

## **TOP STORY**

### **Government Defined Contribution Leaders Meet with Congressional and Federal Representatives**

The National Association of Government Defined Contribution Administrators, Inc. (NAGDCA)'s Executive Board met with key congressional staff and treasury department officials on March 10 & 11<sup>th</sup>, 2008.

During their meetings with key Senate and House offices, congressional tax committee staff, and the Department of the Treasury, the board discussed technical corrections to the Pension Protection Act of 2006 and asked for continued support for the National Save for Retirement Week resolution. The House and the Senate unanimously passed a resolution in 2007 and NAGDCA is working to get a resolution passed again this year. NAGDCA also met with Treasury officials to discuss.

"As the voice of state and local governmental defined contribution plans, it is important NAGDCA show support for legislation and proposals that further the defined contribution industry and benefit plan participants," said Mindy Harris, NAGDCA President .

#### ***Mark your Calendar:***

#### **NAGDCA 2008 Industry Roundtable**

**May 15-16, 2008**

Hyatt Regency Washington on Capitol Hill

400 New Jersey Ave, NW

Washington, DC 20001

Phone: 1-800-233-1234

Fax: 1-202-719-8419

Room Rate: \$299/night plus tax

Important Date: Hotel Room Block Closes on April 15, 2008

#### **NAGDCA 2008 Annual Conference**

**September 13 - 17, 2008**

Marriott Baltimore Waterfront Hotel

700 Aliceanna Street

Baltimore, MD 21202

Ph: 800-228-9250

#### **National Save For Retirement Week**

**October 19 – 25, 2008**

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## PRESIDENT'S CORNER

This has been an extremely busy season for the NAGDCA Executive Board, as well as the organization as whole. Due to all the action going on within the retirement arena, we have been working to communicate NAGDCA's positions



on legislative issues with officials in Washington, while keeping members abreast of the latest news from Capitol Hill. The NAGDCA Board traveled to Washington DC for the annual Hill visits at the beginning of March, where we met with several congressional staff members and representatives of the Department of Treasury. In addition, we were honored to meet personally with Representatives Sam Johnson (R-TX) and Allyson Schwartz (D-PA). You will recognize their names as the sponsors of last year's first House Resolution declaring National Save for Retirement Week. This was a first, since my tenure on the Board, for the NAGDCA board to meet with the elected officials personally, and it speaks very highly of our organization's strong reputation at the national level.

During our time in Washington, we developed the following list of legislative priorities for the organization, and used these as our talking points during our meetings (to view the full letter of legislative priorities, [click here](#)).

- **Maintain Important Distinctions Between Governmental Defined Contribution Plans:** The continued growth in assets in governmental defined contribution plans is evidence of the value of these supplemental retirement vehicles. Therefore, NAGDCA supports the continued existence of substantive distinctions for §457(b) plans and governmental qualified (or 401(a)) plans. NAGDCA is concerned that efforts to further simplify or consolidate defined contribution plans may result in the loss of benefits to public employees and we have identified a number of practical concerns related to those efforts.
- **Parallel Savings Opportunities:** Enhancing retirement benefits and incentives for savings to all governmental and private sector workers.
- **Maintain Exemption From Early Withdrawal Penalty:** Under current law, government §457(b) plan employees are not subject to the 10 percent early withdrawal penalty. This recognizes the fact that many public employees, particularly police officers, firefighters, correction officers and other public safety officers, have access to early retirement options. In addition, many employees currently rely upon these early withdrawals to pursue retirement or phased-retirement options, including using these dollars to supplement health care costs during early retirement. Introduction of a Roth 457 option would be beneficial to lower income and younger employees as well as new hires allows for consolidation of retirement assets and lower fees for administration.

- **Maximize Unused Flexible Account Dollars:** NAGDCA supports allowing state and local government employees to roll up to \$500 dollars in unused flexible spending account dollars into their defined contribution plans (457, 401(k) or 403(b) plans) without having the defined contribution plans be considered a part of the flexible spending account plan.
- **Enactment of a Roth 457 Option:** 401(k) and 403(b) plans are permitted to offer a Roth 401(k) or a Roth 403(b) to allow participants to save for retirement with both pre- and post-tax contributions. It is important that public-employer sponsored 457 plans be permitted to provide this same range of retirement savings options to its participants. Roth 457 provisions are currently contained in H.R. 2419, The Food and Energy Security Act of 2007, and we urge its inclusion in final legislation.
- **Permit Non-Spousal Beneficiaries to Roll Assets to 457 and 403(b) Plans:** The PPA permitted non-spousal beneficiaries to roll assets they obtain as a beneficiary to an IRA. EGTRRA acknowledged that the consolidation of retirement assets is valuable to those with multiple retirement savings accounts. It would be similarly valuable to non-spousal beneficiaries to consolidate their beneficiary assets to their 457(b) or 403(b) accounts.
- **Extend the “National Save for Retirement Week” Resolution:** We appreciate the unanimous congressional support for the National Save for Retirement Week Resolution, first passed in the Senate in 2006 and passed by both the House and the Senate in 2007. We urge Congress to reintroduce and pass this resolution in the second session of the 110<sup>th</sup> Congress. National Save for Retirement Week is a solid example of the partnership we have developed over the years by giving national attention to this issue. It has enabled state and local government employers across the country to create a heightened level of awareness regarding the importance of taking personal responsibility for contributing to saving for retirement.
- **Increase Eligibility for Low Income Savers Tax Credit:** The addition of a provision for indexing of the income limits on the Savers Tax Credit is valuable and would allow more low-income individuals to take opportunity to save.
- **Fee Disclosure:** State and local government plans are open and transparent. Fee disclosure helps plan sponsors evaluate fairness and encourages competition in the industry which ultimately helps the participant. We look forward to continuing to work with Congress on this issue.

Anyone who joined the NAGDCAST #2, A Legislative Update of Defined Contribution Plans, would have been given the full update of our Hill visits, along with additional information on legislation that may affect us all as administrators of defined contribution plans.

