

TOP STORY

NAGDCA Seeks Qualified Speakers for the 2011 Annual Conference

The National Association of Government Defined Contribution Administrators (NAGDCA) is now seeking moderators, facilitators and panelists for its 2011 Annual Conference in Albuquerque, New Mexico on September 10-14, 2011. This year's theme is Retirement Security: Learning from the Past and Envisioning the Future. Through the hard work of the 2011 annual conference committee, the conference is sure to be an educational experience, and will offer clarification on many ongoing issues. New this year!! On Tuesday ONLY during the meeting, concurrent sessions will be divided into two tracks. On other days of the conference, the sessions will not be divided by tracks. Track A sessions are for Attendees with Less than 5 years of experience and are designed to help facilitate the sharing of wisdom to our newer members as well as those who may have recently acquired new duties and responsibilities relative to their Plan. The interactive sessions will focus on the free exchange of concepts, tools, methods and objectives concerning 457 plan design and participant communications. The panels will respond to questions, concerns and challenges as posed by session attendees. This is a great opportunity to hear from your more experienced peers about lessons learned. Track B is for Attendees with 5 or more years of experience in the industry. Four concurrent sessions (offered twice during the conference), five government breakout sessions and four general sessions will also be offered. Knowing that our members want to be apprised on all issues, sessions at this year's conference will cover a wide range of topics including:

- Guaranteed Income Products
- Investments and Fiduciary Risks
- Protecting Participants from Inflation
- Asset Retention: How to Keep Members in DC Plans after Retirement
- Retiree Healthcare Benefits
- Target Date Funds and Regulations
- The Importance of Human Capital in Investing

[Click Here](#) to access the speaker solicitation form. Forms must be submitted by April 29, 2011 for consideration. If you have questions regarding the speaker selection process, call Kari Emmons at 859-514-9218 or e-mail (kemmons@amrms.com).

[Register Today!](#) Conference registration and hotel reservations are now open. The room rate is \$174/night at the Hyatt Regency Albuquerque and is \$145/night at the DoubleTree Hotel Albuquerque. Visit the [NAGDCA website](#) for more information.

Mark your Calendar:

Webcast: Legislative Update of Defined Contribution Plans
April 11, 2011
2:00pm – 3:30pm EDT

Industry Roundtable Meeting
May 12-13, 2011
The Washington Court Hotel on Capitol Hill
525 New Jersey Avenue N.W.
Washington, DC 20001

Annual Conference
September 10 – 14, 2011
Albuquerque Convention Center
Albuquerque, NM

PRESIDENT'S CORNER



Greetings NAGDCA Members:

The NAGDCA board recently returned from its annual visit to Capitol Hill in Washington D.C. Cherry blossoms were in full bloom and the city was more beautiful than ever. As Congress readies itself for either a compromise or a government shutdown, the mood could have been dire, but everyone we met with was very accommodating and gracious. This year for the first time, we met with the Securities Exchange Commission (SEC) where we visited with at least 10 SEC employees regarding prospective regulations surrounding wraps and municipal advisors. They seemed very open to our suggestions and we hope our visit leads to a positive outcome. One of the most prevalent topics was again that of combining the various defined contribution plans to simplify them for employers and participants. NAGDCA's stance is that we believe it is important to keep the provisions in the 457 plan that make it unique, including the exemption from the 10% penalty, the 3-year catch-up and the ability for our employees to contribute to both a 457 and a 403(b) or 401(k) plan without coordinating the benefits. The House of Representatives is no longer providing resolutions, but we are hopeful that the Senate will do so for the next National Save for Retirement Week. This year's priority letter was focused on permitting non-spousal beneficiaries to roll assets out of to other eligible DC plans, eliminating the "first day of the month" requirement, maintaining benefit eligibility upon separation from service, increasing the eligibility for low income savers tax credit, and fee disclosure. We also asked about the Required Minimum Distribution for Roth 457 plans and we hope to hear more on that topic in the near future. The NAGDCA board also asked Lew Minsky, Executive Director of the Defined Contribution Institutional Investment Association (DCIIA) and Josh Franzel, PhD, Vice President, Research Center for State and Local Government Excellence to meet with the Board and give an overview of their organizations.

NAGDCA's recent survey indicates that even in this economic downturn, participants have not made significant changes to their savings behavior. During the last two years, only 5% of the responding members saw a significant number of participants stop their deferrals. Fifty-two percent said there was no change when it came to reducing deferrals, and 40% actually saw a slight increase in the number of new enrollments. There was a slight increase in loans and hardships. However, average participation rates for all plans were approximately 22% in 2010; down from 29% from 2009. Fifty-three percent of the plan sponsors said they were very concerned about the level of retirement savings. Many believe that the main reason for this is that participants do not really understand how much they need in retirement. Other factors are the increasing health care costs; furlough days, pay reductions or freezes, and employee apathy (most have defined benefit plans). Plan sponsors are taking action to help their participants prepare for retirement by making enrollment easier, offering the Roth 457, and participating in NS4RW which draws attention to the retirement plans. They are using their websites, worksite visits and newsletters to get the word out. Currently, 28% say they are considering using social networks. While only 11% are considering auto enrollment, 64% indicate that they believe it would have a huge impact on their participation rates.

Many plan sponsors are working to get the Roth 457 added to their plans. Some states have to have statute changes, while others are working with their record keepers to get them in place. In fact, the recent NAGDCA survey indicated that 41% of the respondents plan to implement a Roth 457. The Roth will give participants another savings vehicle and we're hopeful most plans will see an increase in participation, especially for younger employees. There are still a lot of provisions that are confusing, and NAGDCA will be offering more educational opportunities, both during our legislative webcast scheduled for April 11 and then at the conference in September, where there will be a general session. Registration information for the webcast has been sent to members. Cheryl Press from the IRS will be on the panel, and members have been asked to submit questions for her prior to the call.

Speaking engagements are now open for the 2011 conference. An email was sent out on March 31 calling for interested members to sign up to speak at the conference. If you are interested, please visit http://www.nagdca.org/content.cfm/id/speaker_interest.

The Arthur N. Caple (ANC) Foundation scholarship applications are now available for interested students. InFRE is reaching out to universities to encourage students to complete the application. NAGDCA also prepared an e-postcard for NAGDCA members to forward to colleges and universities close to them to promote the scholarship and NAGDCA's other education initiatives. The Board will be reviewing the applications and awarding scholarships in the

next few months. The ANC fundraising committee is working diligently to get donations for the raffle at this year's conference. If you receive a call from one of the committee members, we hope you will volunteer to donate something specific from your state or monetary donations are always very welcome.

One last note; registration for the 2011 Annual Conference is now open! [Click here](#) to register.

INDUSTRY VIEWPOINT

The Re-Emergence of Collective Investment Trust Funds

Manning & Napier Advisors, Inc. Client Analytics Group

Introduction

As the retirement plan industry has evolved, so has the structure of investment vehicles used in 401(k) plans. Collective Investment Trust funds ("CITs") have been available for decades (first launched in 1927) and were offered in very early 401(k) Plans. However, the early versions of CITs provided investors little access to underlying holdings data and were valued infrequently, typically only once per quarter. As a result, CITs were quickly overshadowed as mutual funds, with daily valuations and greater transparency, became the more popular option. In fact, as of the 11/30/10 release of the Morningstar Direct database, of the \$8.4 trillion invested in U.S. mutual funds and CITs, mutual funds make up the bulk at 92%.

However, given the recent focus on retirement plan fees and full disclosure, and in light of technological advances, it appears that CITs may be gaining market share. Only available through certain qualified retirement plans, CITs equaled approximately \$1.6 trillion of the \$13.4 trillion U.S. retirement market as of the first quarter of 2010. Per Morningstar, that figure represents a 14% increase from a year earlier. Furthermore, this represents a significant increase over the last decade, as government estimates indicate there was less than \$800 billion in CIT assets in 1999¹.

Below we define CITs, discuss how they are structured and illustrate how they compare and contrast with mutual funds.

Collective Investment Trust Funds Defined

While there are several types of commingled or pooled vehicles, a CIT is a trust administered by a bank or trust company that combines assets for multiple investors meeting specific requirements as established in the CIT's regulating document, the Declaration of Trust. CITs are regulated by the Office of the Comptroller of the Currency ("OCC") and subject to oversight by the Internal Revenue Service ("IRS") and the Department of Labor ("DOL").

As defined in the Code of Federal Regulations - Title 12: Banks and Banking (i.e., 12 CFR 9.18) there are two types of CITs:

The first is authorized under section 9.18 (a) (1) and is maintained "exclusively for the collective investment and reinvestment of money contributed to the fund by the bank, or by one or more affiliated banks, in its capacity as trustee, executor, administrator, guardian or custodian under a Uniform Gifts to Minors Act." This type of CIT is referred to as an "A1 Fund".

The second or more commonly known CIT is authorized under section 9.18 (a)(2) and is a "fund consisting solely of retirement, pension, profit sharing, stock bonus or other trusts that are exempt from federal income tax." The Banking industry typically refers to this type of fund as an "A2 Fund".

Simply, A1 funds, or common trust funds as they are generally known in the industry, are funds that are invested by banks or affiliated banks and A2 funds, or CITs are invested by qualified retirement plans and are exempt from federal income tax.

For purposes of this discussion, we refer strictly to A2 Funds or CITs associated with qualified retirement plans.

CITs are....

- Pooled investment vehicles
- Used only in certain qualified retirement plans
- Have Banks or Trust Companies as fiduciaries
- Regulated by the Office of Comptroller of the Currency
- Overseen by the IRS and DOL

¹ The Wall Street Journal, Cheaper Choice in 401(k)s August 2, 2010

CITs are similar to mutual funds or other pooled investments in that qualified investors with similar objectives merge their assets into a single portfolio. The portfolio manager or sub-advisor hired by the bank then invests the assets according to the set investment objectives. Investors receive the performance of the overall fund, net of any related expenses. Despite being offered by banks, CITs assume the same investment risk as other investments and are not guaranteed by the bank or by the Federal Deposit Insurance Corporation (“FDIC”), the independent agency of the federal government that insures deposits in banks and thrift institutions.

The History of Collective Investment Trust Funds

CITs are not new to the retirement plan industry. In fact, they have been a preferred option for many defined benefit plans since Congress amended the Internal Revenue Code in 1936 to provide tax-exempt status to certain bank CITs. A later development further increased their popularity, when in 1955 the Federal Reserve authorized banks to combine funds from pensions, profit sharing and stock bonus plans and the IRS determined that such funds could be exempt from tax. As a result, CITs became the popular choice for defined benefit plans and remained so for many decades. The first CITs were pools of securities that were traded manually and typically valued only once per calendar quarter. Since they were unique to each bank and portfolio manager, information was not publicly available. When 401(k) plans were developed in the 1980s, CITs remained an option in many of the early plans. However, given the operational constraints of CITs and their lack of widely available information, mutual funds soon became the preferred vehicle in most 401(k) plans. Mutual funds offered many of the features that CITs lacked. They provided a wider array of investment objectives, were traded and valued daily, marketed to retail and institutional investors and were easily followed in the news media. An important development for CITs occurred in 2000 when the National Securities Clearing Corporation (“NSCC”) added CITs to its mutual fund trading platform, Fund/SERV®, allowing CITs to trade daily and as fluidly as mutual funds. In recent years, many employers have frozen their defined benefit plans as the number of 401(k) and other defined contribution plans have grown to become the primary retirement savings vehicles. Given that popularity, the structure and cost of 401(k) plans has come under greater scrutiny. As a result, many plan sponsors are once again considering CITs as investment alternatives.

Collective Investment Trust Funds

Then	Now
Lack of pricing flexibility at the plan level	Pricing flexibility through NAV and multiple share classes
Limited product offerings (stable value and passively managed options were most common)	Greater variety of both passive and active investment objectives
Valued quarterly	Daily valuation and liquidity
Not traded daily and manually traded	Standardized daily trading
Limited performance calculations based on quarterly valuations	Performance continuously available due to daily valuations
Limited information available to employees	Fund fact sheets and enhanced communications
Used almost exclusively in defined benefit plans	Used in both defined benefit and defined contributions plans

Why Use Collective Investment Trust Funds?

