

Maximizing Your Defined Contribution Plan

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Today's Objectives

- Risks associated with participant directed accounts
- Solutions/Trends
- Fee Disclosures

Improving Participant Outcomes by Mitigating Complex Decisions

Historically participants have had to make a lot of complex decisions in a self-directed plan:

Participation Risk

Will eligible employees join the plan?

Contribution Risk

Will participants save enough?

Investment Risk

Do participants know how to invest?

Conversion Risk

Do participants know how to turn savings into income?

Longevity Risk

Will participants outlive retirement income?

Risk: Participation

Mandatory Participation 401(a)

VS.

Voluntary Participation 401(k) and 457(b)

- 100% of employees who meet the eligibility definition participate
 - Younger employees benefit most:
 - Least likely to enroll in voluntary plans
 - Potential for most growth with 30 to 40 years before retirement
 - Employee education programs do not have to focus on participation
- Average of 69% participation across industries
 - Nearly 20% of eligible employees intend to enroll, but have not followed through
 - Employee education programs tend to focus on participation

Solution: Automatic Enrollment

Automatic Enrollment in Voluntary Plans defaults participants into the plan, unless the participant opts-out

- **401(k) Plans:** Becoming standard
 - 57% implemented in 2011, up from 19% in 2005
 - Often considered the only retirement plan, getting closer to a “Mandatory” Participation Plan
- **457(b) Plans:** Slower to implement
 - Only 38% of Governmental 457(b) Plans
 - Considered “supplemental” plans to 401(a) Defined Benefit or Defined Contribution Plans

Implementing Auto Enrollment

- Positive outcomes with automatic enrollment
 - On average, plans with automatic enrollment had a participation rate of 86%, compared to 65% for those without it
 - 20 to 29 year olds subject to automatic enrollment had an average participation rate of 85%, dramatically higher than those not defaulted, which was just 43%
- Two-thirds of automatic enrollment plans in the survey had employee opt-out rates of 9% or less which dispels the perception that this is viewed unfavorably by employees
- 81% of employers automatically enroll only new hires, as opposed to also enrolling existing non-participating employees

Source: Impact of Automatic Enrollment on DC Plans, Lessons from the Private Sector," NAGDCA Industry Viewpoint, 2011.

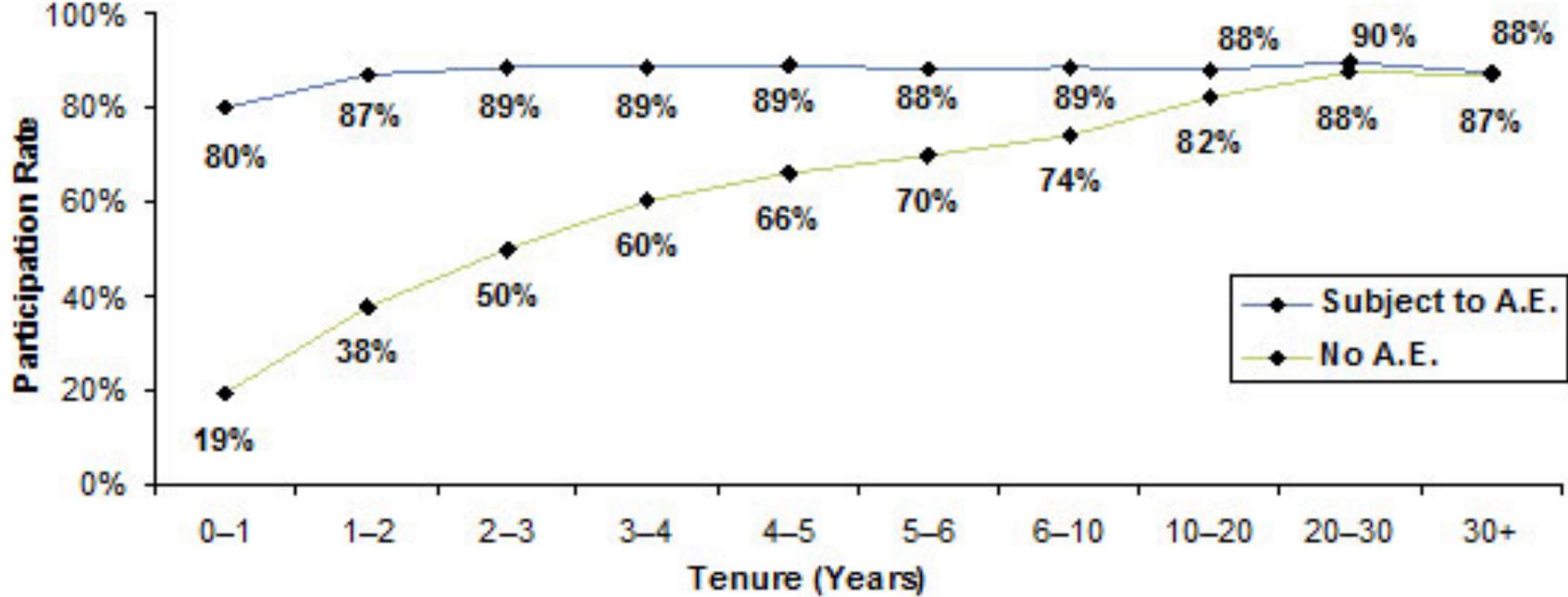
The Impact of Auto Enrollment and Automatic Contribution Escalation on Retirement Income Adequacy," Defined Contribution Institutional Investment Association (DCIIA), 2011



