Coming Full Circle:

Adding Retirement Adequacy Back into the Retirement Picture

Presented By: Marne Carlson, Regional Manager

PLANNING RETIREMENT TOGETHER FOR 70 YEARS

MERS® Municipal Employees' Retirement System

Agenda

- Workplace Trends
- Increased Life Expectancy
- Retirement Plan Trends
- Adequacy Options
- Building a Successful Plan
- Participant Education and Engagement

Workplace Trends

Workplace Trends

- Michigan municipality's are facing shortages of competent workers
- In a 2015 Michigan study of public employers, 37% said attracting and retaining skilled employees is beginning to be a problem or is already a significant problem
- Shortages are growing more acute as Michigan's unemployment rate continues to decline toward 5% and the pool of available talent shrinks
- Gen Y will comprise the majority of participants within 10 years
- Turnover is expected to be high

According to the Michigan Commission on Law Enforcement Standards, there are about **4,000** vacant police officer jobs in the state

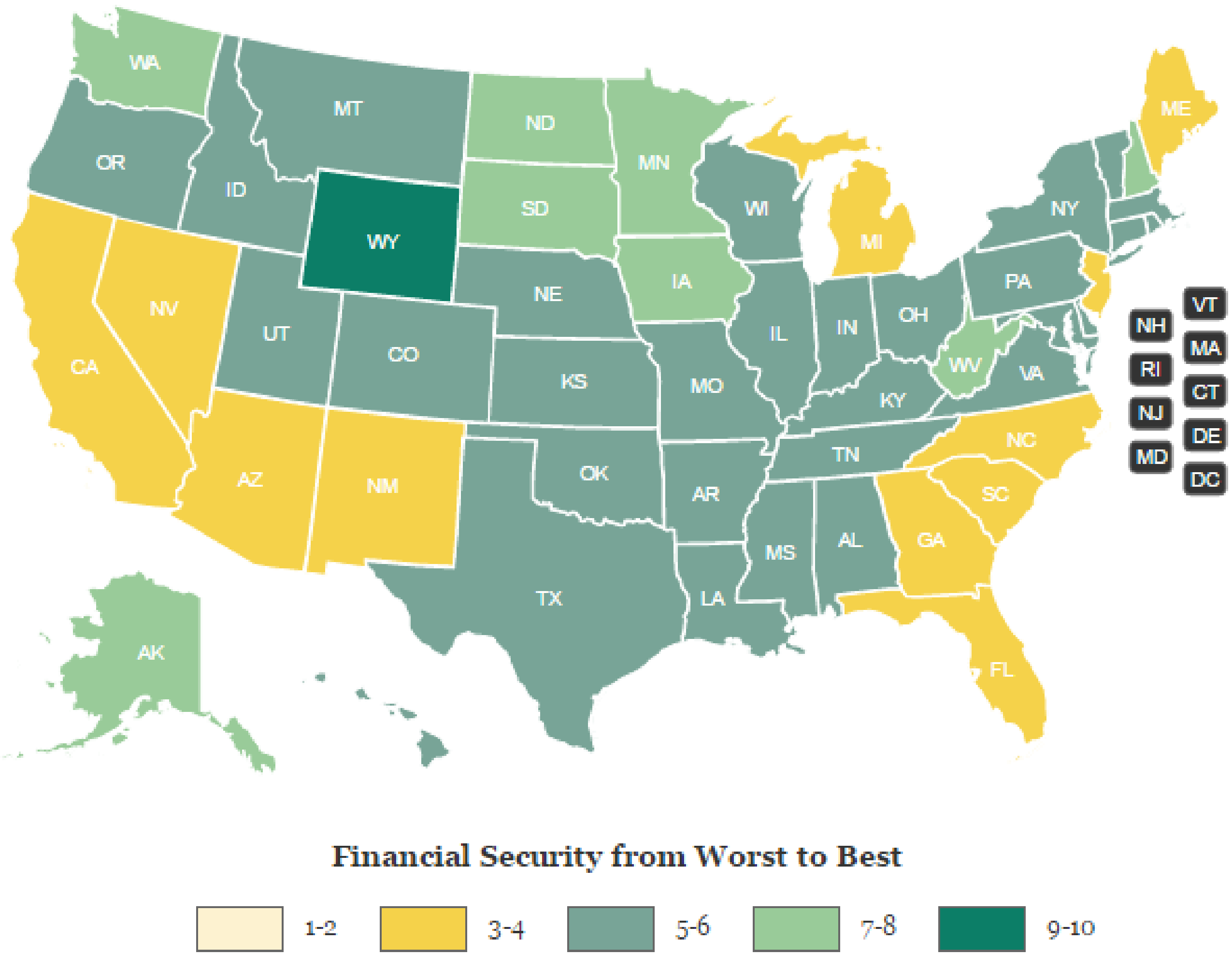
Attraction and Retention: What Employees Value Most