Like most other pooled investment vehicles, CITs are designed to streamline management and mitigate risk by combining assets from multiple accounts with similar investment objectives. The most obvious difference between CITs and mutual funds is how they are regulated. Mutual funds are regulated by the Securities and Exchange Commission (“SEC”) under the Securities Act of 1940, whereas CITs are regulated by the OCC. As a result, CITs do not have the additional compliance costs associated with SEC-required disclosure and filings. Being exempt from the regulation also allows CITs to avoid the costs associated with other activities the SEC requires of mutual funds, such as board meetings, creating and delivering proxies, prospectuses, and Statements of Additional Information. In addition, mutual funds market to all investors and have broader distribution channels (e.g., retail investors, financial advisors, institutional investors) and therefore incur additional marketing and distribution costs. In contrast, CITs are only available to qualified plans and therefore have limited marketing and distribution needs and expenses. CITs are usually less expensive to create than mutual funds and in some cases CIT fees may be negotiable, especially for larger institutional investors. Investment expense is typically the largest expense of a 401(k) plan; thus, the lower investment expenses of CITs provide potentially considerable savings that can be passed on to plan fiduciaries and participants.

Which Retirement Plans can use Collective Investment Trust Funds?

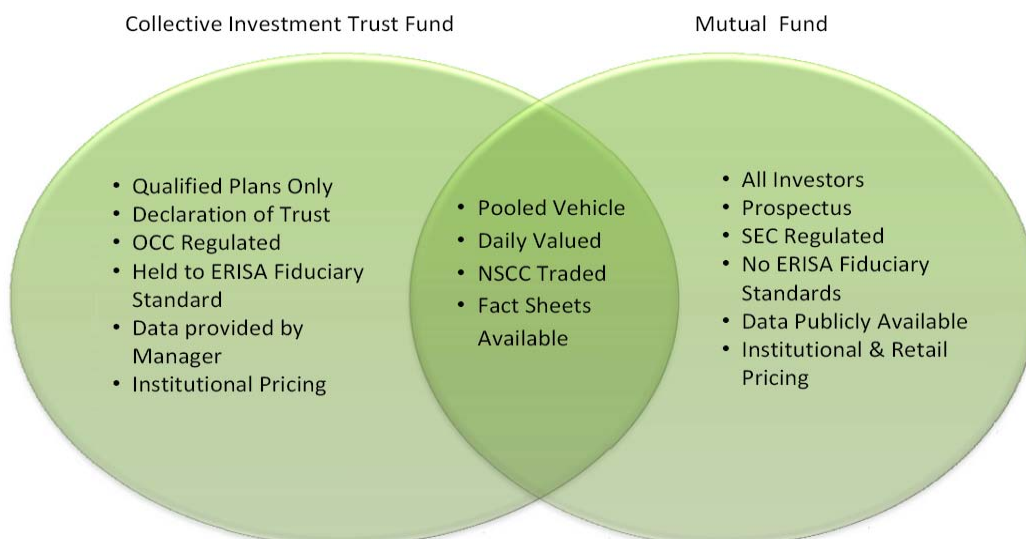
Eligible	Not Eligible
Qualified 401(k) plans	403(b) plans (may change given recent regulation)
Qualified profit sharing plans	457(f) government plans
Qualified stock bonus plans	IRAs and Keoghs

Qualified pension plans	Endowment Plans
401(a) government plans	Foundation Plans
457(b) government plans	
Certain separate accounts and contracts of insurance companies	

How do CITs Compare to Mutual Funds?

CITs and mutual funds share a number of similarities. For example, both are pooled investment vehicles with professional management that are subject to some form of regulation. Each are governed by a controlling document (a declaration of trust for CITs and a prospectus for mutual funds) that provides the basis for investment objectives and how they will be operated and managed. The universe of CITs has expanded and a wide variety of investment objectives can now be found in either vehicle. Data is more widely available today for CITs, and fact sheets now tend to be readily available for both vehicles. Finally, trading for both CITs and mutual funds is automated and standardized transaction processing is available for both CITs and mutual funds through the NSCC's Fund/SERV® trading platform.

As previously mentioned, the exemption from SEC registration offers CITs a substantial cost benefit and, therefore, the lower cost of CITs is the major differentiating factor when compared to the typical mutual fund. However, there are several additional differentiating features of CITs and mutual funds that should be mentioned. First, mutual funds generally do not have eligibility restrictions and can usually be purchased by most investors (i.e., after meeting the minimum initial investment and other possible criteria). In contrast, the use of CITs is limited to certain retirement plans. As previously mentioned CITs and mutual funds are regulated by different organizations and have unique governing documents. Given the differing regulation, CITs may be quicker and less expensive to create and more flexible with regard to pricing than mutual funds. While data is more readily available now than it has been historically for CITs, there are still some limitations on what the average investor can find on a CIT as compared to the information that can be obtained on mutual funds. CITs are not subject to any of the trading restrictions imposed on mutual funds due to short-term buying and selling, commonly known as market timing, nor do they carry redemption fees. (i.e., the penalties imposed to discourage market timing). While CITs have grown with regard to investment objectives available, there is still a much larger selection of investment styles available via mutual funds. Finally, from a fiduciary perspective, trustees of a CIT are considered fiduciaries under the Employee Retirement Income Security Act ("ERISA") and are held to ERISA fiduciary standards while mutual funds are generally not held to ERISA fiduciary standards. In this capacity, the bank, as trustee, must act solely in the best interest of the plan participants and beneficiaries and is generally prohibited from making decisions that are in the bank's best interest, but not in the best interest of the plan invested in the CIT. For additional information on fiduciary standards and ERISA please consult an ERISA Attorney.

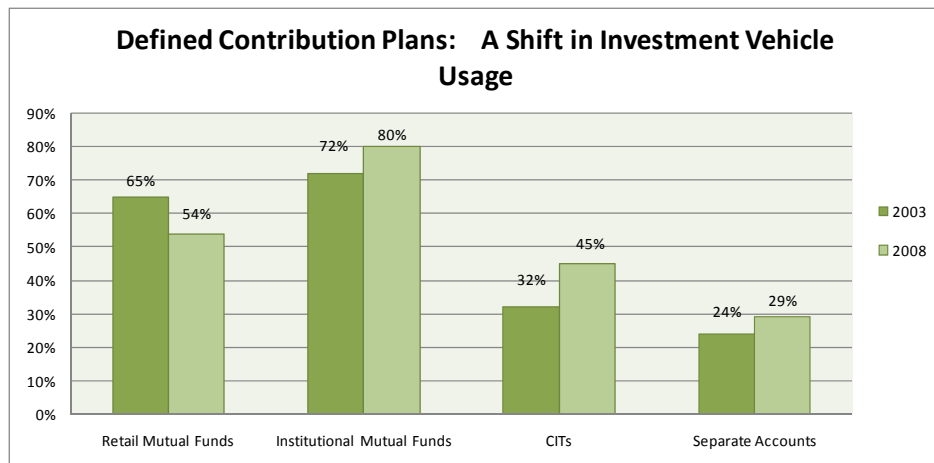


Growth in CITs

While CITs have historically been available to retirement plans as an investment option, interest in them has definitely increased recently and their use is on the rise. The increase in demand can be attributed to multiple factors. First, since defined contribution plans have become the primary employer-sponsored retirement savings vehicle, employers are now looking for multiple options and alternative solutions.

In addition, institutional-favored options providing lower cost solutions, like CITs, are in greater demand as lower cost solutions typically out-perform higher cost alternatives (all else being equal) and participants have become

increasingly more results driven. Recent scrutiny of plan costs and investment fees have also added to the popularity of CITs as alternatives. Furthermore, CITs can often provide greater flexibility when compared to mutual funds with regard to what they can invest in and how they can be priced. Finally, as previously mentioned, technology plays a major part in making CITs easier to use through both trading on standard platforms and publishing information through widely available news media. All of the above have added to the allure of the more institutionally constructed CITs.



Making a Decision on the Investment Vehicle

It is important to remember that investment vehicles should be selected based on what is in the best interest of an individual plan, its participants and beneficiaries. As a result, CITs and mutual funds should both be considered whenever possible. In addition, when selecting options for a participant directed retirement plan, plan fiduciaries need to consider many factors, not just cost. For example, the provider’s available investment options, trading and operational considerations, current market trends and the regulatory environment all play key roles in the decision making process. Given the multiple variables, there is generally not one option that will automatically be a better choice; although, in some situations a plan may not be eligible to use CITs, making mutual funds the only alternative. Regardless of which vehicle is selected, plan fiduciaries must act in the best interest of plan participants and their beneficiaries and make decisions utilizing a prudent decision making process that is well documented. Therefore, it is always important for plan fiduciaries to fully understand all the available options and any other factors involved when selecting investments for their defined contribution retirement plans.

For more information please contact Mary Moglia-Cannon at Manning & Napier Advisors, Inc. (585) 325-6880 ext. 8840

INDUSTRY VIEWPOINT

Operational Risk Management for Defined Contribution Plans

Julian M. Regan, Senior Consultant, Marco Consulting Group

Introduction

In the wake of the 2008 market meltdown, retirement plan sponsors, investment managers and regulators are placing increasing focus on managing risk. That is for good reason.

At one point during the crisis, market risk eliminated \$2.1 trillion from participant directed 401(k) plans and IRA’s, collectively.ⁱ Although operational risk does not get as much media coverage as market risk, participant directed defined contribution plan boards and executives should fully understand operational risk, while adopting a framework for overseeing it, considering the following:

- Operational risk events such as failed transactions, compliance failures or privacy breaches may lead to sizeable losses or threaten the tax treatment of plan assets
- Experts believe that operational risk, not market risk, is the leading cause of reputation riskⁱⁱ
- Plan sponsors and service providers, rather than participants are largely responsible for minimizing the probability and severity of operational risk events
- Effective operational risk management may lead to improved service quality, reduced costs, improved participant decision making and strengthened compliance

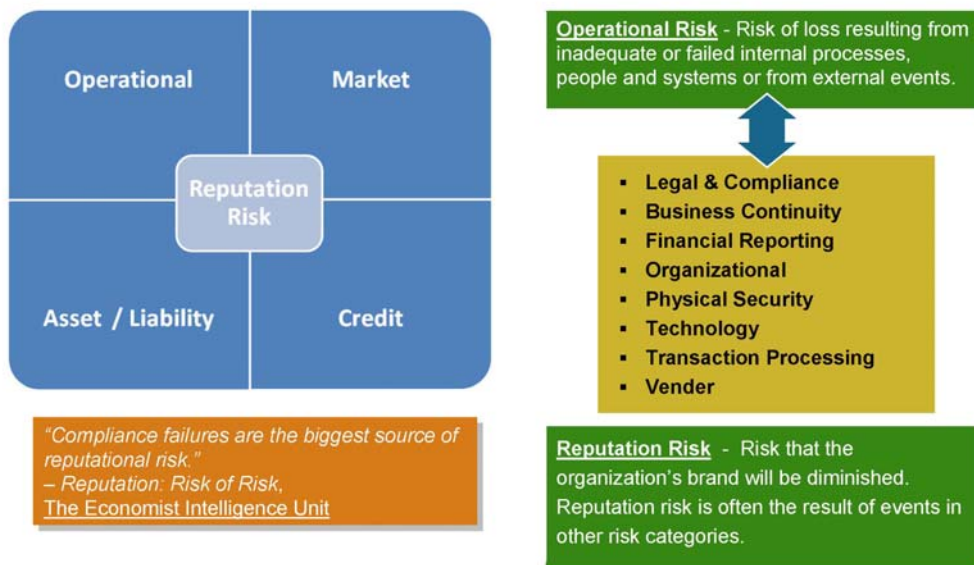
Defining and Categorizing Risk

Risk may be defined as the chance of something happening that will impact an organization's ability to achieve its objectives. By breaking risk into more specific categories, an organization can assign measures to each risk, while allocating responsibility for managing it. The following are definitions:

- **Market risk** is the risk of loss related to adverse movement in market factors, such as asset prices, interest rates or currency rates
- **Credit risk** is the risk of loss due to failure of obligors to honor their payments
- **Operational risk** is the risk of direct or indirect loss resulting from inadequate or failed internal processes, people and systems or from external eventsⁱⁱⁱ
- **Asset/liability risk** is the risk that liquidity will not be adequate to meet operational requirements or financial obligations

Operational risk encompasses potential losses attributable to failures in *compliance, business continuity, financial reporting, physical security, technology, transaction processing, and vendor management*. Not surprisingly, it is considered by many experts to be the most broad risk category.