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Impact of Auto Enrollment

Participation Rates—by Tenure



Source: 'Impact of Automatic Enrollment on DC Plans, Lessons from the Private Sector,' NAGDCA Industry Viewpoint, 2011.



Risk: Contribution Levels

Mandatory Participation 401(a)

- Contribution rate is fixed by employer
- Perception that employer established rate is sufficient
- Employee education should be focused on a participant's entire retirement, encouraging savings in additional programs

VS.

Voluntary Participation 401(k) and 457(b)

- Contribution rate is flexible
- Efforts and resources focus on increasing participation, not on increasing contributions
- Employee education programs talk about saving more but often do not help participant calculate how much

Risk: Contribution Levels

- 67% of participants are somewhat confident they will have enough retirement savings
 - 54% of participants have no idea how much to save
- Average contribution rate is 6.8%
 - Industry standards estimate it will take 12% to 15%
- Only 14% of participants who say they “intend to increase contributions” over the next 4 months actually do
- Average account balance is \$63,199

Source: “Reinventing the Defined Contribution Plan: Research, Analysis and Recommendations,” Prudential Financial

Solution: Automatic Escalation

- Gives participants a path to higher savings rates
- Employer determines the maximum contribution rate for the automatic escalation schedule (i.e. 1% increase a year, until 10% is reached).
- Participants can elect to opt out

Risk: Investment Menu Design

- Traditional “More Is Better” menu design assumes participants will:
 - Read all materials provided to them
 - Know how to design a portfolio and make appropriate changes
 - Have a higher satisfaction with more choices
- Behavioral economics research is helping plans design investment menus that help participants make informed decisions

Investment Design Considerations

- Number of investment choices offered
- Similarity of the choices
- Display/order of the choices

Source: "Asset Allocation and Information Overload." Journal of Behavioral Finance, 2005, Volume 6, Number 2, Julie Agnew and Lisa Szykman

Solution: Looking Back and Moving Forward

Organize the investment options based on asset classification



Menu organized into categories based on participant needs and anticipated level of research and monitoring of funds

Limit to traditional investments only



Add target date funds for those seeking diversification and professional monitoring of investments

Maintain static menu pre- and post-retirement options



Embrace professionally managed solutions that automatically rebalance, even into retirement

More is better - expand the number of investment options



Streamlined options – reduce the amount of complication and research

MERS Investment Menu

1

Retirement Strategies

For the investor who wants a simple way to invest for retirement

2

Diversified Portfolios

For the investor who wants a fully diversified, professionally managed portfolio, where they are in charge of changing their investments

3

Expanded Funds

For the investor who knows their goals, time horizon and risk tolerance, and the way they want to design their own portfolio

4

Brokerage Window

For experienced investors



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MERS Investment Menu

Using this research and best practices, MERS developed our investment information to assist different types of investors:

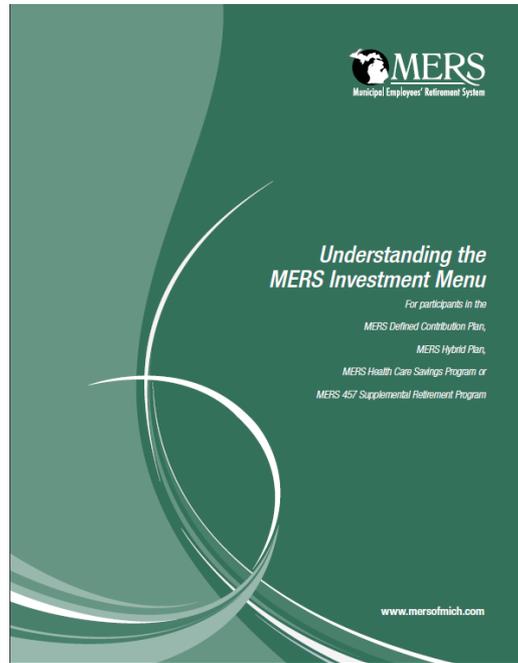
2Q 2013
Investment Menu Summary
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Performance & Fees –
 Defined Contribution Plan, Hybrid Plan (Part II), Health Care Savings Program, and 457 Program

Online users can click on any fund name below for more detailed information.

Fund Name	Proportion of Stocks	Average Annual Total Return				Total Annual Operating Expenses As a % (Per \$1,000)	
		Quarter-to-date	1 yr.	3 yr.	10 yr.		
Retirement Strategies:							
Based on projected retirement date and gradually change from a more aggressive allocation to a more conservative allocation							
MERS 2005 Retirement Strategy	2.12%	4.07%	-	-	0.52%	\$5.20	
MERS 2010 Retirement Strategy	2.10%	6.77%	-	-	0.52%	\$5.20	
MERS 2015 Retirement Strategy	1.34%	8.67%	-	-	0.52%	\$5.20	
MERS 2020 Retirement Strategy	1.47%	10.08%	-	-	0.52%	\$5.20	
MERS 2025 Retirement Strategy	11.13%	11.64%	-	-	0.53%	\$5.30	
MERS 2030 Retirement Strategy	40.69%	13.23%	-	-	0.52%	\$5.20	
MERS 2035 Retirement Strategy	60.62%	14.70%	-	-	0.52%	\$5.20	
MERS 2040 Retirement Strategy	83.55%	15.52%	-	-	0.52%	\$5.20	
MERS 2045 Retirement Strategy	93.34%	15.51%	-	-	0.52%	\$5.20	
MERS 2050 Retirement Strategy	93.34%	15.57%	-	-	0.52%	\$5.20	
MERS 2055 Retirement Strategy	49.30%	15.52%	-	-	0.52%	\$5.20	
Diversified Portfolios:							
Professionally managed by MERS, each with a target allocation mix that is rebalanced quarterly							
MERS Capital Appreciation	48.15%	15.37%	-	-	0.87%	\$8.70	
MERS Established Market	49.38%	11.64%	9.90%	5.37%	0.83%	\$8.30	
MERS Total Market	49.66%	11.91%	10.82%	3.95%	0.96%	\$9.60	
Note: 2.00% charge from annual investment transfer within 90 days of each contribution							
MERS Balanced Income	11.65%	8.22%	-	-	0.80%	\$8.00	
MERS Capital Preservation	27.42%	4.78%	-	-	0.75%	\$7.50	
Expanded Funds:							
A variety of funds that can provide additional diversification to an investment portfolio							
Stable Value and Bond Funds							
MERS Stable Value (not available to HCF or 457)	0.53%	2.28%	-	-	0.50%	\$5.50	
Note: Annual withdrawal rate of 1% for participants in the MERS Short-Term Municipal Bond Fund							
MERS Short-Term Municipal Income	0.27%	0.31%	0.85%	1.72%	4.78%	0.67%	\$6.70
MERS Diversified Bond	3.29%	1.40%	5.10%	6.01%	5.65%	0.75%	\$7.50
Dreyfus Bond Market Index (DBRI)	2.43%	-1.33%	-	-	0.52%	\$5.20	
PIMCO Total Return (PTTR)	24.52%	0.38%	-	-	0.86%	\$8.60	
PIMCO High Yield (PHYO)	1.72%	7.56%	-	-	0.95%	\$9.50	
Stock Funds							
MERS 500 Index	2.38%	20.26%	18.11%	7.33%	7.46%	0.50%	\$5.00
MERS Large Cap	18.17%	18.47%	17.54%	6.05%	7.21%	0.51%	\$5.10
MERS Mid Cap	1.99%	25.17%	17.89%	7.63%	10.27%	0.77%	\$7.70
MERS Small Cap	3.66%	22.50%	16.85%	7.55%	9.56%	0.97%	\$9.70
MERS Emerging Market	2.20%	-	-	-	1.16%	\$11.60	
MERS Global Equity	-	-	-	-	0.70%	\$7.00	
American Beacon Large Cap Value (ABOV)	1.04%	26.78%	-	-	0.97%	\$9.70	
Principal Mid-Cap Blend (PCBD)	1.15%	24.34%	-	-	0.97%	\$9.70	
Invesco Small Cap Equity (SMSE)	1.29%	23.99%	-	-	0.95%	\$9.50	
Schwab International Index (SWIS)	1.50%	17.31%	-	-	0.61%	\$6.10	
American Funds EuroPacific Growth (EREG)	1.40%	14.77%	-	-	0.90%	\$9.00	
Cohen & Steers Realty Shares (CSRS)	2.95%	6.30%	-	-	1.02%	\$10.20	