Also, NAGDCA has several activities on the horizon:

- The 2008 Industry Roundtable (May 15-16, Washington, DC)
- Speaker selection for the 2008 Annual Conference (Begins in April)
- Working with congressional leaders to introduce the Resolution for NS4RW in 2008
- NAGDCAST #3: National Save for Retirement Week (Summer, TBD)

As members of NAGDCA, I encourage you to network with your fellow administrators and experience the variety of educational programs and networking opportunities NAGDCA has to offer. NAGDCA strives to keep its constituents apprised of the latest issues surrounding the defined contribution community and it is our goal to act as an educational resource for individuals throughout the industry. For more information on any of NAGDCA's upcoming events or deadlines, please visit [www.nagdca.org](http://www.nagdca.org) or contact NAGDCA at 859-514-9161.

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## **INDUSTRY VIEWPOINT**

### **Insights on the Continuing Credit Crunch**

*By: Wellington Management Company*

Not long ago, even some seasoned investors had never heard of SIVs or ABCP. Now those terms are part of the common parlance in the ongoing coverage of the credit crisis that was triggered last summer by problems in the subprime mortgage market. Since then, we've seen US mortgage foreclosures hit record highs and bank writedowns run rampant. We've also seen the public and private sector response, including infusions of capital into the markets by central banks. Most notably though, we've watched a true contagion take hold, with the credit crunch spreading well beyond the subprime market, driving increased volatility and risk aversion and pushing uncertainty about the broader economy to new heights.

So the question many are asking is what happened? The story is complex and still evolving, but here's a quick guide to the basic developments that brought us to this point.

### **Anatomy of a Credit Crunch**

Today's problems center on asset-backed securities (ABS), specifically those backed by subprime mortgages. The casualties have been numerous, from downgrades in ABS collateralized debt obligations (CDOs) that held subprime assets to a freeze on withdrawals from a Florida state cash-management fund after investors learned about its subprime-related holdings. More recently, some commercial mortgage-backed securities (CMBS) have been swept up in the credit crunch.

In recent years, ABS and other securitized assets have been increasingly repackaged into structured products, such as CDOs. A CDO is a trust that holds rated assets and issues debt against them. It can hold ABS, leveraged loans, or credit default swaps. The common characteristic is that the CDOs are leveraged, so any changes in valuations are amplified relative to the underlying securities. The problems we're experiencing today are concentrated in ABS CDOs, which represent about 20% of the outstanding CDO market.

How does a subprime mortgage find its way into an ABS CDO? It's a long path that begins with a consumer with poor credit history taking a mortgage from a mortgage originator who then sells pools of these mortgages to an investment bank. The originator can use the proceeds to originate more of these mortgages. The investment bank securitizes these mortgage pools into subprime mortgage-backed securities (subprime MBS) in the form of bonds with different credit ratings, ranging from AAA to BBB, and sells them to institutional investors. Most of the AAA-rated debt is sold to investment managers, banks, insurance companies, and pension funds. Prior to the credit crunch, the rest (AA, A, BBB) generally ended up in ABS CDOs, which were also issued as bonds in multiple rating categories and sold to institutional investors around the world; this segment of the market has effectively shut down since the credit crunch, however.

Banks were most heavily involved in the senior classes of ABS CDOs. International banking standards issued under Basel II encouraged them to hold AAA-rated assets due to risk-based capital requirements. The big underwriters of ABS CDOs – mostly broker/dealers – have been exposed to the super senior AAA tranches, where they earned fees but may now face counterparty risk as a result of potential downgrades of the financial guarantors (companies that insure municipal bonds and some structured products).

### **From Crunch to Contagion**

Since late last summer, the problems in mortgage-related assets have spilled over into other asset classes and, by degrees, the larger economy. Downgrades in subprime MBS translated into downgrades in ABS CDOs, which, due to their embedded leverage, became more sensitive to falling home prices. High-grade (AA, A) and mezzanine (BBB) ABS CDOs outstanding total approximately

US\$300 billion, and that is where the bulk of writedowns have taken place. Some of the downgrades have been severe – for instance, US\$1.5 billion of AAA-rated ABS CDOs were downgraded to CCC or below last year as of December 15.

From there, subprime problems fed into fears about the leveraged loan markets, where the loans are used to back collateralized loan obligations (CLOs). Leveraged loans have dominated the high yield market. Cheap financing enticed private equity firms to keep the LBO craze going, confident that CLO demand would continue, which created an enormous forward calendar of loans. When fears spread, demand for CLOs dried up, which reduced demand for leveraged loans and popped the private equity balloon.

Asset-backed commercial paper (ABCP) programs were the next victims. An asset-backed commercial paper (ABCP) program or conduit is a special purpose finance company that buys and holds receivables or securitized financial assets (auto loans, credit card receivables, commercial loans, equipment leases, CDOs, and subprime MBS) and finances the purchase of assets through the issuance of asset-backed commercial paper. ABCP represents over half of all outstanding US dollar-denominated commercial paper and provides cost-effective funding to a sponsoring bank's customers. The ABCP market allows receivable sellers that otherwise cannot directly access the commercial paper market to finance their receivables at favorable rates.

The problems started with SIVs, a type of ABCP conduit that buys highly-rated securitized assets and finances the purchase of those assets through the issuance of ABCP. SIVs differ from other ABCP programs in two important ways. First, they are leveraged investment companies. And second, unlike other ABCP programs that require liquidity backstops from a large bank to ensure that funds will be available to repay investors at maturity, SIVs do not have backstop liquidity agreements with banks. Instead, SIVs need to mark to market their assets and meet a series of capital and liquidity tests. Failure of these tests can result in SIVs being deleveraged and unwound.

A combination of mark-to-market losses on the assets, the lack of a liquidity backstop, and the leveraged nature of these conduits panicked ABCP investors in late summer and early fall. Investors balked at buying the commercial paper issued by these vehicles, leaving many SIVs unable to roll over their existing commercial paper and forcing their liquidation.

Several banks, including HSBC, Citigroup, Societe Generale, and Rabobank, have brought billions of dollars of their own subsidiaries' SIV assets back on their balance sheets. As SIVs and ABCP work their way back onto balance sheets, it will put more pressure on capital ratios and further reduce lending. In addition, interbank lending has sputtered due to the lack of transparency regarding subprime exposure. That is precisely how financials and the broader economy have become caught up in the credit crunch.