Operational Risk



Risk Management Roles and Responsibilities

Defined contribution plan boards typically delegate operational risk management to contracted service providers and staff who manage risk within the span of their functions. Due to the breadth of their operations, third party administrators (TPA's) who provide participant recordkeeping, communications, contribution processing, web site maintenance, and records retention, have extensive responsibility for managing operational risk. A plan's investment managers, auditor, custodian, counsel and investment consultant also share responsibility within the span of their functions.

Although a plan's board delegates risk management, the board and plan executives are ultimately responsible for risk oversight across all functions. A foundation for effective oversight is achieved through: (a) establishment of a governance structure that assigns responsibilities and reporting requirements, (b) periodic assessments of the control environment, (c) adoption of policies that document risk tolerances and monitoring procedures, (d) corrective actions and, (e) selection of service providers who possess appropriate capabilities.

Defined Contribution Plan Operational Risk Events

Due in part to the volume of transactions, interfaces and regulations in defined contribution environments, operational failures can and do occur. The following are hypothetical examples:

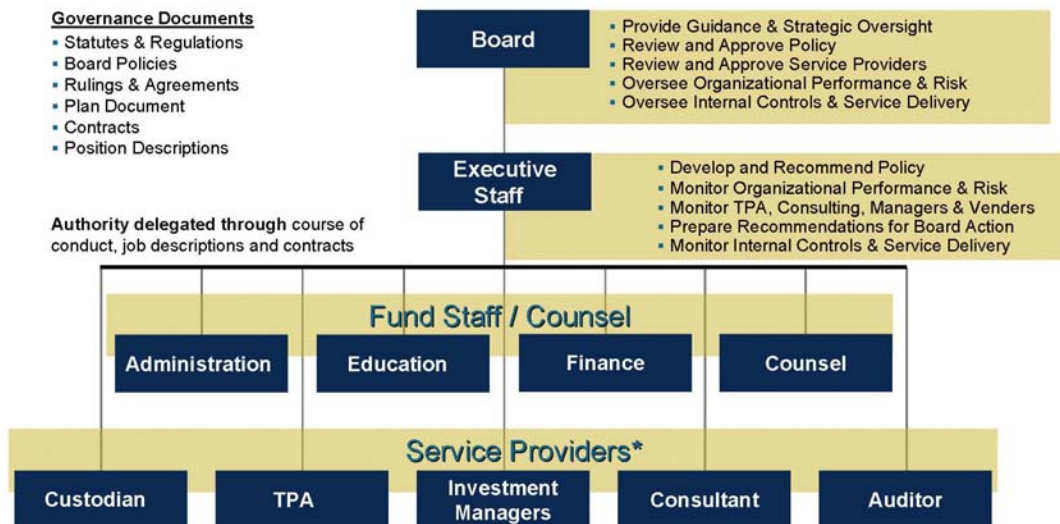
- **Compliance risk** may occur if a TPA inadvertently processes regular contributions to a group of participants who previously reached the Internal Revenue Code (IRC) limit of \$16,500, resulting in a costly reconciliation
- **Transaction processing risk** may occur if participant-requested transfers are delayed by a business day and investment options to which the transfers were requested appreciate in value
- **Financial reporting risk** may occur if participant statements misstate balances, prompting some participants to transfer assets to higher risk investment options that subsequently incur losses
- **Vendor risk** may occur if a board selects a new TPA through a procurement only to find out that the TPA is exiting the business, necessitating another procurement and conversion

Risk management and internal controls are designed to reduce the probability of operational failures and the severity of their impact if they do occur. Plan sponsors routinely seek to achieve these objectives when they perform tasks in line with their fiduciary duty including:

- Amending a plan document, which reduces the probability of IRC compliance failures
- Conducting audits to assess the integrity of internal controls and financial reporting

- Reviewing investment option communications to ensure proper disclosure of fees and risks
- Replacing a service provider whose service has deteriorated to an intolerable level

Operational Risk Governance & Oversight Roles



Risk Management Framework Components

In the wake of the financial system crisis, financial organizations including retirement plans are adopting more advanced approaches to managing risk. For example, a 2010 survey of institutional investors found that 89% established a chief risk officer role to centralize accountability^{iv}. A number of large defined benefit systems have created distinct risk and compliance units.^v For plans with scarce resources, such a change may be impractical. However, an equivalent outcome may be achieved by taking one or more of the following steps:

- Embedding risk management responsibilities into updated staff job descriptions
- Explicitly assigning risk management responsibility in contracts and the investment policy
- Forming an audit or risk committee that reports to the full board
- Adopting a risk management policy or equivalent

Regardless of tactical steps, plans have the ability to reduce operational risk and, by extension, reputation risk by adopting a framework that includes the following components:

- A program of assessments that may include the annual audit, testing of TPA and custodian controls, review of service provider SAS 70's, fee assessments and participant surveys
- Establishment of key risk measures for critical functions such as failed transactions, participant complaints, web site down time and late trades
- A risk governance approach that defines and allocates roles, responsibilities and reporting requirements in plan governance documents
- Establishment of risk reporting requirements that give the board transparency into key risks as well as the ability to monitor results against established measures and tolerances

Defined contribution plans may have many of the above components in place. However, board's who build these components into an integrated approach will position their plans for improved results, while unequivocally communicating their risk awareness to participants and service providers.

¹ *The Wall Street Journal*, September 21, 2009

¹ *Reputation: Risk of Risks, The Economist Intelligence Unit*, 2005

¹ *Operational Risk, Basel Committee on Banking Supervision*, January 2001

¹ *Pensions and Investments*, August 3, 2010

¹ *Pensions and Investments*, December 13, 2010

INDUSTRY VIEWPOINT

Beyond benchmarking — building blocks of a target date fund

By Bill Ralls, CFA, Fidelity, Senior Vice President, Research

Executive Summary

- Target date funds should be designed to pursue a long-term investment strategy, not performance versus a capital market benchmark as with many traditional mutual funds.

- Plan sponsors should fully understand the philosophy underpinning the creation and implementation of the glide path for a target date fund series.
- Through the roll downs they construct, fund managers declare their core investment philosophy.
- The frequency of severe stock market downturns may be greater than predicted by Modern Portfolio Theory.
- A target date fund series should be designed to provide growth potential throughout the accumulation phase and the distribution phase.
- The assumptions used for retirement spending are critical.
- Above all else, plan sponsors should demand transparency from their target date series manager.

A unique approach is required to evaluate and select a target date fund series (a family of multiple target date funds based on different planned retirement dates). Unlike many traditional mutual funds, target date funds are designed to pursue a long-term investment strategy, rather than attempt to outperform a broad equity or bond index. Target date funds share a common foundation based on two fundamental principles — the funds invest for a particular time horizon and diversify to reduce risk. Investors in target date funds obtain exposure to a range of assets — from domestic and international stocks, to corporate and government bonds — and the asset allocation automatically adjusts as the retirement date approaches. Because of their focus on retirement dates and their use of multiple asset classes, evaluating target date against standard peer groups, market indices, or asset allocation groups does not address whether a target date fund is suitable for a particular defined contribution plan. To help understand how a target date fund achieved its performance, it is important to first evaluate the investment philosophy and process behind the design of a target date fund series. In this paper, we will discuss a comprehensive approach to evaluating and selecting a target date fund series. Plan sponsors should evaluate a target date series in at least four areas:

- 1 How the asset allocation is designed to change over time (glide path);
- 2 The assumptions used for participant demographics and behavior;
- 3 How the portfolios are constructed;
- 4 How the portfolios are managed and monitored to ensure performance is meeting expectations.

Focus on the Goal

The first, and perhaps most important, tenet that should guide due diligence is that target date funds pursue a long-term investment strategy, not a particular market or asset class as with many traditional mutual funds. A target date fund employs a long-term, strategic investment approach across a mix of asset classes with varying risk and return targets. While performance comparisons to appropriate benchmarks are a vital component of the due diligence process, it is important to look beyond short-term performance.

The investment time horizon in the pre-retirement, accumulation years can be as long as 40 years. The post-retirement, distribution phase can be 20-30 years, or more. Therefore, the potential time horizon for a participant in a target date series could be 60-70 years. For an investment horizon this long, short-term performance comparisons to any benchmark will merely inform plan sponsors how fast a target date fund reached a particular mile marker on the road to retirement. While most people prefer to arrive at their destination quicker — especially when it involves retirement savings — focusing too much on short-term results may overlook the risks taken to achieve the performance.

Benchmarks serve as a speedometer, not a map. Performance versus benchmarks will not tell plan sponsors if their target date fund stayed on the *right* road, or if it veered off the main highway looking for a short cut to boost returns — and encountered a detour that will lengthen the road to retirement.

To understand if a target date fund series is appropriate for participants, plan sponsors must look beyond benchmark comparisons. Plan sponsors need to understand how the fund is designed to navigate the investment markets over multiple decades and guide participants to a more secure retirement. One of the most important due diligence steps is to gain an understanding of the investment philosophy underpinning the design of a target date fund's glide path.

Glide Path Assumptions

One of the self-evident truths postulated by most every market pundit is that stocks are for the long-term. In other words, the longer the investment horizon, the more that investors can bear short-term risks of downturns in pursuit of the higher long-term returns offered by equities. This is also the rationale underlying the glide path of target date funds. However, underneath this truism are decidedly different rationales for how and why the allocation to equities should decline as retirement approaches.

Evaluating Target Date Funds

Evaluating Target Date Funds			
Asset Allocation	Portfolio Construction	Management & Monitoring	
Evaluation Criteria			
Realistic Inputs	Disciplined Process	Team Focus	Flexible & Adaptive
<ul style="list-style-type: none"> ✓ Empirical or theoretical approach to model building? ⇒ Strategy should incorporate actual investor behavior and stress testing 	<ul style="list-style-type: none"> ✓ Does process use well-defined risk parameters? ⇒ Portfolio should focus on long-term stability, not short-term outcomes 	<ul style="list-style-type: none"> ✓ Does investment team have depth and experience? ⇒ Team should have broad skills: economic, actuarial, investment, quantitative 	<ul style="list-style-type: none"> ✓ Does team strive to improve process and portfolio construction? ⇒ Team should identify and implement ways to enhance portfolio construction

Multiple studies have shown that asset allocation can account for up to 90% of the variation in portfolio returns — and the glide path determines how the asset allocation changes over time.¹ Consequently, understanding the assumptions underlying the glide path is an essential step in the due diligence process. In a target date fund, investment philosophy is reflected in the manager's approach to the glide path. Through the roll downs they construct, fund managers are effectively declaring their core assumptions and investment philosophy.

To varying degrees, most target date funds rely upon the portfolio diversification and asset allocation theories that have emerged out of Modern Portfolio Theory (MPT). Many target date fund providers also have a point of view on how real world, empirical data on participants and markets should be incorporated into glide paths and asset allocation decisions. Both approaches can provide essential inputs for constructing target date funds. However, it is important to distinguish which factors have had the more dominant influence on the construction of a particular target date fund series — theoretical models of markets and investors, or empirical data on markets and participant behavior.

Market Risk

A vital input needed to build a glide path is the expectation for long-term market risk. The level of long-term market risk helps determine the theoretical maximum return that can be achieved for a given level of risk. The mainstream media and popular books have advanced the notion that the riskiness of stocks diminishes over time and therefore “stocks are for the long run.”² However, time diversification, as this concept is known, remains the subject of debate, at least within the academic community. Academic research has found scant evidence to support the theory that volatility in stocks falls over time.³ Nevertheless, investors with longer investment time horizons likely have more time to recover from market declines. Consequently, long-term investors may be better positioned to allocate a significant portion of their portfolios to risky assets such as stocks.