Performance and fee summary with categories



Overview booklet with glossary of terms

Detailed fund sheets

Risk: Conversion

Changing “Account Balance” to “Retirement Income”

- Defined Benefit plans provide a specific monthly pension amount
- Defined Contribution plans show an account balance
 - The participant translates the lump sum into a monthly retirement income
- Income replacement varies by participant but generally is 60-90% of working income

Solution: Participant Readiness

- Creating accounts to last a life-time
 - Limit low balances by restricting/eliminating loans
 - Reduce liquidation of accounts from previous employment by encouraging account consolidation
- Industry developments
 - Retirement income replacement calculation provided in detailed statements and individualized reports
 - Evaluating lifetime income options

Recent Developments

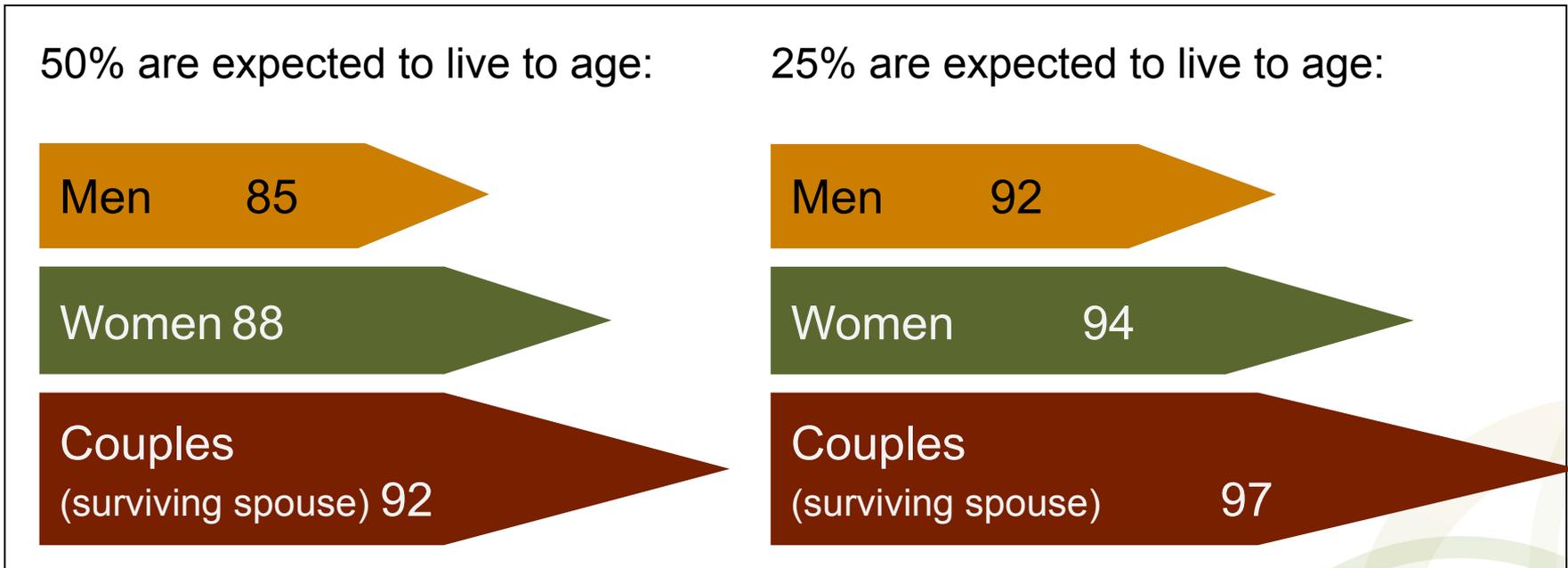
In 2010, the Department of Labor (DOL) held a hearing on Participants Lifetime Income Options in Retirement Plans:

- Various stakeholders urged the DOL to issue guidance that encourages plan sponsors to disclose income values, in addition to lump-sum (balance) values, on participants' account statements
- The DOL has yet to issue such guidance, however it is believed they will soon

Risk: Longevity

With people living longer than ever, longevity is a tremendous risk to retirement sustainability

The expected life span of individuals and couples age 65



Risk: Longevity

- Participant Decisions

- Most models for an account paying out stable and reliable income over decades show a 4% draw-down
- Participants run the risk of depleting this account too soon because they typically expect to draw more.
 - 27% expect to draw between 1-6%
 - 12% expect to draw 7-9%
 - 43% expect to draw 10+%
 - 18% have no clue how much they will be able to draw

Source: AllianceBernstein research, 2011

Solution: Longevity

- In-Plan Lifetime Income Options
 - The industry is beginning to offer innovative in-plan solutions
 - Individual investment option where a participant may elect a fund that provides a draw-down based on their highest balance while they were an active participant
 - Participants may elect the fund or it can be the default fund
 - By offering this type of fund, employers help ensure participants will have lifetime income

MERS Annuity Option

Stable Income Annuity

- Participants may elect to convert all or a portion of their assets into a guaranteed income stream
- Insures against outliving assets
- Matches personal financial needs while adding the flexibility of lump-sum payment options
 - Multiple payment choices, including an inflation protection option

Key Points

- Implement automatic enrollment with annual automatic escalation for 457 programs
- Limit or eliminating loans
- Offer simple tiered investment menu with a target-date fund default and core options
- Offer an investment option with a guaranteed annual income stream



Fee Disclosures

Participant Fee Disclosure

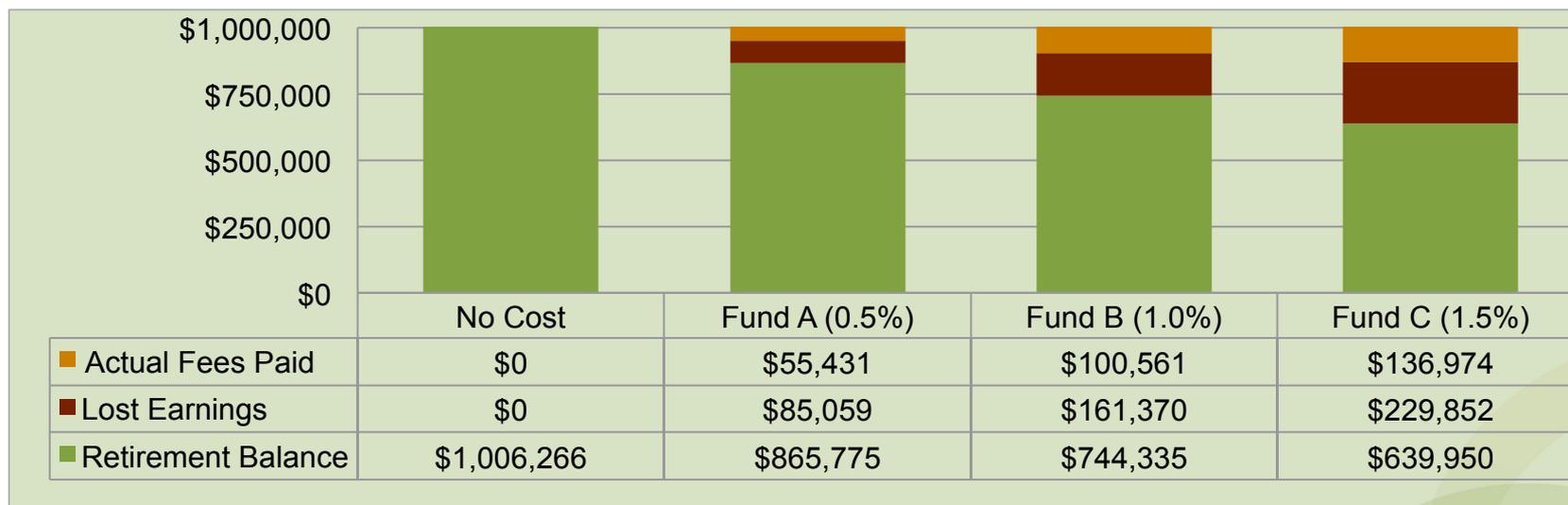
- In 2012, the Department of Labor set new fee disclosure regulations for self-directed individual account plans.
- Plan Administrators have the responsibility to disclose fees to all eligible employees, not just plan participants
- All participants and beneficiaries should:
 - Have access to general plan and investment information
 - Be made aware of rights and responsibilities
 - Have sufficient information to make informed decisions about management accounts