## **Sizeable Damage**

Financial institutions have taken approximately \$150 billion in writedowns due to their exposure to the subprime mortgage sector so far. These include writedowns related to subprime mortgage-backed securities, direct mortgage lending, ABS CDOs, and bank loan exposure. Further writedowns are expected.

Meanwhile, mounting balance sheet pressures and growing losses have made banks hesitant to lend. This can be seen in a number of markets. Swap spreads around the world, for example, are at elevated levels, and swap curves are inverted, reflecting more near-term concern.

## **Looking Ahead**

There are mixed signals about the near- and longer-term outlook. The potential positives include monetary policy and government support. The Federal Reserve has cut the federal funds rate and the discount rate, and introduced several non-traditional lending facilities to support the financial system. For its part, Europe has served up a huge volume of reserves to mitigate stresses in the banking system.

The lingering problems, on the other hand, include the continued deterioration of housing, signs that the consumer may be pulling back, and tighter lending conditions.

The credit crunch story is still being written. The situation is very fluid with new developments coming out every day that need to be understood and evaluated. Recent months serve as a stark reminder that credit ratings are but one factor to consider when evaluating the multi-faceted risks inherent in today's complex financial instruments. In this environment, independent credit research and in-depth structured finance expertise are of paramount importance.

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## **Riding the Market**

*By: The Hartford*

Some of the lessons we learned as children have important applications for us as adults. Remember learning to ride a bike? You'd be sailing along – then suddenly hit a bump – and down you'd go without warning. Most of us had similar experiences, and taken over the course of our childhood, they were relatively few and far between. Despite our bruises, we'd get back on that bike. We didn't let one crash – or even several – keep us from the joy we found on the open road. In other words, the benefits outweighed the risks.

## **What Goes Up Must Come Down**

Investing in the market can be a lot like riding a bicycle. The ups and downs market can be as varied as the terrain we traveled as kids. We learned then “what goes up must come down” – and if as investors we look at the big picture we better be prepared to handle the bumps we're bound to encounter in the market.

## **Getting a Handle on Market Terminology**

To help keep a proper perspective about the market, every investor should be familiar with some widely used market terminology. For instance, what is the difference between the correction and a crash? What is a bear market? What are some strategies you can use to help protect your investments from changes in market activity?

A *correction* refers to a drop in the price of a stock, bond, commodity or market, following a rise.

A *bear market* is more drastic, characterized by at least a 20% drop in the market, which lasts for a prolonged period.

*Crashes* are much less common – though much more severe – and are characterized by an instantaneous plummeting of the value of the market. Two notorious market crashes are the Crash of 1929 and the 1987 crash.

### **Help Guard Against a Fall**

Though experts and amateurs alike can watch market trends and speculate, it is impossible to predict what the market will do next. But many experts agree certain strategies, when implemented as part of a long-term investment strategy, can help work for the overall benefit of the investor.

### **Buy and Hold**

The “buy and hold” strategy has long been a recommendation of stock analysts and industry experts. This means purchasing a stock and holding onto it, even if the market is pitching and peaking. Although past performance is no indication future results, historically, stocks have outperformed other types of investments (Ibbotson, December 31, 2004)

### **Risk Targeting**

Another prudent strategy is knowing your risk tolerance – and investing accordingly. Equities have a certain level of risk associated with them, because they offer no guarantee of return. Generally, the greater the risk, the greater the potential for return. If you are averse to the prospect of losing some – or all – of your investment in a market downturn, you may want to structure your investment portfolio with few or no high-risk equities. Attractive returns on aggressive or high-risk equities tempt investors who are otherwise quite conservative. It's important to know an equity's history – and its potential for loss relative to its risk – before investing.

### **Diversification**

Diversification is the practice of spreading your investments – and thereby your risks – across a number of different types of equities. If one type of investment performs poorly, positive performance in other areas of your portfolio may help offset your losses.

### **Dollar Cost Averaging**

Dollar cost averaging is an investment concept that can help make the market's ups and downs work for you. By making systematic, continuous investments over time, this strategy allows you to purchase more shares when prices are low, and fewer when they are high. The result is the opportunity to purchase more shares at a lower average price.

Keep in mind that continuous or periodic investment plans neither assure a profit nor protect against loss in declining markets. Dollar cost averaging involves continuous investing – regardless of fluctuating price levels – so you should carefully consider your financial ability to continue investing through periods of fluctuating prices.

## **Charting Your Course**

Your financial professional can give you additional information about investments and investing which can help you determine an investment strategy that is suited to your needs, goals and personal risk tolerance.

Remember, investing in the market is a lot like riding a bike: If you're comfortable with the path you've chosen and are aware that there will be bumps in the road, it can be a great ride.

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## **Why plan sponsors should do everything they can to retain participants through retirement**

*By: Bob Beasley, CRC, CIC, Communication Consultant*

If you have a stake in a state or local government's workforce, you may be facing an important dilemma: whether or not to take a more active role in retaining current employees as participants in your deferred compensation plan into and throughout retirement.

This question may have seemed absurd just a decade ago; few money managers were actively pursuing participants' retirement assets, and rollovers from deferred compensation plans weren't easy. It may seem even more absurd today, given the inverse is true — there are plenty of product providers who'll gladly take those assets off your hands. Several tax law revisions since 2000 actually encourage rollovers out of employer-sponsored retirement plans.

At Nationwide, we believe it is in your best interest to help your employees not only pursue asset accumulation with deferred compensation throughout their careers, but also to help them better understand how to manage their assets as they prepare for and enter retirement.

## **Getting plan participants to stay**

Sixty-eight percent of employer-respondents to a recent survey conducted by Ernst & Young say retaining key employees and maintaining intellectual capital were the human capital issues of most concern, yet 62% of respondents say retirements would cause a talent gap or brain drain.<sup>1</sup>

Public employers are not immune to this growing challenge. However, through programs encouraging pre-retirees to continue deferred compensation participation, you can open the door to other income solutions such as phased retirement, or post-retirement part-time or seasonal work. These avenues may allow you to tap the knowledge and experience of your retirees, without adding “new employee” costs onto your budget.

You can also earn employee goodwill. When you openly promote your plan’s services as a way to help retiring employees prepare for the transition, you show current employees that they will remain valued through their careers and into retirement.

So the question may not be whether or not to take a more active role in retaining current employees as participants in your deferred compensation plan into and through retirement. It may be how to do it effectively.