- Nearly three-quarters of employees at companies sponsoring defined benefit plans say the retirement program is a compelling reason to stay on the job
- Employee turnover:
  - Companies that have a pension plan have lower turnover rates
  - Pension plan coverage increases tenure by 4 years as compared to no plan whatsoever, and by 1.3 years as compared to a defined contribution plan
- Plan design can create efficient retirement management
  - Designs can facilitate appropriate and optimal retirement decisions
  - Efficient retirement is crucial during economic downturns, as well as times when the labor market is tempting your skilled employees

Source: Towers Watson, *Attraction and Retention: What Employees Value Most*

Economic Outlook

Retirement Security Based on Retirement Income, Expenses and Job Market for Older Workers



Source: NIRS Pensions & Retirement Security 2013

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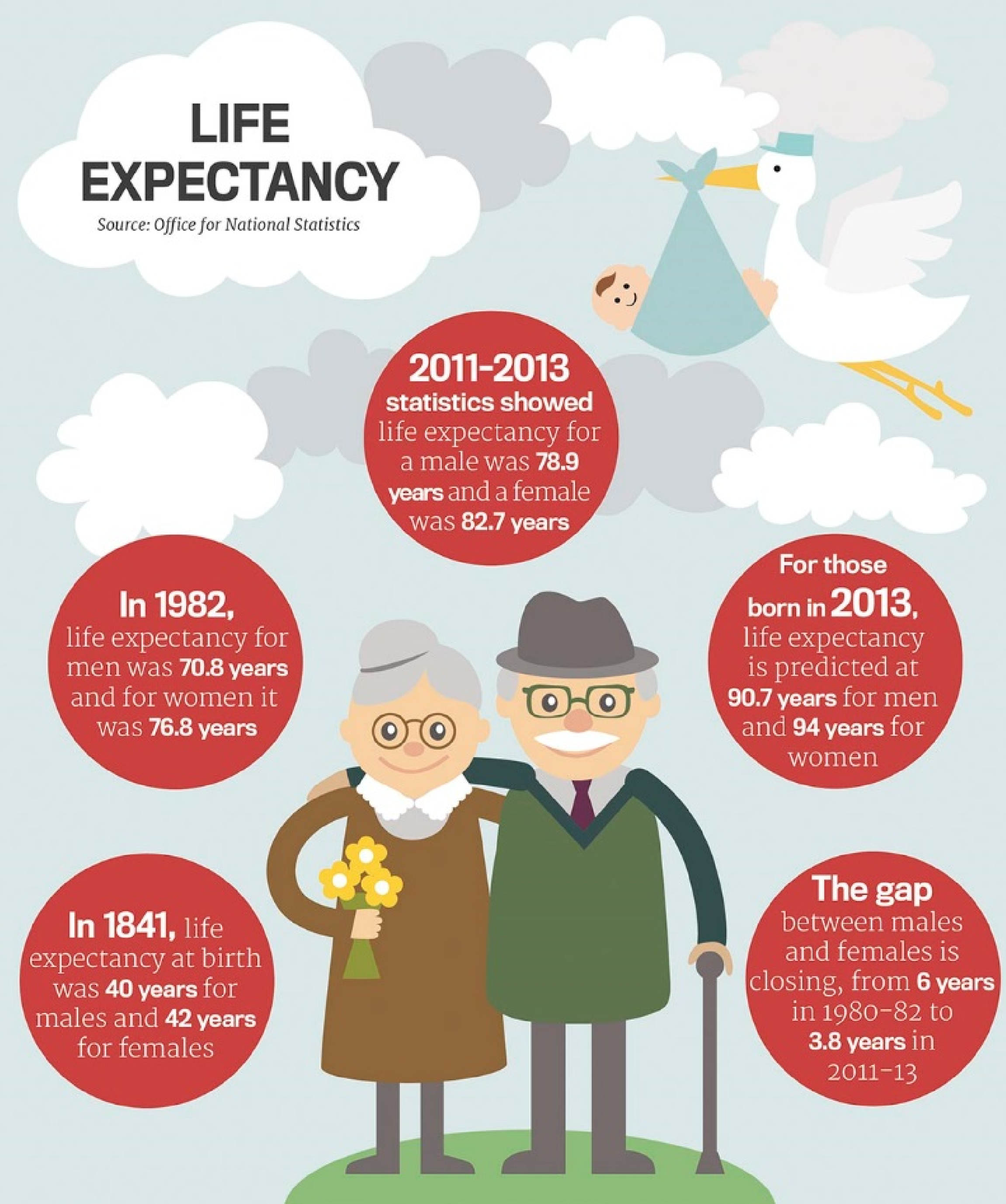
Increased Life Expectancy