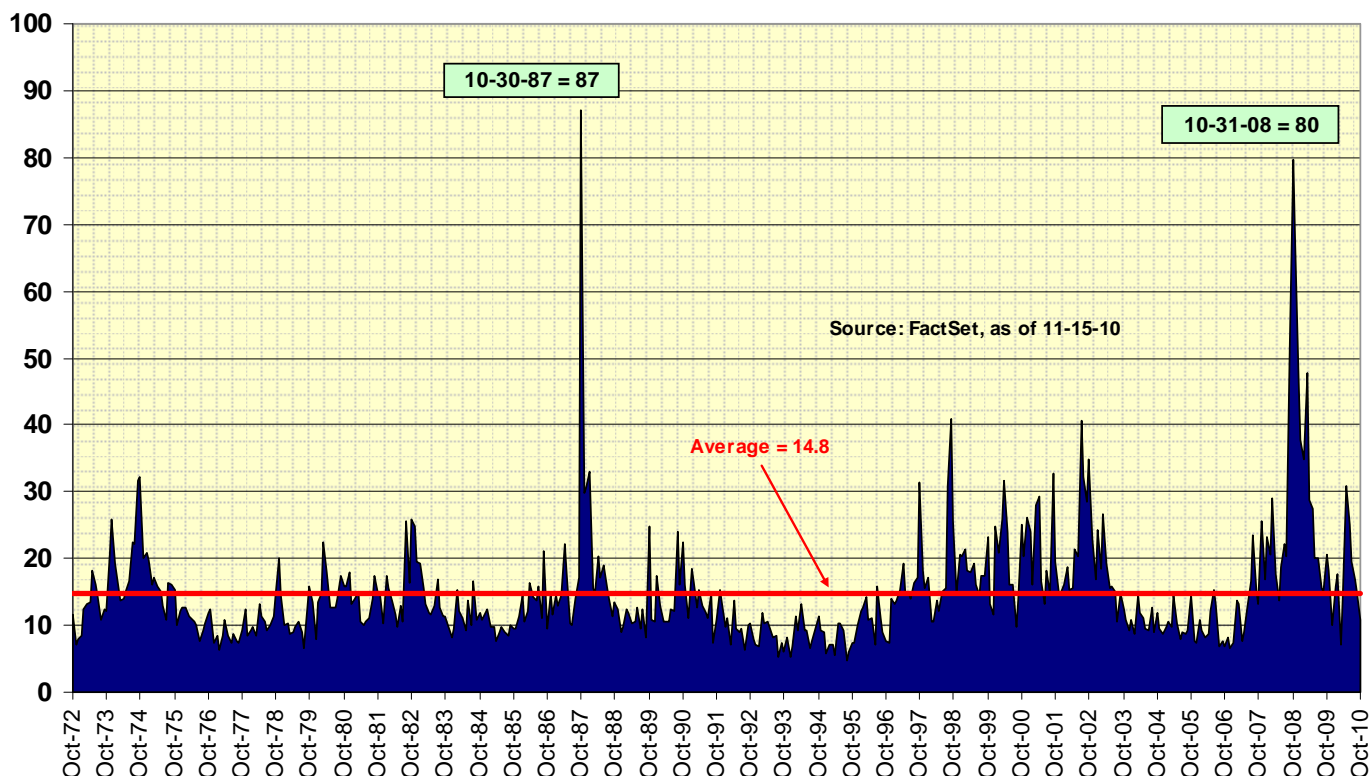
Modern Portfolio Theory states that equity risk is linear (i.e., it increases, or compounds at a constant rate) and that stock returns have a normal (bell curve) distribution. However, the extreme volatility periodically witnessed in the stock market — such as over the past few years — belies the bell curve distribution of MPT. While the models and tools based on Modern Portfolio Theory may correctly simulate what happens over longer time horizons, stock market uncertainty and volatility make it difficult to use these models for shorter periods.

An efficient, rational stock market should produce a narrow band in the standard deviation of returns. If the market is efficient and quickly incorporates new information, then violent spikes that increase volatility 4-8 times versus the prior

few months should occur rarely, if ever. However, as shown in the chart at the top of the next page, this is not the case. Extreme stock market movements (often referred to as the “fat tails” of the distribution) seem to occur more frequently than MPT predicts. In other words, for more volatile asset classes such as stocks, the risk of a significant and severe downturn may be far greater than predicted by Modern Portfolio Theory.

One of the most traumatic risks for participants planning for retirement is for the value of their retirement assets to decrease just as their retirement date arrives. This is exactly what happened in 2008 for those participants getting ready to retire. Stress testing a portfolio to see how it performs during the “fat tail” events will not make a target date fund immune from sizable losses during market downturns. However, it may sharpen the fund’s focus on how to incorporate fat tail risks into glide path construction.

Rolling 30-Day Annualized Standard Deviation of Daily Returns of the S&P 500® Index End of Month Values, October 1972 – October 2010



Human Capital Theory

One of the theoretical reasons for decreasing equity exposure is what is known as Human Capital Theory.⁴ This approach argues that at any age before retirement, investors’ wealth has two primary components: financial wealth (equities, bonds, and other financial assets) and human capital (the present value of remaining labor income). According to this theory, the equity glide path should slope down because early in investors’ careers their estimated retirement income is based on a small amount of current savings and a large amount of human capital (in the form of future savings contributions from labor income).

Human Capital Theory states that, for most people, the value of their future earnings and Social Security payments is a bond-like asset — a reasonably assured income stream, barring any unforeseen financial or health calamity. In addition, younger people have more time to work and flexibility to change jobs and careers. To offset this bond-like asset (future labor income), younger investors can and should take more equity risk in the form of higher stock allocations. As investors age, the present value of their income from future work declines — and reaches the lowest level at retirement. In other words, older investors have less time remaining to earn income in the labor market and therefore a lower capacity to absorb stock market losses. To replace the decreasing present value of future work income, it should be replaced with a similar asset — bonds.

Human Capital Theory presents an intriguing method for incorporating a participant's income generating potential into asset allocation planning. Although many academic researchers have studied it, Human Capital Theory has only recently begun to be used widely by target date fund managers and third-party target date index providers to guide asset allocation or glide path policies.

Mean Reversion

A more common theoretical basis for decreasing equity exposure as the investment horizon shrinks is mean reversion. This approach is based on the assumption that, over time, equity returns gravitate to their mean (average) long-term return. Mean reversion suggests that younger investors, who have long time horizons until retirement, can take more equity risk.

Many portfolio models are based on this assumption that the longer the holding period, the greater the likelihood that stock performance will converge on its long-term, historical average. However, as the performance of the stock market over the past 10 years has shown, there can be extended periods where stocks not only fall far below their historical averages, but do not even keep pace with Treasury Bills. Therefore, plan sponsors should give careful attention to what happens as participants enter retirement. Because of the long horizon still remaining (20-30 years), many target date providers extend the use of risky assets (stocks) well into retirement. Others take a more conservative approach, which poses the risk of retirement savings being depleted too early.

While Human Capital Theory and mean reversion are based on theoretical models, their use can have profound implications for target date funds. If the glide path is constructed based on Human Capital Theory, a reasonable assumption is that the earning potential of participants will remain more or less constant once the retirement date is reached. This suggests that the asset allocation would remain constant throughout retirement. In contrast, if the glide path were constructed based on the mean reversion rationale, then the level of equity exposure in the glide path would be based on the remaining time horizon. Therefore, a mean reversion approach suggests that higher levels of equity might continue for many years after the retirement date.

Longevity Risk

Another important input needed to build a glide path is the retirement time horizon. Longevity in retirement tells the target date manager how long a participant's retirement savings needs to last. Longevity itself is not the risk; living a long time is generally considered a good thing. The risk comes from a participant's retirement savings running out too early. Therefore, it is crucial to model a range of possible longevity outcomes, rather than only use one static retirement time horizon. Using a range of possible life expectancies will give a target date fund a more robust set of scenarios to help build the glide path.

Liability Driven Investing

Liability Driven Investing (LDI) is an empirical rationale used for asset allocation strategies that has been commonly used with defined benefit (DB) plans.⁵ LDI is a method of investing in which the main goal is to generate sufficient assets to meet current and future liabilities. Retirement income is essentially a future liability that needs to be planned for and funded during an investor's working years. Therefore, the concepts used in LDI can also be applied to target date funds used in defined contribution (DC) plans.

At its most basic level, a liability driven approach redirects the investment strategy away from maximizing asset returns and towards minimizing risks. It shifts the focus from making glide path decisions based on expectations for asset class returns and volatility and toward decisions based on shortfall risk — having enough savings to achieve a particular level of income in retirement.

When LDI is used with DB plans, the performance objective is the funding level necessary to cover the liabilities of the pension plan. In the case of a target date fund series, the retirement income needs of the typical participant help inform and guide the creation of the glide path. An LDI approach strives to use asset classes that have a high correlation to the retirement income liability. As the nature of the liability changes as the retirement date approaches, a target date fund's asset allocation also changes in response. Because an LDI approach with target date funds is based upon assumptions for retirement income liabilities, the processes used to determine retirement income needs are critically important.

Participant Behavior

It is critical for target date fund managers to understand how participants are using target date funds. There are key differences between defined benefit and defined contribution plans. In a DB plan, the risk is pooled across all the participants in the plan. However, in a DC plan, each individual bears responsibility for saving and investing the money needed for retirement spending. Consequently, it is vital for target date fund managers to anticipate how participants may react during market downturns. Will they stay the course and continue investing in the target date fund? Or will they abandon their retirement savings plan and retreat to less volatile investments?

Spending in Retirement

A target date fund series should not only focus on growing and protecting retirement savings until participants retire, but should also seek to provide growth potential throughout the accumulation phase and postretirement date phase. Therefore, it is important for a target date fund manager to have a thorough, detailed understanding of participants' spending patterns in retirement. It is also imperative to incorporate retirees' additional sources of income and savings when evaluating investment risk. For most investors in a target date fund, their investment in the target date fund series is not the only asset they will use for retirement spending. Most American retirees will also have access to Social Security benefits.

Building a Target Date Fund: Are Theoretical or Empirical Rationales Used?

Issue	Theoretical Rationale	Empirical Rationale
Rationale for Declining Equity Allocation as Retirement Approaches	Human Capital Theory and/or Mean Reversion of long-term equity returns	Liability Driven Investing (LDI)
Long-term Market Risk	Time Diversification: Market risk diminishes over longer holding periods	Fat Tail Events: Severe market declines occur more often than Modern Portfolio Theory suggests
Longevity in Retirement	25+ years for all investors	Range of planning horizons, with average life expectancy of approximately 20-30 years
Investor Behavior	Rational, unemotional	Emotional, may panic during extreme market downturns
Spending Pattern in Retirement	4-5% per year, adjusted for inflation ⁶	Range of spending throughout retirement, based on sampling of actual participant data
Default Vehicle	Designed for ideal, often high-net worth investor	Designed for typical retirement investor; "one size fits most"

The assumptions used for postretirement spending are critical because they help target date fund providers determine how much retirees may be able to withdraw from their target date fund each year for retirement spending needs. By taking a holistic view of retirees' retirement income sources, target date fund providers can more accurately match the asset allocation and the appropriate level of risk with estimated retirement spending needs.

If investors' additional sources of potential retirement income are not factored into the design of a target date fund series, then the percentage of equities (and the associated level of risk) could be set at a suboptimal level that does not accurately consider the withdrawal rate needed to provide retirement spending over a 20 to 30-year time horizon. In the accumulation phase, a multitude of investing patterns should be considered, from investors who start saving for retirement early in their lives, to those who wait to begin until much later. As investors transition from the accumulation

phase into the retirement phase of their lives, there are several conflicting forces that affect the ability to assume investment risk. Some of the key forces include concerns about outliving accumulated savings (i.e., withdrawal rate risk), immediate cash needs for current expenses and consumption, and inflation pressures (e.g., increases in the prices for health care and housing).