## **Your employees need your help**

Today’s workers are likely to live a long time in retirement. At age 65, average life expectancy is 17 years for American men and 20 for women. Thirty percent of all women and almost 20% of men age 65 can expect to reach 90.<sup>2</sup>

Unfortunately, medical costs for retirees over 65 not covered by Medicare may exceed \$1 million for a couple over their lifetimes.<sup>3</sup> According to a recent report by The Commonwealth Fund, over the period 1980–2005 annual inflation in the U.S. for all items has ranged from 1.1% to 8.9%, and has averaged 3.3%. For

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Sources:

<sup>1</sup> 2007 U.S. Aging Workforce Survey, page 3, Ernst & Young, <http://webcast.ey.com/thoughtcenter/default.aspx?pid=802>.

<sup>2</sup> “Key Findings and Issues: The Impact of Retirement Risk on Women”, 2005 Risks and Process of Retirement Survey Report, page 2, citing US Life Tables 2002, Society of Actuaries, August 2006, <http://research.soa.org/WomensShortReportfinal.pdf>.

<sup>3</sup> “Key Findings and Issues: The Impact of Retirement Risk on Women”, 2005 Risks and Process of Retirement Survey Report, page 2, citing US Life Tables 2002, Society of Actuaries, August 2006, <http://research.soa.org/WomensShortReportfinal.pdf>.

medical care, the annual average has been 6.4%.<sup>4</sup> Yet, several targeted investments could improve the health and financial security of older adults.<sup>5</sup>

The National Retirement Risk Index — a calculation based on research conducted by the Center for Retirement Research at Boston College and underwritten by Nationwide — has shown that even if households work to age 65 and annuitize all their financial assets, 44 percent will be ‘at risk’ of being unable to maintain their standard of living in retirement. More realistic assumptions put the percentage ‘at risk’ even higher. And once health care is considered explicitly, the percentage of households that will be ‘at risk’ rises from 44 percent to 61 percent.<sup>6</sup> All current workers need to invest now to overcome that risk — a major selling point for encouraging enrollment — and all pre-retirees need to recognize and account for that risk as they develop their retirement-income plans.

### **Your employees need to know you can help**

In its March 2006 report, the [Nationwide Retirement Education Institute](#)<sup>SM</sup> found data showing that few pre-retirees establish an income plan or are familiar with an income annuity, yet most recent retirees wish they’d had an income and distribution strategy.<sup>7</sup> At the same time, they may feel besieged by enticements for rollovers or, potentially worse, more dubious options for their assets.

You, as plan sponsor, have already established a trusted role by providing retirement-planning services that are not motivated by profit. You can help future retirees see how they benefit by staying in your deferred compensation plan after they leave your employment. As *The Early Show* financial adviser Ray Martin reported for CBS News, there are at least three advantages for them:

1. In general, investment management fees for funds offered through your plan are a bargain when compared with those in IRAs.
2. Your plan is likely to offer lower account fees and unique investment options not found elsewhere.
3. Your plan provider may offer attractive and flexible distribution options designed to help you retain assets.

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<sup>4</sup> “Will You Still Need Me? The Health And Financial Security Of Older Americans: Findings From The Commonwealth Fund Survey Of Older Adults”, pp. xiii-xiv, The Commonwealth Fund pub. no. 840., June 2005, citing Consumer Price Indices, US Bureau of Labor Statistics, Bureau of Labor Statistics.

<sup>5</sup> “Will You Still Need Me? The Health And Financial Security Of Older Americans: Findings From The Commonwealth Fund Survey Of Older Adults”, pp. xiii-xiv, The Commonwealth Fund pub. no. 840., June 2005, [http://www.commonwealthfund.org/publications/publications\\_show.htm?doc\\_id=282096](http://www.commonwealthfund.org/publications/publications_show.htm?doc_id=282096).

<sup>6</sup> “Health Care Costs Drive Up The National Retirement Risk Index”, page 3, Center for Retirement Research at Boston College, February 2008, [http://crr.bc.edu/images/stories/Briefs/IB\\_8-3.pdf](http://crr.bc.edu/images/stories/Briefs/IB_8-3.pdf).

<sup>7</sup> “Trends in Public Sector Retirement Plans”, *America’s Retirement Voice*, Page 66, March 2006.

But, as Martin points out, retiring employees need to know your plan offers these (and other) advantages to them.<sup>8</sup> ***You need to tell them!*** As a leading provider of governmental supplemental retirement programs, Nationwide can help you with your participant retention. To get started, contact your Nationwide representative.

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## **Target Date Funds: The Case for a More Conservative Glide Path**

*By Paul T. Torregrosa, Ph.D., Director of Research, Global Index Advisors, Inc., and David A. Koenig, CFA, Wells Fargo Funds Distributor, LLC*

Target date fund assets have been growing rapidly in recent years, reaching \$152 billion at the end of the second quarter of 2007, according to the Investment Company Institute (ICI).<sup>1</sup> That's up from \$114 billion at the end of 2006 and \$71 billion at the end of 2005. In light of new legislation, target date funds are expected to become the dominant default option for automatic enrollment in defined-contribution (DC) retirement plans<sup>2</sup>. In making this shift, plan sponsors need to carefully consider the differences among fund offerings as they face the fiduciary responsibility of providing a prudent choice from among the growing number of fund families that offer these retirement solutions.