LIFE EXPECTANCY
Source: Office for National Statistics
2011-2013 statistics showed life expectancy for a male was 78.9 years and a female was 82.7 years
In 1982, life expectancy for men was 70.8 years and for women it was 76.8 years
For those born in 2013, life expectancy is predicted at 90.7 years for men and 94 years for women
In 1841, life expectancy at birth was 40 years for males and 42 years for females
The gap between males and females is closing, from 6 years in 1980–82 to 3.8 years in 2011–13

Life Expectancy Effects on Retirement Plans

- Defined benefit pension plans
  - Many plans have updated the mortality tables used to determine required contributions
  - This is causing an increase in actuarially required contributions, which are often times shared by the employer and employee
- Defined contribution plans
  - Since employees bear this risk alone, some may choose to work longer than expected
  - Many employees worry that they will not be able to save enough to last their lifetime
  - Use of longevity annuities in plan designs

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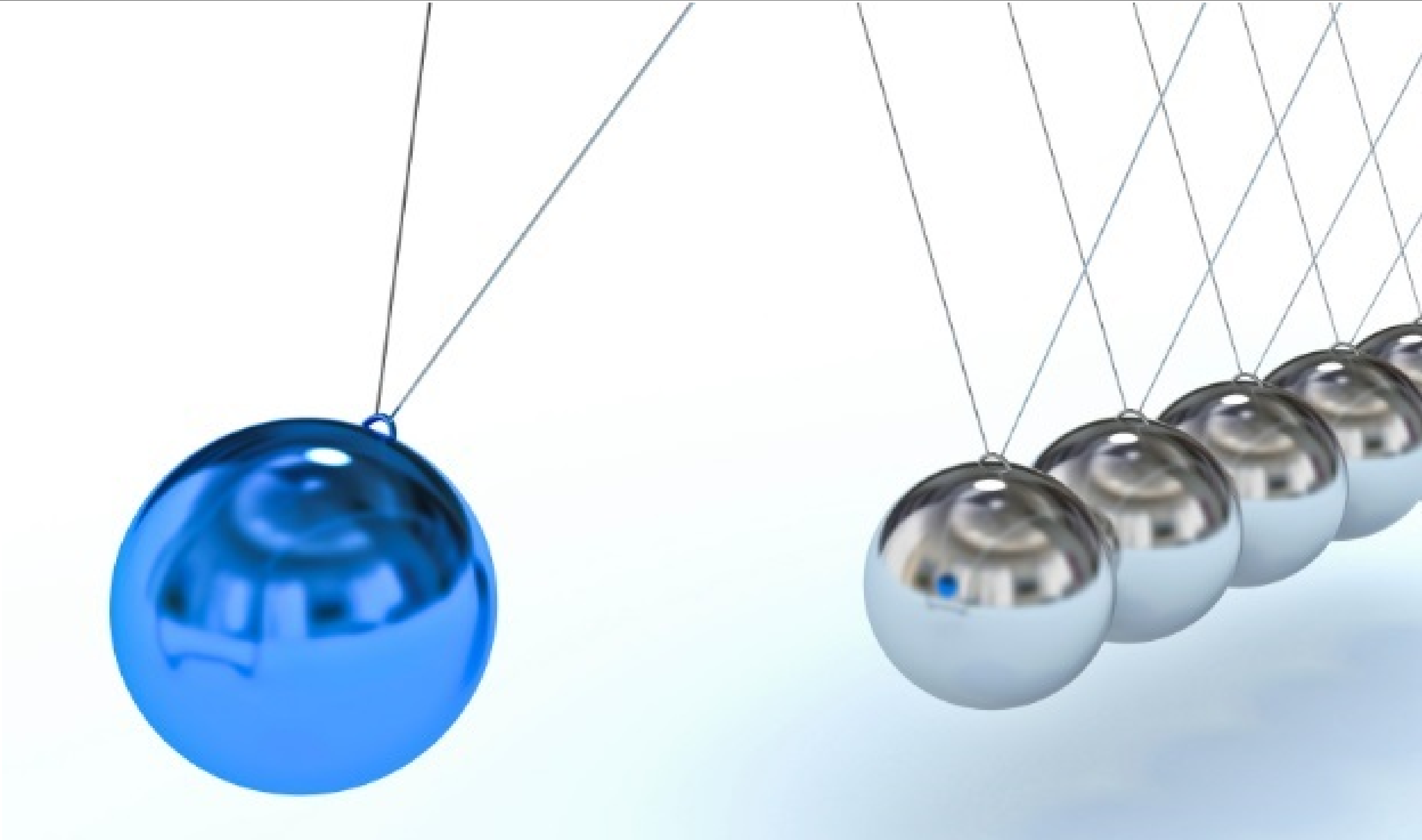
RETIREMENT PLAN TRENDS



