
- Default Target Funds vs. Specified Funds vs. Models

Passing out enrollment booklets and expecting folks to read the material and fill out forms is not the answer…that booklet will end up in a pile on the kitchen table never to be revisited again.

Courtenay Shipley, CEO of Shipley Capital, Tennessee

Keep me from making a dumb decision

- Keep investment choices to a reasonable number
  - Cover asset classes, but don't duplicate
  - Provide me with models I can easily follow
  - Don't let me align my employment risk too much with my investment risk
- Don't design fund choices for a limited few
  - Avoids risk of inappropriate investing
  - Limits communication risk
  - Reduces cost of administration
- Default investment choices have a place

We need to stop trying to teach people as much to become better investors and teach them more to become better savers.

Multiple parties from multiple venues

Inform me where you can to make me a better investor

- Left brain thinkers vs. Right brain thinkers
  - Keep it simple and let more detailed folks drill down
  - Think structured flexibility to tailor

- Use models or target funds
  - Models offer structured flexibility
  - Target fund offer a turn-key approach
  - Only 63% of 401(k) funds are in equities, which is the average for an age 63 old investor

- Make me save more per pay period
  - Dollar averaging cures market timing risk
  - Most market timers miss the market

Create motivated learners using messages for the beginners, not the financial pros. If they cannot explain it, they did not learn it.

Dennis Ackley, CEO of Ackley Associates, Missouri

Don’t confuse me with too many and too much

- Know your audiences
  - Companies are a confederation of audiences
  - Marketing, accounting, distribution, manufacturing, sales
  - Demographics may vary within each group and group to group
  - Employees learn differently; give them choices and direction
- Think, Plan, Do
  - If I need to do something, tell me quickly
  - If I need to plan something, make it easier for me to talk
  - If I just need to think about something, let me know I have some time
- Do not give me too many choices – there is a diminishing return

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Critical Elements of a Successful 401(k) Plan Education Program – Christopher Carosa of Fiduciary News

- Element 1: Determine measures of success
  - Could be as simple as increasing levels of contributions
  - Could be increasing participation numbers
  - Could be the use of investment tools
- Element 2: Be consistent and regular
  - Do written communications jive with web communications?
  - Have a continual communication mindset
  - Define communication strategy – new enrollees, ongoing
- Element 3: Tie in with investment policy
  - Pains were taken to codify a strategy to determine asset classes, select manager and monitor performance
  - Communicate with employees this governance mindset and link their communications to the strategy

Critical Elements of a Successful 401(k) Plan Education Program – Christopher Carosa of Fiduciary News (cont.)

- Element 4: Cover both administration and investment
  - Must communicate fees, so define clearly what they pay for and why it is important
  - Link investment performance to fees and contrast both to benchmarks
  - Know this stuff is complex, so simplify where possible

- Element 5: Customize to the plan's audiences
  - Provide direction, but allow employees to seek their best path to learn
  - Measure what tools and media they use; desist less used tools if added cost; sell better avenues for learning
  - Think structured flexibility; key messages for all, but allow tailoring without undue administration
  - Balance cost and effectiveness; use your vendor budget wisely

Questions?

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