A common industry modeling input is to use a 4-5% annual rate of spending for the first year in retirement, and then adjust the spending in subsequent years based upon inflation. However, if actual spending turns out to be significantly higher, then this increases the risk that investors may outlive their retirement savings. Historically, investment in equities has provided the long-term growth potential needed for investors' retirement savings to (1) keep pace with inflation, and (2) achieve real capital appreciation (investment returns after subtracting the inflation rate) over a time horizon as long as the average post-retirement date period (2030 years). Therefore, it may be appropriate to maintain higher levels of equity if higher spending rates are assumed.

Portfolio Construction

Once participant demographics have been analyzed and the glide path evaluated, it is time to turn to portfolio construction and security selection. The asset mix should be globally diversified and include inflation hedges. Treasury Inflation-Protected Securities (TIPS), commodities, and real estate can provide diversification and hedge against inflation. At the more basic level, plan sponsors should have an opinion on whether active or passive management is used. Active management offers the opportunity to outperform index returns. Passive investments seek to match the return of the targeted capital market index.

Tactical versus Strategic Asset Allocation

Tactical asset allocation is a type of dynamic asset allocation that actively and systematically adjusts the portfolio mix based on market conditions. Such an approach attempts to add value by overweighting asset classes that are expected to outperform on a relative risk-adjusted basis in the near term.

By contrast, strategic asset allocation involves establishing long-term target allocations to broad asset classes based on financial goals, risk tolerance, time horizon and other considerations. Although this approach is designed to be mostly stable over the short term, changes to the asset mix may occur over the medium and long term. However, it is important to remember that neither diversification nor asset allocation ensures a profit or guarantees against loss.

Managing & Monitoring

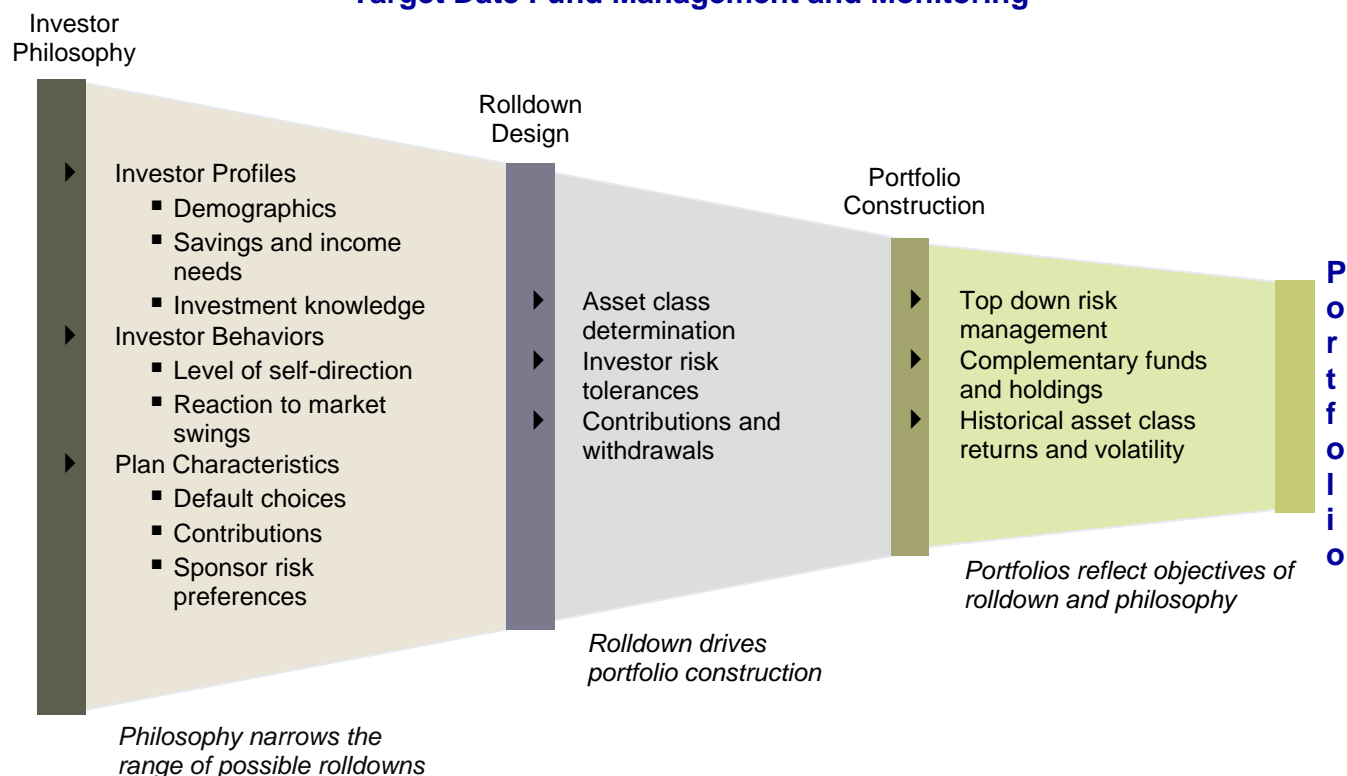
Once a target date fund series is chosen, plan sponsors need to implement a systematic and comprehensive monitoring process. Ongoing evaluation should focus on whether the target date fund series exhibits the design and philosophy characteristics that the fund management team intended. Important questions to ask include:

- Is there a process for updating, analyzing, and incorporating participant demographic and retirement spending data?
- How does the manager handle cash flows, asset class rebalancing, and rolldown adjustments?
- What is the process for adding and removing underlying funds?
- What types of portfolios are used — retail mutual funds, dedicated funds that are reserved only for use in the target date series, institutional portfolios, or some mix of these three?

Performance benchmarking is a complex, yet crucial step. Regardless of the method used to evaluate performance, fund results should be analyzed over varying market conditions and periods.

Investment policy statements should also be updated to reflect the complexities and unique attributes of target date funds. The different issues discussed in this paper offer a starting point for criteria that should be outlined in the investment policy statement.

Target Date Fund Management and Monitoring



Putting it all Together

Plan sponsors face a growing challenge to evaluate and select the target date fund provider that best fits their participants' needs. Participants in a target date fund are entrusting the plan sponsor to determine an appropriate investment solution. Consequently, plan sponsors must know the demographic assumptions and mechanics that underlie the glide path and portfolio construction of a target date series. Whether in the initial selection process or ongoing performance monitoring, evaluating target date funds requires a distinctly different approach than that typically used for traditional mutual funds. Above all else, plan sponsors should demand transparency. Target date fund managers must provide a detailed explanation of the rationale for how the target date series has been constructed and managed.

Before investing in any mutual fund, please carefully consider the investment objectives, risks, charges, and expenses. For this and other information, call or write Fidelity for a free prospectus or, if available, a summary prospectus. Read it carefully before you invest.

Target date mutual funds are generally designed for investors expecting to retire around the year indicated in each fund's name. The funds are managed to become gradually more conservative over time. The investment risks of each target date fund change over time as its asset allocation changes. Principal invested is not guaranteed at any time, including at or after their target dates.

The information presented herein is general in nature and should not be construed as legal advice or opinion. You should always consult your legal counsel to assist with any questions you may have or with specific situations that apply to your plan.

Notes

- ¹ Empirical studies have demonstrated that the vast majority of investment returns can be attributed to the asset allocation decision. See Gary P. Brinson, L. Randolph Hood, and Gilbert L. Beebower, 1986, "Determinants of Portfolio Performance," *Financial Analysts Journal* 42(4), pages 39–48 (reprint, 1995, *Financial Analysts Journal* 51[1], pages 133–38, 50th Anniversary Issue); Gary P. Brinson, Brian D. Singer, and Gilbert L. Beebower, 1991, "Determinants of Portfolio Performance II: An Update," *Financial Analysts Journal* 47(3), pages 40–48; Roger G. Ibbotson and Paul D. Kaplan, 2000, "Does Asset Allocation Policy Explain 40, 90, or 100 Percent of Performance?," *Financial Analysts Journal* 56(1), pages 26–33.
- ² In his book, "Stocks for the Long Run," author Jeremy Siegel argued that over the long run stocks have less risk than bonds and Treasury Bills. See Jeremy J. Siegel, "Stocks for the Long Run," 1994, New York: McGraw-Hill, page 29.
- ³ Time diversification is the term for the concept that the volatility of stocks diminishes over longer time periods. This remains the subject of debate within the academic community and financial services industry. See Donald G. Bennyhoff, 2008, "Time Diversification and Horizon-Based Asset Allocations," Vanguard Investment Counseling & Research, Vanguard Group; Jack Duval, "The Myth of Time Diversification: Analysis, Application, and Incorrect New Account Forms," Spring 2006, *PIABA Bar Journal*; Robert A. Olsen and Muhammad Khaki, "Risk, Rationality, and Time Diversification," *Financial Analysts Journal*, September/October 1998, pages 58-63.
- ⁴ For additional information on Human Capital Theory, see Roger G. Ibbotson, Moshe A. Milevsky, Peng Chen, and Kevin X. Zhu, 2007, "Lifetime Financial Advice: Human Capital, Asset Allocation, and Insurance," Research Foundation of the CFA Institute; Peng Chen, 2007, "Is Your Client a Stock or a Bond?," *Morningstar Advisor*, Spring, pages 12-14.
- ⁵ According to recent surveys, a large percentage of corporate plans (66%) are favorably disposed toward the concept of LDI strategies. See "2010 Pyramis US Defined Benefit Survey," Pyramis Global Advisors, FMR LLC, December 2010, section 3; Paul Menchaca, "Corporate Plans Say They'll Cut Risk Next Year," December 28, 2010, *FundFire.com*.
- ⁶ A retirement spending rate of 4-5% in the initial year of retirement is often cited as a rule of thumb to guide retirees. After the first year, the level of spending is adjusted for inflation. See Philip L. Cooley, Carl M. Hubbard, and Daniel T. Walz, "Retirement Savings: Choosing a Withdrawal Rate That Is Sustainable," February 1998, *AAIL Journal*; Rande Spiegelman, "Retirement Spending: The 4% Solution," August 17, 2006, *Schwab Investing Insights*; Walter Updegrave, "Retirement: The 4% Solution," August 16, 2007, *CNNMoney.com*.

Views expressed are as of 3/15/11 and are subject to change based on market and other conditions.

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Past performance is no guarantee of future results.

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INDUSTRY VIEWPOINT

The Retirement Income Management Process

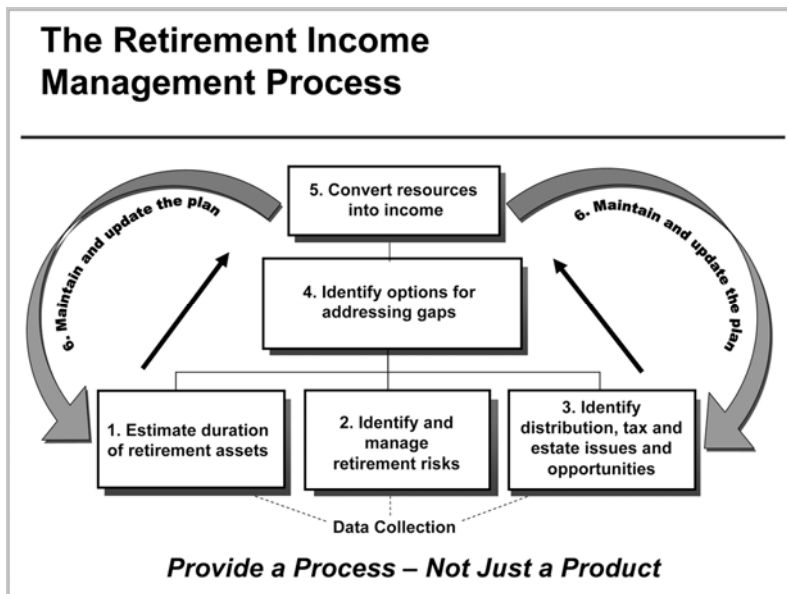
By: Betty Meredith, CFA®, CFP®, CRC®, is Director of Education and Research for the International Foundation for Retirement Education (InFRE) and Kevin S. Seibert, CFP®, CRC®, CEBS, Managing Director of InFRE

Because retirement income management is complex, determining solutions for employees require employment of a *process*, not just products. There is no single product that will meet all of a retiree's income needs. There is no "magic bullet" that can be applied to every situation. This is where the retirement income management (RIM) process comes into play. Built on the six-step financial planning process, the RIM process identifies an employee's goals, resources, unique retirement risks, tax and estate planning opportunities, and options for closing income gaps prior to and during retirement. It then drives those variables through a series of income conversion considerations to optimize retirement income streams through an assortment of retirement vehicles like Social Security, IRAs, mutual funds, employer retirement plans and immediate annuities. This optimization involves many trade-offs and timing considerations that must be identified and agreed upon by the retirement counselor and employee.