Public Sector Retirement Plan Landscape

Pre 2008 Financial Crisis

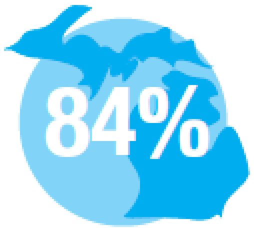
- The majority of public sector workers were covered by pension plans
- Some states had introduced a defined contribution plan to their structure
- Most of these plans took form of an optional defined contribution plan
  - Only two plans—the State of Michigan and Alaska—introduced mandatory defined contribution plans for new hires
  - Four state run systems—Michigan (MPSERS), California, Indiana and Oregon—adopted mandatory hybrid plans

Public Sector Retirement Plan Landscape, Cont.

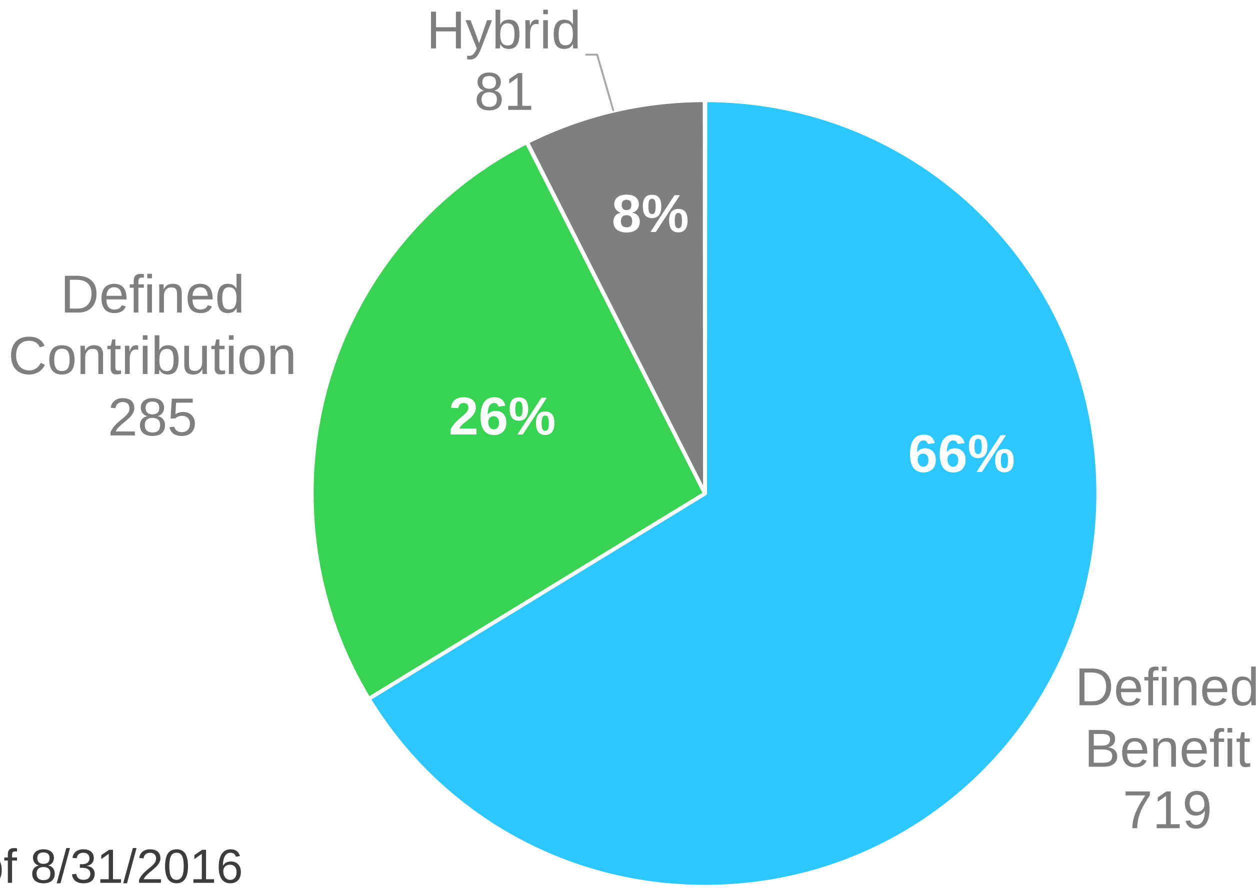
Post Financial Crisis

- Post-crisis changes are different than pre-crisis changes
  - New plans are mandatory, as opposed to mainly voluntary
  - Being mandatory, they apply only to new employees
  - The post-crisis plans consist of either a hybrid plan or a cash balance plan (a defined benefit plan that maintains notional individual accounts but provides some guaranteed base return)
- A vast majority have modified their existing pension plans
  - Increased employee contributions
  - Reduced benefits for new hires, including higher retirement age
  - Cost of Living Adjustment (COLA) reductions for retirees and existing workers (some changes are being challenged)