Impact of fees

Fees impact the retirement account balance

Example: Participant invests \$100,000 over 30 years with an 8% market return. The fee has two impacts:

- Fee Expense: Actual fee charged comes out of the account
- Lost Earnings: Lost growth after fees were paid



The expected “Cost” of investing in “Fund C” would be the 36% reduction in the account value at retirement.

Calculated using the U.S. Securities and Exchange Commission’s “Mutual Fund Cost Calculator” (www.sec.gov/investor/tools)

Plan and Fee Disclosures

- Plan disclosure must:
 - Be provided at initial eligibility and annually thereafter
 - Provide notice of changes must be 30 – 90 days before effective date
 - Describe:
 - How investment may be chosen
 - Voting, tender, and similar rights
 - Plan alternatives and any designated plan investment managers
 - Brokerage window and associated fees
- Fee disclosure must show:
 - Administrative Expenses
 - Individual expenses charged per use

General Investment Information

Required for designated investment alternatives:

- Identifying information, including asset class and type
- Performance data
- Fee and Expense Information (expressed as dollars, formula, percentage of assets or per capita charge)
- Website address for additional investment information
- Glossary of investment terms

MERS Fund Sheet

MERS Short-Term Managed Income Fund

Defined Contribution, Hybrid (Part II), Health Care Savings Program, 457, and Retiree Health Funding Vehicle

Total Fund Assets: **\$0.15 billion**

Fund Category: **Short-Term Bond**

Total Annual Operating Expense: **0.50%***

Objective

MERS Short-Term Managed Income Fund seeks to obtain maximum current income, while preserving capital and liquidity. This goal is sought through investing in investment grade commercial paper, corporate bonds, and U.S. agencies. The objective is to outperform the Barclays U.S. Treasury 1-3 Year Index.

Portfolio Management

MERS manages the asset allocation and monitors the underlying investment managers of the MERS Short-Term Managed Income Fund. The MERS Short-Term Managed Income Fund is part of the MERS Total Market Fund.

* Fee and Expense Information

MERS Operating Costs: Costs to run the day-to-day operations of the plan, which include legal, accounting, auditing, compliance, printing, and overhead costs.	0.20%
Custody and Recordkeeping Costs: Costs related to bookkeeping, settling trade activity, and holding assets in custody at a bank.	0.20%
Investment Management Expense: All costs incurred in the overall management of the fund. The Investment Management Expense varies based on the level of assets. As assets increase, the Investment Management Expense is expected to decline.	0.10%
Total Annual Operating Expense: The Total Annual Operating Expense reduces the rate of return of the fund. A Total Annual Operating Expense of 0.50% means that for every \$1,000 invested in the MERS Short-Term Managed Income Fund, a participant is charged \$5.00 in fees a year.	0.50%

Total Fee for Easy Comparison

Explained with Fee Sub Categories

Fee converted to a dollar amount

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