The following six steps provide a systematic method of tackling these issues and producing a customized plan to generate and manage sufficient retirement income for middle-market employees:

- Step 1: Estimate Duration of Retirement Assets**
- Step 2: Identify and Manage Retirement Risks**
- Step 3: Identify Distribution, Tax and Estate Issues and Opportunities**
- Step 4: Identify Options for Addressing Gaps**
- Step 5: Convert Resources into Income**
- Step 6: Maintain and Update the Plan**

When all the steps are put together sequentially, they form the *Retirement Income Management Process* as shown below.



Step 1: Estimate Duration of Retirement Assets

Until an employee defines retirement on a holistic basis, it will be hard to determine what their total spending needs will be. So even though planning for retirement may not be just about the money, it all ties back to what will be needed in terms of financial resources to live a desired lifestyle.

According to the 2007 General Population Retirement Readiness Study conducted Matthew Greenwald and Associates for the International Foundation for Retirement education (InFRE), success or happiness in retirement for today's retirees requires integration of three major life areas: wealth, engagement and health (see figure below).

1. *Wealth* (the geo-financial sphere) means not only the sufficiency of the savings accumulated, but also the cost of living, access to healthcare, activities, etc. in the area of the country that the retiree lives.
2. *Engagement* (the psycho-social sphere) includes participation in activities that increase a personal sense of engagement and fulfillment. Such activities could include spending time with family and friends, providing volunteer labor for a favorite charity or non-profit organization, or working part-time for the social benefits of work.
3. *Health* (the bio-medical sphere) includes an awareness of inherited biological characteristics and managing health and long-term care risks during retirement.

What quality of life do they want to retire to?

- Ask client: what are you retiring to? In other words, are you ready for a month of Saturdays?
- Defining retirement *holistically* helps determine spending needs.

InFRE Retirement Readiness Profile

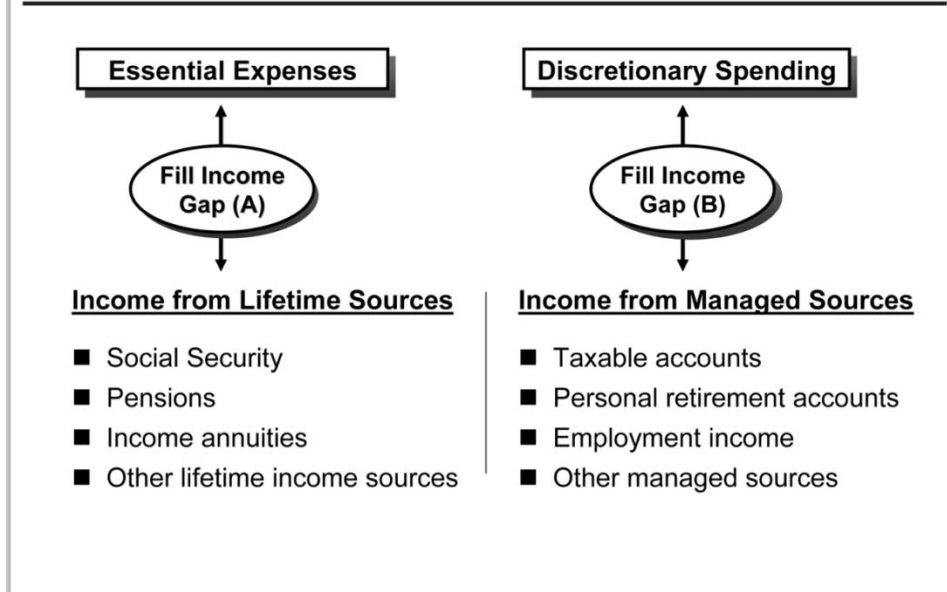
**Engagement
(Psycho-Social)**

**Wealth
(Geo-Financial)** **Health
(Bio-Medical)**

The first step in the Retirement Income Management Process then is to obtain an understanding of a retiree's retirement expense needs and income resources from a retirement readiness perspective, and then evaluate how long those resources might last based on the retiree's expected longevity.

When planning for a retiree's income needs, divide their spending needs into two elements: 1) essential expenses (or needs), and 2) discretionary spending (or wants).

A retirement income planning solution



The first goal when planning for retirement income for middle-income employees is to ensure that essential expenses (such as food, clothing, and housing) are covered by income from lifetime sources. As a general rule, help employees match essential expenses to lifetime income sources, which include resources such as Social Security, pensions from defined benefit plans, immediate annuities and other lifetime income sources. Discretionary spending needs (such as travel and entertainment) can be matched to income from managed sources. These resources could include taxable accounts, personal retirement accounts, employment income or other managed sources. As a retirement professional, you need to recognize that a key difference between lifetime and managed income resources is that the managed income resources are *not* guaranteed for life. Retirement income management is not just about managing investment assets, although this is a key component. In retirement, *income* allocation now becomes a critical part of the process to make sure that a retiree does not outlive his or her assets, and that a retiree's lifestyle is financially feasible. Income allocation provides a base for managing retirement-specific risks and income.

To make a quick estimate in an initial meeting of how long a middle-income employee's resources may last, a retirement counselor can take the sum of the essential and discretionary income gaps (A + B), and divide that total into the retiree's managed sources. For instance, assume a retiree has \$200,000 of managed sources and a \$20,000 total annual income gap. $\$200,000/\$20,000$ means the retiree's resources might last roughly 10 years, using simplistic assumptions. The ability to make a quick estimate like this allows a retirement counselor to quickly size up an employee's situation and determine if the retirement counselor should suggest the employee delay retirement a few more years.

Step 2: Identify and Manage Retirement Risks

One of the keys to successfully creating a retirement income plan for the middle market is to be able to "identify and manage retirement risks," which is Step 2 in the retirement income process. There are many risks that employees face that may not have been as critical during their working/accumulation years. Some of these risks apply to all retirees and some others may be unique to the individual. The goal of this step is to help the employee identify primary risks, prioritize them and then engage in a discussion to determine practical methods for managing those risks when implementing the retirement income plan.

The risks listed below are the main post-retirement risks that could impact retirement income. Most retirees in the middle market will face one or more of these risks.

1. **Longevity risk** (the likelihood a retiree will outlive his or her financial resources).
2. **Inflation risk** (the likelihood a retiree's standard of living will decline due to inflation).
3. **Healthcare and long-term care risk** (the likelihood that medical expenses will consume an ever-growing percentage of a retiree's budget).
4. **Investing risk** (the likelihood that investment performance will not occur as expected).

As retirement professionals, we argue that the heart of retirement income planning centers around helping a retiree identify and manage their unique personal retirement risks, whether real or perceived, and understanding the trade-offs associated with managing those risks.

Step 3: Identify Distribution, Tax and Estate Issues and Opportunities

Deferring and reducing taxes over time can have a substantial impact on the duration of a retiree's assets, or in other words, how long a retiree's assets last and how much might be available to their heirs. At the same time, there are many tax-related issues to consider when creating income from retirement plans and other assets. As a retirement professional, you need to understand these issues before implementing a retirement income plan.

For example, there are various types of retirement plan distributions, such as direct and indirect rollovers, lump sum distributions, Roth and annuity distributions; each form of distribution carries its own set of potential penalties and income tax treatments. To avoid a penalty for underpayment of federal income taxes, retirees may need to pay estimated taxes each year while drawing various forms of retirement income. The tax code recognizes capital gain income, qualified dividend income and ordinary income. Different types of assets produce different types of these incomes, so where an asset is located (in a taxable account or a tax-deferred account) can further complicate the retiree's tax picture.

Retirees must also consider asset liquidation order. Conventional wisdom says liquidate taxable assets first, then tax-sheltered, and finally Roth money. But it is important to look at the assumptions involved in conventional wisdom and examine the tax treatment of the particular assets that are sheltered compared to those which are not sheltered. When distributing retirement assets, the whole process is often not as simple as conventional wisdom makes it out to be. In addition to the usual estate planning for needed for retirees, be sure the employee confirms the beneficiaries on all of their retirement accounts are current. Rather than take an employee's word that the beneficiaries are current and correct, a retirement counselor should ask to see copies of all beneficiary documents, as mergers happen, custodian ownerships change, and plan administration data can sometimes get dropped during employer-sponsored plan recordkeeping conversions.

Step 4: Identify Options for Addressing Gaps

Steps 1, 2 and 3 examine the issues and challenges retirees must factor into their decision-making process when managing retirement income. Those decision-making issues and challenges are: (1) how to estimate income needs, (2) how to understand and manage the particular risks they face, and (3) tax considerations when managing for retirement income. These three steps make up the data collection phase of creating a retirement income plan. At this fourth point in the income management process, any income gaps will have become apparent. There are eight major options middle-market employees can use to fill those gaps and extend the number of years their money may last.

Options for closing potential gaps between retirement resources and expenses

Priority	Options for Closing Gaps	Essential Gap	Discretionary Gap
<input type="checkbox"/>	1. Increase returns on managed assets	<input type="checkbox"/>	<input type="checkbox"/>
<input type="checkbox"/>	2. Create additional lifetime income	<input type="checkbox"/>	<input type="checkbox"/>
<input type="checkbox"/>	3. Spend less in retirement	<input type="checkbox"/>	<input type="checkbox"/>
<input type="checkbox"/>	4. Work full-time	<input type="checkbox"/>	<input type="checkbox"/>
<input type="checkbox"/>	5. Work part-time	<input type="checkbox"/>	<input type="checkbox"/>
<input type="checkbox"/>	6. Postpone Social Security and pension	<input type="checkbox"/>	<input type="checkbox"/>
<input type="checkbox"/>	7. Increase savings	<input type="checkbox"/>	<input type="checkbox"/>
<input type="checkbox"/>	8. Use home equity	<input type="checkbox"/>	<input type="checkbox"/>

Combinations of options may be necessary!