### **Target Date Funds as Default Option**

As of June 30, 2007, about 90% of target date fund assets were held in retirement plans. With U.S. plan participants holding \$3.0 trillion in 401(k) plans and \$4.4 trillion in all employer-based defined-contribution (DC) retirement plans, according to ICI, the assets held in target date funds are forecast to continue to grow rapidly. Indeed, target date fund flows exceeded the flows into domestic equity funds during the 12-month period that ended October 2007, according to Strategic Insight.<sup>3</sup>

Facilitating that growth are the Pension Protection Act (PPA) of 2006 and final rules from the Department of Labor that went into effect in December 2007 that permit the use of target date funds as the default option for automatic enrollment

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<sup>8</sup> "Retirement Plan Versus Rollover IRAs", CBS News, Feb. 1, 2006, <http://www.cbsnews.com/stories/2006/01/31/earlyshow/contributors/raymartin/printable1263713.shtml>.

in DC retirement plans. A 2007 Wells Fargo survey of plan sponsors reported that 66% of those who intended to change their default option planned to switch to a target date fund.<sup>4</sup>

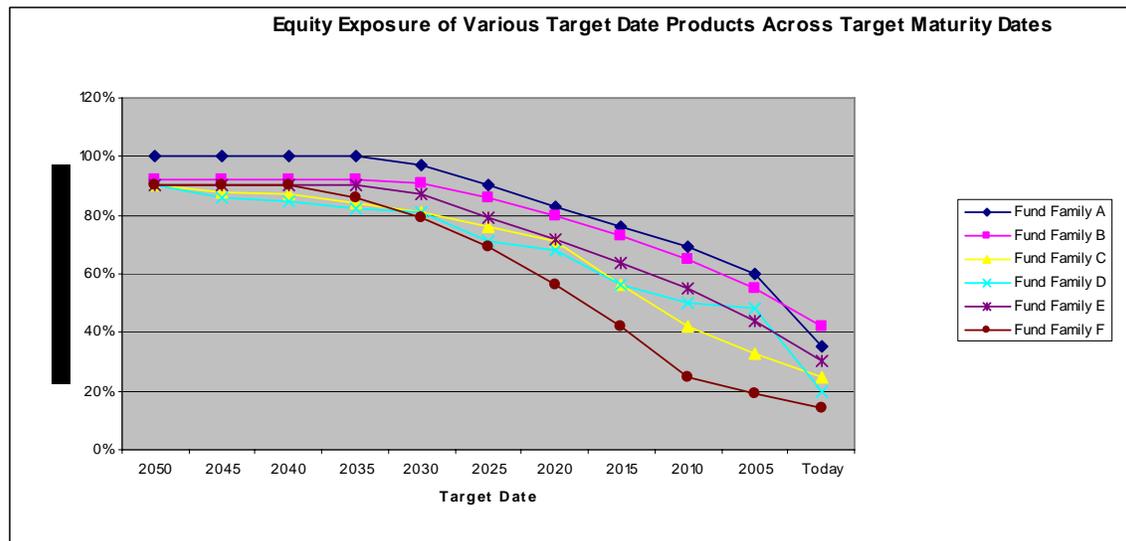
### The Glide Path: A Key Differentiator

While various target date funds may initially appear similar, beneath the surface they can be quite different in terms of construction and risk exposure. One of the most significant differentiators among target date fund offerings is the “glide path,” or the dynamic asset allocation strategy used to construct the funds. The choice of weightings among various asset classes as participants move along the path from accumulation to distribution is what provides the greatest impact on fund returns and potential downside volatility for participants. While greater equity exposure has the potential to produce higher returns in rising markets, it is important to determine whether those higher returns are the result of better active management or just more market risk.

In choosing from among the many target date fund options, plan sponsors need to ensure that they select a product that shares their philosophy about the appropriate risk level at each stage along the glide path and that provides a diversified, transparent, and repeatable investment process.

### Equity Exposure of Various Target Date Products Across Target Maturity Dates

(As of December 31, 2007)



Source: Fund family Web sites

## **DC Plan Participants Shoulder the Risk**

The evolution of retirement savings plans from traditional defined-benefit (DB) pension plans to DC plans has shifted the risk from plan sponsors to individual participants. While this has been occurring over many years and is well-understood, it is important to remember that individual participants have limited time horizons, unlike DB plan sponsors whose investment horizons can be infinite. Depreciation in DB plans due to market volatility can be absorbed more easily than in DC plans, as losses in the DB plan can be counterbalanced by gains over a longer future.

In DC plans, however, each participant's investment experience is path-dependent and a direct result of the specific time period when that individual is a participant in the plan. Because of this, participants with similar time horizons and risk exposure but different investment periods could have significantly different outcomes. A significant market decline at or near retirement can be catastrophic for individual plan participants as they do not have sufficient time or income to replace those losses.

With this transfer of risk to individual DC plan participants, as default options increasingly shift from stable value or money market funds to target date funds, fiduciary responsibility dictates that a more conservative approach to glide path construction be used in seeking to provide prudent downside principle protection.

## **Longevity Risk: A Savings Issue**

In assessing retirement savings risks, two significant types of risk must be carefully considered: market/volatility risk and longevity/shortfall risk. Market risk is one of the primary drivers of irrational participant behavior, but its impact on individual investors can be mitigated through product design that incorporates a more conservative approach to glide path construction. Longevity risk, or the risk of outliving your nest egg, is a predictable risk and is most influenced by participant saving behavior. It is impossible to eliminate this risk through product design, but research shows that automatic enrollment and automatic contribution increases can reduce it significantly.<sup>5</sup>

Plan sponsors need to understand that product design can only attempt to address one of these two types of risk. While some target date options attempt to mitigate longevity risk through greater equity exposure near and into retirement, we believe that this is an inappropriate response. Longevity risk is a savings issue, which is unlikely to be solved with an investment solution. Shortfalls in retirement savings should not be made up through aggressive allocation to risky assets.

## **Why Greater Equity Exposure Isn't the Answer**

More exposure to equities can't be the answer to inadequate savings levels. Markets are inherently volatile, as evidenced in recent quarters, and significant declines will occur. Higher levels of equity exposure mean more market/volatility risk, which can be catastrophic for plan participants who are at or near retirement and lack the time or

income to replace significant losses. While higher equity exposure should increase the expected average return over a long time horizon, it also increases the dispersion of expected returns among participants. With the relatively short time horizons of individual participants, that wider dispersion translates into a greater number who would be expected to fall short of their retirement savings goals.

In reviewing the table below, a plan sponsor needs to consider how many months or years of distributions an investor would have lost in just a few days. With significant market declines, a participant could lose an entire year's distribution in just one or two trading days. To plan participants, it's not the probability of an event that matters, it's the magnitude of the loss.