Participating MERS Municipalities



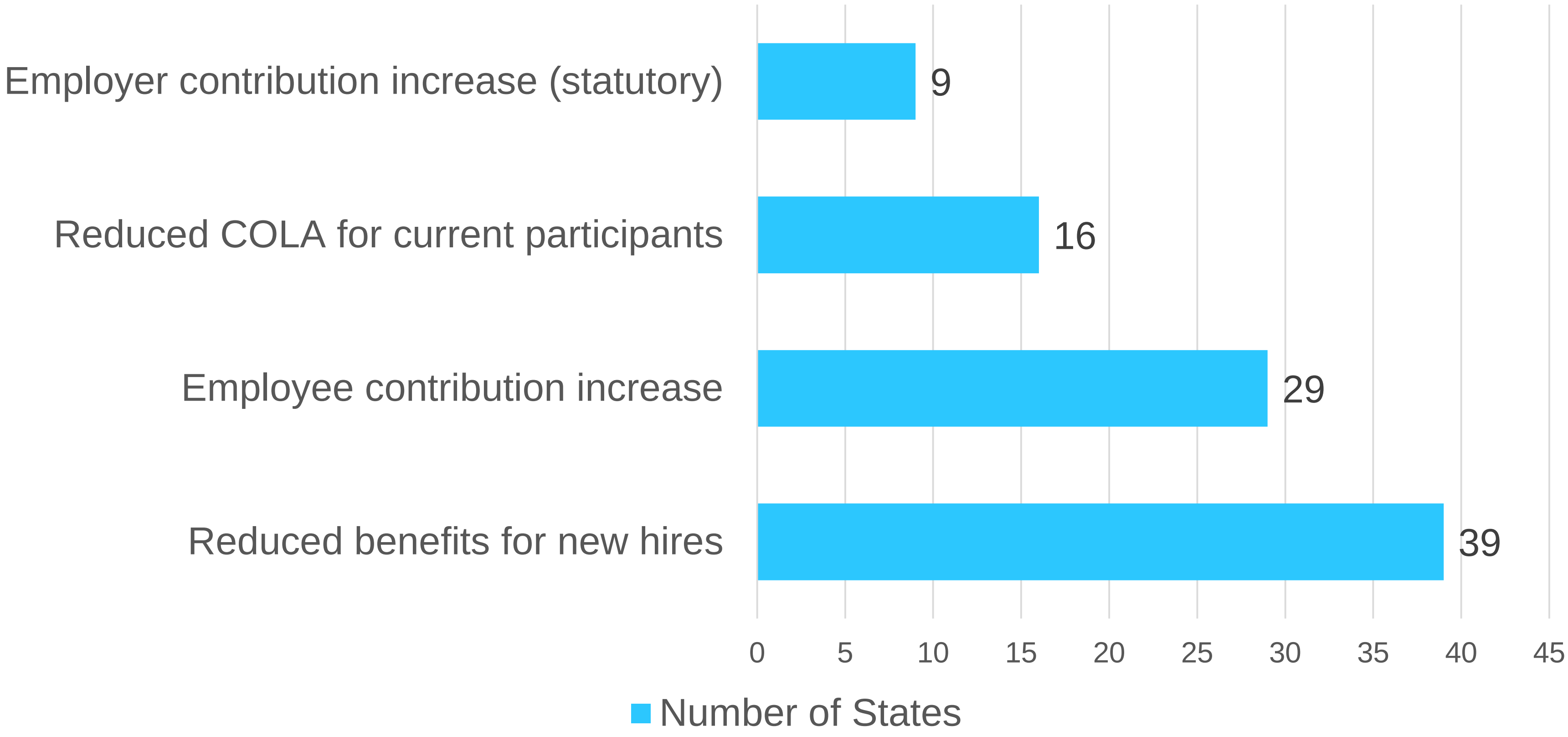
of Michigan municipalities participate in MERS programs



As of 8/31/2016

Reforms in Virtually All States

State Plan Changes Enacted Post Financial Crisis



Source: Analysis of NCSL data. Significant Reforms to State Retirement Systems. June 2016
Changes affect some or all members of state-run plans in each state.

Trends in Plan Design - MERS

Strategy	Description	Trend					
		2011	2012	2013	2014	2015	2016
Cost Sharing for Existing Employees	• Employees contribute to help fund the overall cost of the plan	176	149	280	143	97	58
Lower Benefit to New Hires	• New hires receive a lower tier of defined benefit provisions	63	49	53	43	52	14
Bridged Benefits for Existing Employees	• Benefits are offered in parts to existing employees • Multiplier is then lowered on a going-forward basis	14	17	19	29	16	20
Hybrid for New Hires	• New hires receive a hybrid plan	31	67	31	43	21	10
Defined Contribution for New Hires	• New hires receive a defined contribution plan	21	20	45	30	37	27
Bonding	• Municipalities may bond for all or a portion of their unfunded accrued liabilities—pension or OPEB				4	1	2
Voluntary Contributions	• Additional payments made into plan toward unfunded liability		180	211	210	277	192

National Retirement Risk Index

- The National Retirement Risk Index (NRRI) is published by the Center for Retirement Research at Boston College
- The index measures the percentage of working-age households at risk of being unable to maintain their pre-retirement standard of living during retirement