Most employees will need your help prioritizing their options, and a combination approach will likely be necessary. A sampling of these options includes:

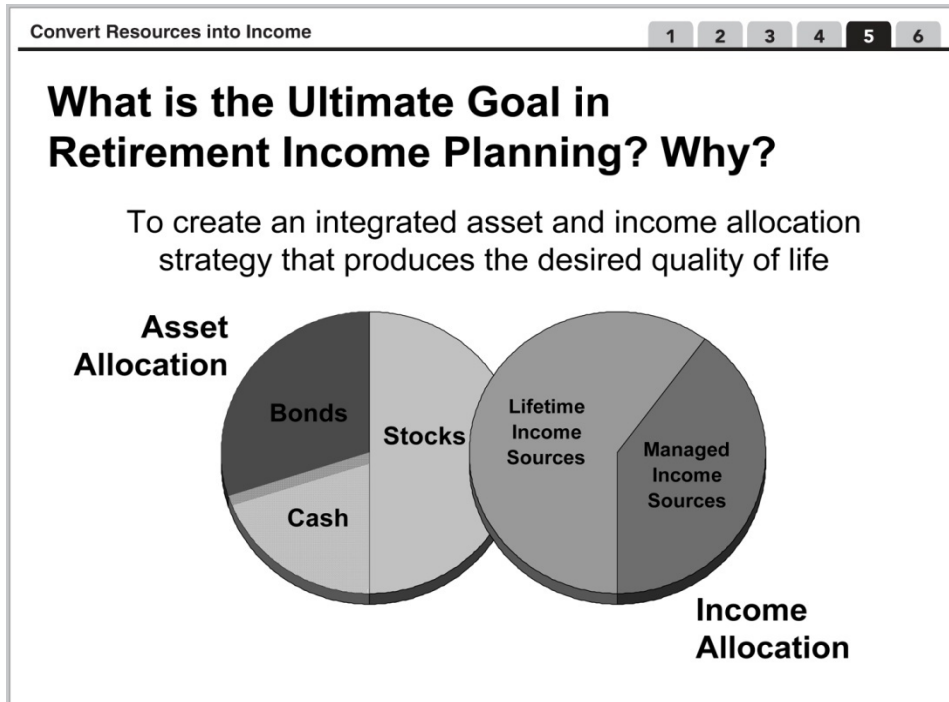
- Postpone Social Security and pensions.*** If a person waits until after FRA to begin collecting, their Social Security benefit can be increased in two ways: 1) waiting to take benefits until up to age 70; and/or 2) working and continuing to contribute Social Security payroll taxes. The Social Security system provides an increased benefit for those employees who choose to wait until after full retirement age to start their retirement benefit. Called delayed retirement credits, the monthly increase starts at FRA, whatever age that is for the retiree. The benefit amount is increased by a certain percentage for each month the individual is beyond FRA but does not receive benefits. The increases are automatically added to the benefit from the time the individual reaches FRA until the individual begins taking benefits or reaches age 70. A person born before 1938 could get up to 5 full years of increased benefits, from age 65 to 70. A person born after 1960 would only get up to 3 full years of increased benefits, from age 67 to 70, depending on when exactly benefits begin. The increased benefit amount that received is for life.
- Work part-time.*** According to a Vanguard study² on work in retirement, 45% of respondents said they were fully retired, not looking for work; 23% were working part-time, perhaps fitting the definition of being in “phased retirement;” 17% were working full-time; and 12% were self-employed. Working full- or part-time in retirement, however, can affect a retiree’s Social Security benefits if the retiree continues working after beginning benefits. Beyond income taxation, Social Security benefits may also be reduced based on a retiree’s earnings between age 62 and their Full Retirement Age (FRA). Once a retiree reaches their FRA, they can earn as much as they want without any reduction in benefits. To determine the reduction, an excess earnings test is used.
- Create additional lifetime income.*** This income source could take one or more forms, such as interest from laddering intermediate to long-term corporate, treasury, or TIPS bonds; dividend income from stocks; rental income; REITs (real estate income trusts), which historically pay high dividend amounts; and fixed and variable immediate annuities. The retiree may have to reposition existing assets (such as equities or mutual funds) if there is insufficient cash available for investment in additional lifetime income options. Historically, some of these

² Vanguard Center for Retirement Research, *Six Paths to Retirement*, 2007.

options provided 4% or more income over long periods of time, but still allowed the employee to have full access to the underlying assets.

Step 5: Convert Resources into Income

What is the ultimate goal in retirement income planning for middle-market employees? The ultimate goal in Step 5 is to help the employee create an integrated asset and income allocation strategy that provides the desired quality of living throughout retirement. As a retirement professional, you know what asset allocation is in the traditional sense.



The goal of an *income* allocation plan, however, is to create spending power out of a retiree's potential income resources by determining an optimal mix between lifetime income resources and managed income resources. Simultaneous to this process is the identification and management of risks, minimization of taxes, and the implementation of legacy plans.

There are four ways to convert assets into retirement income that may apply to middle-income employees. One method is to combine a systematic withdrawal plan (SWP) with annuitization of a portion of the assets. For many employees, a mixed approach using both SWP and annuitization may provide the lifetime income needed to meet essential needs as well as protect against longevity risk. The SWP income component offers the flexibility and control needed to meet discretionary spending needs and potentially protects the retiree's income from inflation. The annuitized income component provides more income per dollar invested than the systematic withdrawal plan due to mortality credits. This approach combines the advantages of both strategies: the guaranteed lifetime income of an immediate annuity — and the security and peace of mind it brings — plus the flexibility and control of a SWP.

By purchasing an immediate annuity with a portion of a retiree's initial portfolio when additional lifetime income is needed, you not only create an additional lifetime income stream to meet all or a portion of their essential needs, but you also have a significant impact on the duration of the remaining non-annuitized assets. In other words, annuitizing a portion of retirement assets can dramatically impact the remaining portfolio's longevity, particularly for more conservative portfolios; even growth portfolios may benefit, though often not as greatly as conservatively-

managed portfolios³. Since a greater portion of the retiree's overall income need is met by annuitized income, the remaining portfolio can benefit from a lower withdrawal rate, potentially resulting in longer portfolio longevity. For employees who need income that keeps pace with inflation and also want to maintain a base of guaranteed income that can never run out, this combined approach again supports the concept of using both an asset allocation *and* income allocation approach for creating retirement income.

Another point worth mentioning is that the use of an immediate annuity creates a guaranteed income floor that might make the middle-income retiree more amenable to assuming more risk with a portion of their managed retirement assets — especially when the retiree understands that managed investments can be used to better manage inflation, health, longevity and investing risks.

Step 6: Maintain and Update the Plan

As a general rule, the retirement income plan should be reviewed at least annually. Retirement counselors will want to determine if the retiree's income goals are being met. Life expectancies will change with the passing of time and changes in health status. The retiree's circumstances may change, as well as his or her risk tolerance. Income sources (portfolio assets) will also likely need to be rebalanced. Additionally, there are several events that can trigger a revision to the retiree's income plan, such as:

- Death of a spouse;
- Actual spending exceeding planned spending;
- Change in health;
- New retirement products; or
- Returning to work.

Summary

The retirement income management process is much more complex than most middle-market employees and retirement counselors realize. An entire host of dynamic, employee-specific variables can affect the income management outcome, including different types of risk (such as longevity, health, investment), different types of products (annuities, IRAs, long-term healthcare insurance), and different timing decisions (when to start Social Security, when to annuitize, when to quit working). Because each retiree is in a unique situation, a successful income plan calls for a customized approach to creating lifetime income. By understanding all you can about the multitude of variables that can impact a retiree's lifestyle, you increase the probability that the lifetime income plan you develop will meet a retiree's needs throughout their golden years.

This article is an excerpt from The Professional's Guide to Managing Retirement Income. A portion of this material is also included in book four of the self-study materials for InFRE's Certified Retirement Counselor® (CRC®) certification. If you are interested in a retirement-specific, accredited certification that covers both the accumulation and distribution phases of retirement, and also offers state insurance, CFP® and CPA continuing education credits, as well as employee education materials, find out more by visiting www.infre.org.

³ John Ameriks, Robert Veres and Mark J. Warshawsky, *Making Retirement Income Last a Lifetime*, Journal of Financial Planning, December 2001.

WASHINGTON REPORT

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

The State of Congress

The change in the majority in the House has left a divided government. Many of the new Republicans ran and won with few campaign promises except to cut the deficit. Thus, it is unclear how much legislation beyond appropriations can be passed in this Congress. As we have seen in the past few weeks even the enactment of appropriations seems to be quite difficult. Because of the division between the two parties that has developed in recent Congresses, it remains to be seen how and if compromise can be reached.

Budget

Since the beginning of the fiscal year last October, the federal government has been funded by a series of continuing resolutions to keep the government running. There have been a series of two to three week resolutions and Congress is still working on passing a resolution that will fund the government through the rest of the fiscal year ending in September. The more aggressive budget cutters in the Republican Caucus are seeking cuts equivalent to a \$100 billion annual cut which translates into about \$60 billion for the remainder of the fiscal year. This is about twice what the Republican leadership had originally proposed and well under the proposed budget of President Obama. As of today, the President and the Democratic leadership in the Senate has proposed \$33 billion in cuts. This is near the level of cuts the Republican leadership originally suggested before their more aggressive caucus demanded greater cuts.

In addition to overall cuts are riders that are specifically aimed at cutting or ending particular programs that are opposed by the Republican majority in the House. The most significant of these are the defunding of Planned Parenthood, National Public Radio and a number of EPA programs. Senate Democratic leadership has emphatically rejected these riders.

While appropriators in Congress decide on this year's budget others are working on the budget for next year. This week House Committee on the Budget Chairman Paul Ryan (R-WI) will announce the budget for the coming year and years to come that he will propose to the Committee on the Budget. He has indicated in news interviews the extraordinary proposals he intends to make. They include major overhauls of Medicare and Medicaid and tax cuts, and possibly tax reform.

Both Committee on Finance Chairman Baucus (D-MT) and Committee on Ways & Means Chairman David Camp (R-MI) have indicated an interest in tax reform. Most likely, this will begin with hearings from now through the summer, with no expectation of any legislating until the fall, but more likely in 2012.

Executive Board Visit

On March 28-29, the NAGDCA Executive Board held its annual legislative visit and held a series of meetings to discuss the NAGDCA legislative priorities. NAGDCA President Gay Lynn Bath provided these in letters during the meetings held over the two days. The priorities include National Save for Retirement Week, tax reform, required minimum distributions, TIPRA 2005, municipal advisor definitions and whether wrap contracts should be included in the definition of swaps. Meetings were held with Representative Allyson Schwartz (D-PA), Senator Ben Cardin (D-MD), majority and minority tax counsel for the Senate Committee on Finance, Senate Committee on Health, Education, Labor and Pensions and the House Committee on Ways and Means, the Joint Committee on Taxation, Counsel to Representative Sam Johnson (R-TX), the Department of the Treasury and the SEC.

National Save for Retirement Week

The House of Representatives has a number of new internal rules that the Republican majority passed at the beginning of Congress. One of these rules banned commemorative resolutions and while both Representative Schwartz and Johnson would support passing a National Save for Retirement Week Resolution it does not appear that the House would take it up this year.

Although the House cannot pass a resolution this year, the Senate does not have that rule and NAGDCA will work on passing a National Save for Retirement Week Resolution in the Senate. The first year that the resolution was passed, 2006, there was only a Senate resolution and NAGDCA will continue advocating for the resolution to help people save for retirement.

Tax Reform

During the Executive Board visit, NAGCA board members discussed the possibility of tax reform with Congressional staff and while most staff members did say that it was on the radar they also said that there was likely to be no substantive legislation in the current Congress. Staff also mentioned that there was the possibility that tax reform could occur during the next Congress and this Congress would be used essentially as a fact finding mission to lead into reform during the next Congress.

Required Minimum Distributions

A further issue that NAGDCA discussed are the required minimum distributions. This issue grew out of the fact that Congress passed a Roth 457 last year and it seems that the legislation was drafted to mirror other Roth legislation. The difference between the Roth 457 and other Roth legislation is that in the Roth 457 taxes have already been paid on the income and many 457 plans are designed to allow money to remain in the retirement plan as opposed to other plans where it is designed to distribute the capital in the plan. As this was likely passed to mirror other Roth plans, and was possibly an oversight, staff said they would look at the issue.

TIPRA 2005

At the end of this year, the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA) will require state and local governments to withhold three percent of nearly all payments to contractors or vendors. The withheld money would then be remitted to the federal government for federal income tax purposes. This provision was estimated to raise \$7 billion between 2011 and 2015. There have been a number of bills passed that have delayed the implementation of TIPRA but it is currently slated to take effect at the end of the current year. Last year, the House of Representatives passed a bill that would repeal the TIPRA requirement but the Senate would only agree to a one year extension of the bill. Congressional staff mentioned that they were aware of the requirement and many members are opposed to it but as it raises significant revenue it is unlikely that a repeal will be passed and the current prognostication is that it will be put off until next year with another one year delay.

SEC Proposed Rules

The SEC is in the rulemaking process for a number of rules two of which concern NAGDCA and these are whether wrap contracts should be included in the definition of a swap and the definition of a municipal investment advisor. NAGDCA has weighed in and submitted comments to the SEC on both of these issues and will continue following them until the rulemaking process is complete.

NAGDCA opposes including wrap contracts in the definition of a swap and in the *Dodd-Frank* Wall Street Reform and Consumer Protection Act (Pub.L. 111-203) the issue was not decided. In the legislation, the SEC and CFTC are to undertake a study and publish the results fifteen months (this October) after the legislation was passed. This study is not an SEC or CFTC priority and

until the study is completed, which will likely be after the October deadline, wrap contracts are not included in the definition of a swap.