**Impact of Risk Posture on Plan Participants:  
October 10, 2007–March 10, 2008**

Participants in "Income/Today" Funds

|               | <b>Fund Option</b> | <b>Equity Exposure</b> | <b>104-Day Return</b> | <b>Dollar Loss on \$200,000 Participant Portfolio</b> |
|---------------|--------------------|------------------------|-----------------------|---|
| <b>Income</b> | A                  | 35%                    | -8.67%                | -\$17,346   |
|               | B                  | 42%                    | -6.05%                | -\$12,099   |
|               | C                  | 25%                    | -6.01%                | -\$12,026   |
|               | D                  | 20%                    | -3.05%                | -\$6,098  |
|               | E                  | 30%                    | -4.91%                | -\$9,824  |
|               | F                  | 14%                    | 0.69%                 | \$1,382   |

Participants in "2010" Funds

**2010 Funds**

|   |     |         |           |
|---|-----|---------|-----------|
| A | 69% | -13.07% | -\$26,144 |
| B | 65% | -10.50% | -\$21,008 |
| C | 57% | -12.00% | -\$23,994 |
| D | 50% | -8.59%  | -\$17,173 |
| E | 55% | -7.38%  | -\$14,755 |
| F | 36% | -1.56%  | -\$3,127  |

**Conclusion**

Plan sponsors should consider whether their chosen target date solution delivers an appropriate level of risk dictated by the original target date investment philosophy that they determined was appropriate. With the recognition that markets are inherently volatile and that declines will occur, sponsors need to understand that no one product can completely address both volatility risk and longevity risk. Significant market declines can be catastrophic for participants at or near retirement, so we believe that a more conservative glide path provides a more appropriate balance between upside potential and prudent downside protection at this crucial stage in the investment lifecycle.

Plan sponsors should consider a target date product's role in overall plan design and seek a fiducially sound product foundation on which behavior-enhancing changes such

as auto-enrollment and auto-increase can be implemented. They should then monitor the chosen product on how well it delivers on their philosophy about appropriate risk levels, not necessarily on how well it does compared with its peers.

#### **Target Date Selection Criteria**

- Choose a product that shares the plan sponsor's philosophy about the appropriate risk levels at each stage of retirement and saving. Focus on whether the investment process is meaningfully diversified, transparent, and repeatable.
- Provide significant opportunities for capital appreciation when investors are willing and able to take the associated risk.
- Implement a risk reduction methodology with a high probability of keeping participants invested at all stages.
- Provide meaningful exposure to key global asset classes.
- Recognize and reduce the danger of significant market losses immediately prior to retirement.
- Consider a target date product's role in overall plan design. Seek a fiducially sound "product foundation" on which behavior-enhancing changes like auto-enrollment and auto-increase can be implemented.
- Monitor the chosen product on how well it delivers on your shared philosophy, not necessarily on how well it does versus peers.

<sup>1</sup>*The U.S. Retirement Market, Second Quarter 2007*, Investment Company Institute, December 2007.

<sup>2</sup>*Trends and Experience in 401(k) Plans 2007*, Hewitt Associates, November 2007.

<sup>3</sup>Strategic Insight. Domestic equity is defined as the Morningstar nine-box categories plus domestic sector funds.

<sup>4</sup>*Strategic Initiatives in Retirement Plans 2007 Survey Analysis*, Wells Fargo Institutional Trust Services, August 2007.

<sup>5</sup>*Pension Design and Structure, New Lessons from Behavioral Finance*, ed. Olivia S. Mitchell and Stephen P. Utkus, Oxford University Press, 2004.

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## **Managed Accounts Ease Retirement Savings Challenges**

*By: David McLeod, Managing Director, Advised Assets Group, LLC*

Despite the development of innovative features and technology for defined contribution plans during the past 20 years, many government plan sponsors' to-do lists for this year likely still look like this:

1. Motivate employees to participate.
2. Encourage them to save.
3. Guide them to invest appropriately and manage their accounts over time.

Thankfully, a variety of specialized investment alternatives – particularly managed accounts – will make those tasks easier to achieve this year.

### **“Tell Me What to Do”**

Most participants recognize their lack of investing expertise, says Bob Wuelfing, president of RG Wuelfing & Associates, a leading retirement industry research and consulting firm. “When we survey participants about their needs in managing their defined contribution accounts, the most common response we get is, ‘Tell me what to do.’ Many employees are insecure about the investing process, and prefer professional advice to going it alone,” Wuelfing says.

Equally important is the need for plan participants to personalize their retirement planning to ensure the successful achievement of individual retirement goals.

“Knowing how much to save is as important as knowing where to invest,” says Gregg Seller, senior vice president of government markets for Great-West Retirement Services®. “Participants also need to consider their own individual circumstances and goals. When they take these steps, they’re more confident that their retirement plan is right for them,” he says.

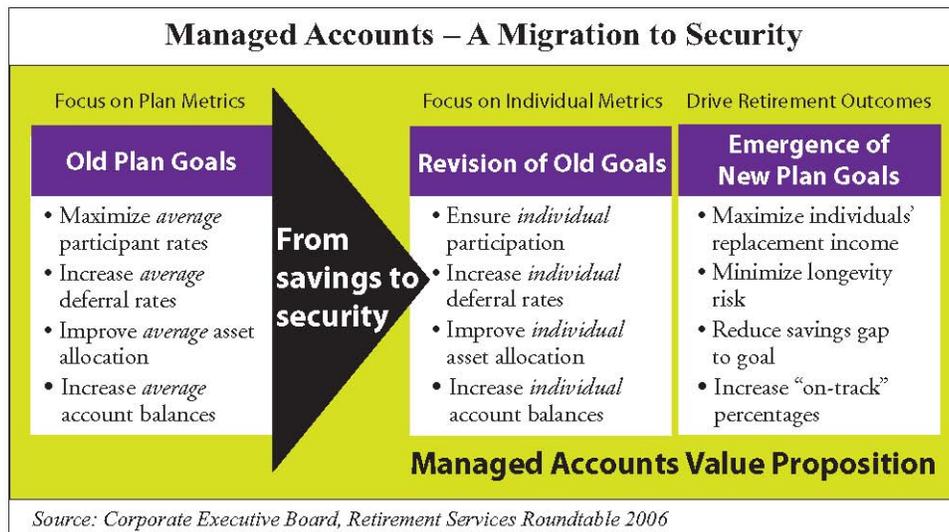
Fortunately for both plan sponsors and participants, there is an option that addresses these needs. It’s a managed account. Unlike “lifestyle” funds that have pre-set asset allocations based on risk tolerance, or target date funds that have an asset allocation mix designed for a particular retirement year, managed accounts analyze individual factors. They focus on the participant’s goals and provide specific recommendations on how to reach those objectives.

The employee and/or employer provide data about the employee’s deferral rate, account balance and account investments. The employee then provides information about his or her expected retirement age and retirement goals. Managed accounts also can take into consideration an employee’s or spouse’s assets outside the plan, such as a defined benefit plan.

## Managed Account Features

In our program at Advised Assets Group, we partner with an outside independent financial expert, Ibbotson Associates, to:

- Determine a specific investment allocation and savings rate recommendation for the participant.
- Assign an investment mix to the account using the current plan options.
- Realign the account to reflect that mix.
- Rebalance or reallocate the account quarterly.
- Adjust the participant's investment mix over time to align with their unique financial picture.
- Regularly provide each participant with their status with respect to achieving their personal retirement goals.
- Provide easy-to-use tools to administer individual financial profiles.
- Support participants with a staff of registered investment advisors for individual consultations on their use of the managed account program and its features.



As a result of this more personalized approach, managed accounts have become increasingly popular among plan sponsors and participants. In fact, according to industry research, through the end of the third quarter of 2007, more than \$56 billion had been invested in managed accounts through retirement plans, an increase of more than 50 percent from the \$37.3 billion reported at the same time in 2006.<sup>9</sup>

By following a best practices approach to investing and retirement planning that is monitored quarterly, rebalanced and reallocated over time to reflect individual life changes and market adjustments, a managed account enables plan participants to increase the opportunity and probability for improved outcomes

<sup>9</sup> Cerulli Associates

and a financially secure retirement. In the end, that is the goal for any retirement plan.

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## **WASHINGTON REPORT**

*By Susan J. White and Jonah Mainzer, Susan J. White and Associates, Inc.*

### **Washington Climate Continues to Add Uncertainty to Most Legislation; Although Various Retirement Related Issues Push Forward**

The combination of looming presidential and congressional elections and continued acrimony with the White House has slowed the pace of legislation and overall action by Congress this year. Additionally, party leaders on both sides of the aisle are concerned with forcing at “risk members” to vote on controversial issues, slowing congressional deliberations even further.

Entitlement spending and overall budget negotiations have combined to take up much of the legislative schedule recently and will likely remain on the calendar after Congress returns from its two week spring recess. In the last days before the Easter recess the House and Senate Committees on the Budget passed budget resolutions that set overall spending limits and the Senate and House Committees on Appropriations will begin deliberations in earnest in April on how to fund the thirteen federal agencies in the face of almost certain Presidential vetoes.

It is likely that the political climate will continue to affect the work that Congress is able to do this year. In fact, the only major legislation to pass may be a bill to continue funding for the Iraq war. This supplemental appropriations legislation may well serve as the only viable legislative vehicle this year in Congress—and many other “interests” may attempt to “pile on” before it passes late this spring. It is a sure bet that congressional leadership will attempt to keep such “add ons” to minimum, given the continual threats of Presidential vetoes.

In spite of the federal stalemates on so many issues, there is some movement on a number of NAGDCA priorities and concerns, including National Save for Retirement Week, Roth 457s and Fee Disclosure, as NAGDCA’s Executive Board learned while in Washington last month.

### **Executive Board Annual Visit**

The NAGDCA Executive Board recently held their annual visit to Washington to conduct visits. The day and a half of meetings included meetings with Representatives Sam Johnson (R-TX) and Allyson Schwartz (D-PA). Both members reiterated their strong support for a National Save for Retirement Week Resolution, and told the Executive Board that they would, once again, co-

sponsor the Resolution and seek its passage as soon as possible. Other meetings were held with the House Committee on Ways and Means, Senate Committee on Finance, The Joint Committee on Taxation, the office of Senator Gordon Smith (R-OR) and key officials at the U.S. Department of the Treasury.

As part of these meetings the Board discussed NAGDCA's legislative priorities for the coming year including the reintroduction of National Save for Retirement Week, the possibility of making National Save for Retirement permanent, Roth 457s, fee disclosure and technical corrections for the Pension Protection Act (PPA) of 2006.

### **Legislative Priorities**

During the Executive Board visit, NAGDCA distributed it's annual [priorities letter](#) letter. NAGDCA's priorities include maintaining the distinctions between governmental defined contribution plans, such as maintaining the exemption from the early withdrawal penalty; the creation of parallel savings opportunities between public and private employees; maximizing unused flexible account dollars; and, permitting non-spousal beneficiaries to roll assets to 457 and 403(b) plans.

### **National Save for Retirement Week**

With last year's co-sponsors—Representatives Schwartz (D-Pa) and Johnson (R-TX)—both members of the House Committee on Ways and Means—committed to move forward, it is likely that the National Save for Retirement Resolution will be reintroduced in the House in April or May of this year. In the Senate, Senator Gordon Smith (R-OR), member, Senate Committee on Finance and Senator Conrad (D-ND), Chairman of the Senate Committee on the Budget, are both committed to reintroducing the Resolution soon in that chamber and have completed a draft that NAGDCA has reviewed. Senators Smith and Conrad were the original sponsors of the first Resolution, passed by the Senate in 2006.

NAGDCA is also working with the Senate and House to make National Save for Retirement Week permanent—although it is likely that it would be extended to one month, as some co-sponsors have suggested. A permanent resolution, would require Judiciary Committee hearings in both the Senate and the House and, ultimately, sign off by the President proclaiming a certain month as National Save for Retirement Month. It is not likely that a permanent measure will work its way through this Congress; however, planning and discussions continue.

### **Technical Corrections**

On March 12, the house passed a technical corrections bill to the PPA on the suspension calendar. HR 3361, the Pension Protection Technical Corrections

Act of 2008 passed by voice vote and now must pass the Senate. The Senate, at the end of December, did pass S. 1974, Pension Protection Technical Corrections Act of 2007, on the Unanimous Consent calendar but as the two bills are not identical they must either go to conference or the Senate must pass the House bill before it can be signed into law. As both of these bills passed with out opposition it is possible that this can be passed in the current year.