The other rule that NAGDCA is concerned about would be municipal advisor registration. The legislation was vague about who would have to register and the SEC is currently in the rulemaking process defining who would have to register. The proposed rule is currently very broad and in the recent meeting, SEC officials said that the many retirement boards who include retirees and other members were not meant to be covered by the rules. The rule is meant to cover people who are trying to sell products and serve on retirement boards and it is likely that the final rules will narrow the regulation to only include the intended targets. The SEC stated that the reason that the original rules were very wide was that under the Administrative Procedure Act (Pub.L. 79-404) rules can be narrowed but if they had wanted to widen the rule the process would have to start from the beginning.

Around the Country

Participant Fees: Meeting the Communications Challenge Head On

Provided by the Employees Retirement System of Texas

Each year, Employees Retirement System of Texas (ERS) undertakes a communications challenge that isn't very glamorous but is vitally important to participant education: fee disclosure. Timely and effective fee disclosure is so important that it is highlighted in the Plan communication strategy.

The primary tool in this annual effort is the **Understanding Fees** flier mailed to every Texa\$aver 401(k)/457 Program participant with their fourth quarter statements. This method of delivery is vital to reaching a broader audience than if it was just posted on the website. Even though the Texa\$aver Program isn't subject to ERISA regulations, ERS chooses to follow the ERISA guidelines for fee disclosure to ensure fees are communicated as clearly as possible. Because fees can be a challenging topic for participants, the flier clearly discloses the following in an easy-to-understand format:

- **How much participants pay in fees** – For administrative fees, participants can see what they pay on a monthly and annual basis.
- **The different types of fees** – The flier covers the full range of fees a participant may see on his or her statement, including fees for plan administration, optional services (such as managed account participation and loans), and investment-management.

Employees Retirement System of Texas (ERS) is responsible for the administration of the TexasSaver Program. No money is appropriated by the State for administrative costs. Fees and expenses associated with the day-to-day management of the TexasSaver 401(k) and 457 Program are deducted from your account on a monthly basis.

Administrative Fees

- This covers the cost of Program recordkeeping expenses.
- Fees are assessed to the 401(k) and 457 plans separately and are based on your account balance.

Account Balance	Monthly Fee per Participant per Account	Annualized Fee per Participant per Account
\$10,000 or less	No Fee	No Fee
Between \$10,001 and \$1,000,000	\$1.88	\$14.10
Between \$1,000,001 and \$16,000,000	\$3.88	\$47.80
Between \$16,000,001 and \$32,000,000	\$6.32	\$76.80
Between \$32,000,001 and \$48,000,000	\$9.48	\$113.83
Between \$48,000,001 and \$64,000,000	\$12.65	\$151.78
\$64,000,001 or more	\$15.81	\$189.72

Monthly fees are rounded to the nearest cent.

Managed Account Fees

- For each account, monthly fees are charged to the total balance.
- Fees are assessed for the calendar month, regardless of how many days your account is enrolled in the Managed Account service that month.
- Fees apply to balances in the TexasSaver Managed Account service.* No additional fees are charged for Online Investment Guidance or Online Investment Advice.

* The Managed Account service is an optional service for TexasSaver participants.

Account Balance	Monthly Fee*	Example Account Balance	Monthly Fee Charged
<\$100,000	0.0375%	\$10,000	\$3.75
Next \$150,000	0.0292%	\$20,000	\$7.50
Next \$150,000	0.0208%		
>\$400,000	0.0125%		

* Managed Account fees are based on account balance.

Loan Fees

- \$50 initiation fee is deducted from loan payout.
- \$2.08 is deducted from the account for loan maintenance every month.
- Loan fees can be found on the quarterly statement under the Expenses section.

Schwab Personal Choice Retirement Account® (PCRA) Fees

- Transaction fees and commissions are outlined in the PCRA welcome kit.
- There is no cost to open a PCRA.
- Balances in Schwab PCRA are also assessed administrative fees.

Other Fees

- \$25 fee is charged for overnight delivery of distribution checks.
- \$15 fee is charged for onetime wire transfers of distributions.



TEXASAVER 401(k) and 457 Program

Investment Management Fees

- Investment management fees are deducted from the investment return of the fund.
- Investment management fees are included in daily fund pricing and are not shown on participant quarterly statements.
- Certain funds charge redemption fees when shares are bought and then sold within a 30-day holding period.
- Although not guaranteed, some investment options give voluntary and/or contractual reimbursements (see chart below), which are credited to participants who invest in those funds. Reimbursements are given at the end of each quarter or month, depending on the fund. Reimbursements can help offset the plan administrative expenses.
- You can also view the management fees charged for each investment option on the Investment Performance document located under the Investment tab of the website. Fees are listed in the "Gross/Net Expense Ratio" column.
- Target date funds may be subject to a fund operating expense at the target date fund level, as well as a predated fund operating expense fee for each underlying fund. For more information, please refer to the fund's prospectus.

The following funds give money back to participants and may help offset the plan administrative fees for October 31, 2016:

Fund	Net Expense Ratio	Reimbursement	TexasSaver Net Expense Ratio
Target Index Fund (TIOFDX)	0.45%	0.25%	0.20%
Target 2010 Fund (TFOGX)	0.48%	0.25%	0.23%
Target 2015 Fund (TFSQD)	0.49%	0.25%	0.24%
Target 2020 Fund (TFOBX)	0.50%	0.25%	0.25%
Target 2025 Fund (TFTYD)	0.50%	0.25%	0.25%
Target 2030 Fund (TFOOD)	0.51%	0.25%	0.26%
Target 2035 Fund (TFOGX)	0.52%	0.25%	0.27%
Target 2040 Fund (TFOGX)	0.52%	0.25%	0.27%
Target 2045 Fund (TFOGX)	0.52%	0.25%	0.27%
Target 2050 Fund (TFOGX)	0.52%	0.25%	0.27%
Davis New York Venture Fund A (NYVDX)	0.92%	0.45%	0.47%
First Eagle Fund of America Y (FEADY)	1.51%	0.40%	1.11%
Mutual Mid-Cap Core Growth Fund Y (MCOGY)	1.12%	0.25%	0.87%
Lord Abbett Small-Cap Value Fund I (LSVXY)	0.94%	0.10%	0.84%
Fidelity Diversified International Fund (FDIVX)	1.01%	0.25%	0.76%

An investment in a Money Market Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the Fund seeks to preserve the value of your investment of \$1 per share, it is possible to lose money by investing in the Fund.

Please consider the investment objectives, risks, fees and expenses carefully before investing. For this and other important information, you may obtain mutual fund prospectuses from www.texasaver.com under "Investments," or by requesting one from your registered representative. For prospectuses related to investments in your PCRA, contact Schwab at (800) 393-7272. Read them carefully before investing.

Investment Option	Contribution Source	Effective Date	Transaction Description	Amount	Check Number
Lord Abbett Small-Cap Value	EMPLOYEE DEFERRED TAX VOLUNTARY	01 Dec 2016	Reimbursement	\$1,000.00	01011601
Lord Abbett Small-Cap Value	EMPLOYEE DEFERRED TAX VOLUNTARY	01 Dec 2016	Reimbursement	\$1,000.00	01011602
Lord Abbett Small-Cap Value	EMPLOYEE DEFERRED TAX VOLUNTARY	01 Dec 2016	Reimbursement	\$1,000.00	01011603
Lord Abbett Small-Cap Value	EMPLOYEE DEFERRED TAX VOLUNTARY	01 Dec 2016	Reimbursement	\$1,000.00	01011604
Lord Abbett Small-Cap Value	EMPLOYEE DEFERRED TAX VOLUNTARY	01 Dec 2016	Reimbursement	\$1,000.00	01011605

Here's how reimbursements appear online

Log in to your account, click on "Statement on Demand," then select a link from the "Activity by Investment Option" section. You may also find this information under the "Transaction History" section of your quarterly statement.

For more information, visit texasaver.com³
(800) 634-5091 | texasaver@ers.texas.gov

TEXASAVER
401(k) / 457 Program

¹ Each fund has its own fund operating expenses. For more information on the investment option you select.
² The TexasSaver program offers the flexibility to reimburse the investment option and administrative fees spent again. The reimbursement may be modified at any time. Additional information on the fund of the fund prospectus for the fund is available on the website.
³ Funds are ranked by fund operating expenses. Funds with the lowest expenses are ranked highest, as an estimated expense.
⁴ Large investments involve special rules, including currency fluctuations and political developments.
⁵ Based on the information provided and available from the fund or available from prospectus, annual, and underlying expenses regarding investments in other assets.

To complement and reinforce the information in the flier, we also offer the following web tools:

- Fee Calculator:** This interactive online calculator helps participants see the amount and types of fees deducted from their accounts on a monthly basis.

- **News Bulletin:** Located on the login home page, the news bulletin echoes the information provided in the hard-copy flier and encourages participants to use the fee calculator after they log in.
- **Fee Frequently Asked Questions (FAQ):** The FAQ addresses the most commonly asked participant questions on fees and provides a detailed breakdown of the Program's fee structure.

Fees are often an overlooked topic, but they have a direct effect on participant account balances and future retirement income. ERS believes that it's important to remind participants each year about the impact of fees and to highlight how the Texa\$aver Program's fees are highly competitive with the other options available to them in the commercial market. Informed participants make smarter decisions. The better our participants understand the Texa\$aver Program's fee structure and what they get in return for those fees, the more likely they are to make the Program an important part of their long-term financial plan.

A Process for Planning Retirement Income in the Mid-Market

In focus groups of retiree spending and investing jointly sponsored by the Society of Actuaries and LIMRA,⁴ the participating retirees described what is, in essence, a five-step approach to determining how much money is needed to maintain a retirement lifestyle. We can think of this as the "laymen's approach" to retirement spending. Their informal five-step approach is:

1. Calculate average monthly expenses
2. Add up any lifetime monthly income sources (such as Social Security and defined benefit income)
3. Subtract the monthly income from the monthly expenses to determine any gap that needs to be filled
4. Add up any financial assets (savings accounts, retirement plans, etc.) and multiply that total by roughly a 6% expected return, and then divide that result by 12 to determine a monthly investment income stream
5. If the expected income stream fills the gap, the retiree can afford to retire.

While there is a certain amount of logic to following an approach like this, there are clearly also potential problems that non-professionals would not be expected to foresee. Accordingly, in 2003 the Insured Retirement Institute (IRI) and International Foundation for Retirement Education (InFRE) worked in conjunction with the InFRE[®] Retirement Resource Center to develop a professional retirement income management process geared toward servicing middle-market Americans that is both broader in scope and deeper in understanding than the "do-it-yourself" approach identified in the retiree spending study, because this population segment is most at risk of running out of money during retirement. Our purpose in this article is to provide you with an overview of our approach to managing retirement income on a professional basis.

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. Join me in welcoming our new members!!!

State Government

DC Plan Entity from State of South Carolina
Nevada System of Higher Education

⁴ Society of Actuaries and LIMRA International, *Spending and Investing in Retirement: Is There a Strategy?* 2006.

Local Government

Foster City, CA

Primary Industry

Bidart & Ross, Inc.

Tax Deferred Services

Morningstar

PHL Group

NAGDCA Member Benefit Spotlight

To remind members of benefits they receive throughout the year, NAGDCA spotlights a benefit of membership in each edition of *The Contributor*. For more information on this or any benefits of membership, please visit our website at <http://www.nagdca.org/> or contact NAGDCA staff at (859) 514-9161.

Information

- Career Center - Post job openings and review resumes
- The Contributor, NAGDCA's quarterly newsletter that provides the latest information on association issues, members and legislative matters
- Free or discounted participation in NAGDCASTs. NAGDCA's interactive, web-based educational programs.
- An interactive Website at www.nagdca.org that provides current information on federal activities, meetings, members, RFPs, presentations and more!
- An electronic clearinghouse with resources that offer answers and perspectives on various issues by showing actual practices used by members across the country
- Legislative representation in Washington, DC

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 December 19, 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 Kari Emmons at kemmons@AMRms.com or contact her at 859-514-9161 with any questions or comments.

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