### **Roth 457**

Last year, NAGDCA's Executive Board added the adoption of Roth 457 plans for governmental employees to the NAGDCA agenda. Since then the Senate Committee on Finance has proposed Roth 457's and a provision authorizing these plans for state and local government employees is currently pending in the Senate Farm bill, H.R. 2419, the Food and Energy Security Act of 2007. Currently it is unclear whether this bill will move forward or whether Congress will pass a simple extension of the measure before year's-end. The provision was also included in a Senate tax bill last year that did not move forward.

### **Fee Disclosure**

Chairman George Miller (D-CA), House Committee on Education and Labor, last year succeeded in bringing fee disclosure to the forefront, holding hearings and introducing legislation-- mainly affecting plans governed by ERISA. His legislation met with substantial opposition by the industry and he is in the process of re-drafting with plans to re-introduce legislation shortly.

Additionally, the House Committee on Ways and Means has conducted one oversight [hearing](#) with NAGDCA's President, Mindy Harris testifying as one of a number of witnesses. The Committee is in the process of writing a bill that will contain some provisions affecting disclosure for plans that are not governed by ERISA—however, according to Committee staff, the bulk of the legislation will address fees and how they are designed. There is no further word at this time regarding details of the awaited measure.

NAGDCA works closely with the Ways and Means tax panel and looks forward to reviewing draft legislation when it is available. In the meantime, NAGDCA has added this issue to its overall priorities, calling for fair, transparent and open disclosure of plan fees. Much of the Association's position was developed based on the Fee Disclosure Task Force appointed last year and the [survey](#) of NAGDCA membership designed by the Task Force.

NAGDCA has discussed with both the Senate Committee on Finance and the Senate Committee on Health, Education, Labor and Pensions (HELP) whether they have plans to proceed with hearings and legislation, as in the House. Although, these Committees have not ruled out action, it appears, at this time, they are waiting for further developments to unfold in the House.

On all fronts we will continue to work with the Committees of jurisdiction and the key members on the NAGDCA priorities and will keep NAGDCA informed as issues move forward.

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## **AROUND THE COUNTRY**

### **IRS Advisory Committee seeks input on Public Sector Plan Recommendations**

*Provided by: Julian Regan, Fidelity Investments*

The IRS Advisory Committee on Tax-Exempt and Government Entities (ACT) is reaching out to industry leaders including NADGCA to ensure public sector defined contribution plan recommendations the committee is developing incorporate expertise from across the government plan community. NAGDCA members who have not done so already may send comments to the ACT at one of the email addresses identified below by April 11, 2008.

The ACT serves as an advisory group to the Commissioner, Tax-Exempt and Government Entities Division of the IRS and includes members from the employee retirement plan, exempt organization and government entities communities.

ACT recommendations are aimed at facilitating improved compliance for public sector defined contribution (DC) plans. They will be finalized in late April for presentation to the IRS at a public meeting in June. The recommendations will likely encompass the following topics:

- Potential establishment of a prototype system for public sector 401(a) DC plans.
- Educational tools and initiatives the IRS might undertake to further facilitate compliance across all categories of DC plans (e.g. 401(k), 401(a), 457, 403(b)).
- General discussion of public sector compliance challenges, gaps and solutions.

As many NAGDCA members know, a prototype system, such as the system currently available to corporate 401(k) plans, provides a standardized form of agreement and may facilitate a lower cost of adoption as well as a reduced need for employer-initiated amendments as tax laws change. In addition to addressing compliance challenges, such a system may encourage more employers to adopt plans, particularly among smaller entities. The ACT recommendations will weigh these potential benefits, along with input from stakeholders and the implications to the IRS of administering such a system.

Beyond exploring the concept of a prototype system, the ACT will recommend cost-effective initiatives the IRS might undertake to serve the needs of the public sector plan community across all categories of plans. Such initiatives may include tools to assist employers and service providers in understanding and executing against statutory requirements. It should be noted that the IRS is already taking action in these areas. The ACT recommendations are intended to complement these efforts.

The ACT first contacted NAGDCA on this project in the spring of 2007 and NAGDCA immediately assisted by posting a survey to its web site. Beyond obtaining input from surveys, the ACT is meeting with industry experts and recently met with senior management from the IRS to stay abreast of IRS-led initiatives such as the Government Plans Roundtable the IRS will conduct on April 22.

As a final step in the outreach process, the ACT will include information through the NAGDCA Listserv. We encourage all members to send any comments to me at [julian.regan@fmr.com](mailto:julian.regan@fmr.com) or, to my fellow ACT member Susan Diehl at [sdiehl@penserv.com](mailto:sdiehl@penserv.com).

The ACT looks forward to delivering cost-effective recommendations that will advance the interests of governmental employers and their hard-working employees who are saving for retirement.

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## **NAGDCA Member Benefit Spotlight**

To remind members of benefits they receive that they may not be aware of, we will be spotlighting a benefit of membership in each edition of *The Contributor*. For more information on this or any benefit of membership, please visit our website at <http://www.nagdca.org/> or contact NAGDCA staff at (859) 514-9161.

### **Networking**

- An Annual Conference with unparalleled networking opportunities
  - An on-line Membership Directory that assists in locating other members
  - Government and industry member listservs to enable open channels of communication. The NAGDCA listservs provide an outlet for individuals to gather information in a timely manner.
-

## **New Members**

Please visit the NAGDCA on-line directory for member's full contact information. You will need a username and password to access the information.

### **NAGDCA Government Primary Member**

Debra A Ocheltree  
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**ABOUT THE CONTRIBUTOR**

*The Contributor* is published quarterly by the National Association of Government Defined Contribution Administrators, Inc. (NAGDCA). NAGDCA encourages the submission of articles on topics relating to defined contribution/ deferred compensation retirement savings/plans. Articles that appear under the by-line of an individual express the opinions of the author and not those of NAGDCA as an organization. The deadline for submissions for the next issue is June 14, 2008. Articles should be approximately two pages in length and should be submitted in Word format. Please direct all newsletter items and questions to NAGDCA, 201 East Main Street, Ste. 1405, Lexington, KY 40507. You may also e-mail submissions to Robert Hansel at [rhansel@AMRms.com](mailto:rhansel@AMRms.com). Please contact Robert Hansel at 859-514-9161 with any questions or comments.

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