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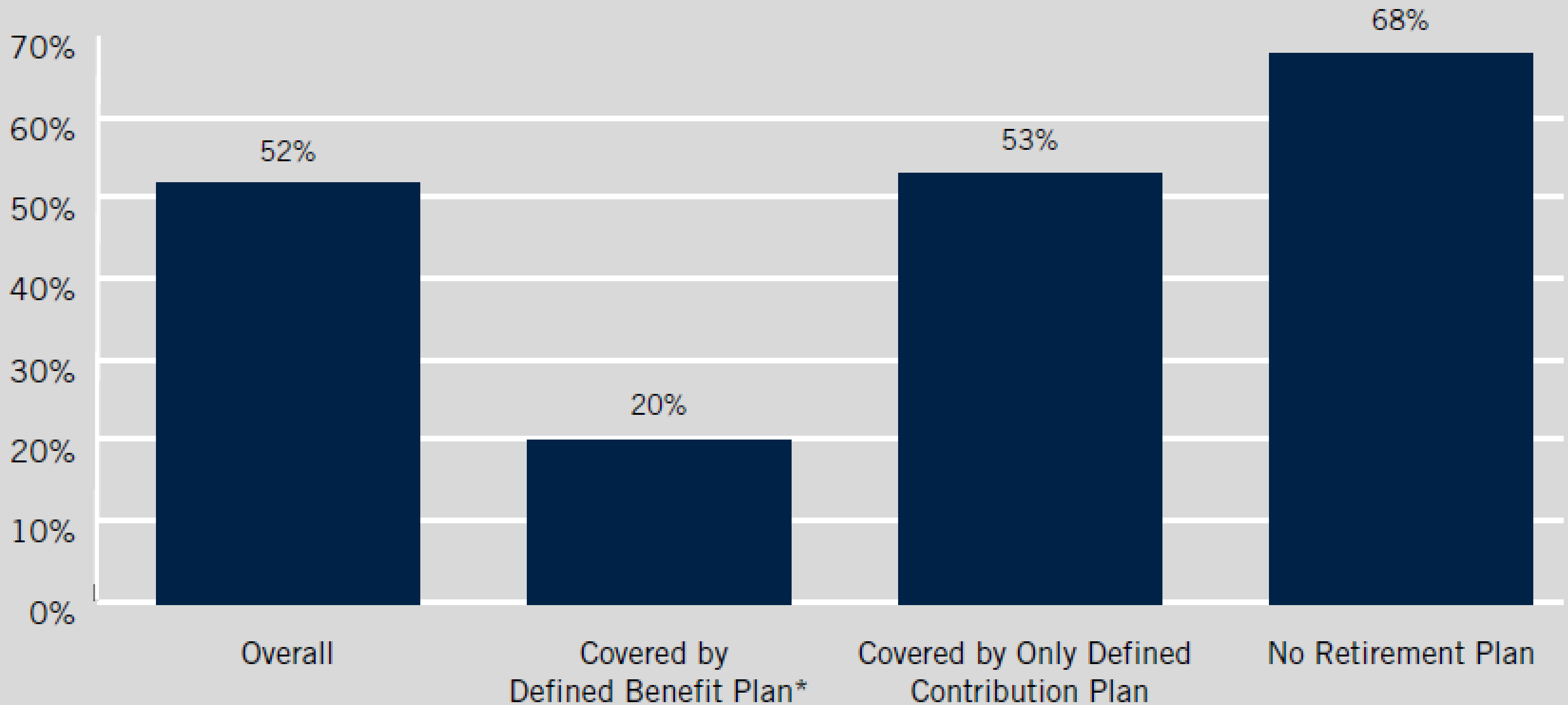
At Risk Households

Percentage of households "at risk" at age 65 based on pension coverage



*Includes those with both defined benefit and defined contribution plans.

Source: Center for Retirement Research at Boston College

A Shift Back to Defined Benefit

- The biggest shift in pension plan design is the focus, increasingly, moving defined contribution plans back toward defined benefit features
  - The difference in retirement preparedness for those households with a defined benefit plan and those with only a defined contribution plan is significant
  - Defined benefit plans automatically enroll participants, have required funding standards, and provide a guaranteed lifetime income at retirement
- This trend is being seen in both the private and public sectors

Adequacy Options

Risks of Not Providing an Adequate Retirement Plan

Recruit

Decreased ability to compete with other employers to attract talented employees

Retain

Talented employees may not be engaged in their current position and seek future opportunities

Retire

Potential employer costs if employees have inadequate savings to retire:

- Higher health care costs than younger employees
- Higher absenteeism and lower productivity while at work
- Decreased engagement for other workers unable to advance in their career

Evaluating Adequacy

Understanding the target income replacement rate for your plan

- Age at Hire: 25
- Starting Salary: $45,000
- Annual Salary Increase: 4%
- Highest 5-year Avg. Salary: $129,951
- Benefit Multiplier: 2.5%
- Retirement Age: 55
- Age of Death 90
- Investment Return While Working: 5%
- Investment Return in Retirement: 4%
- National Average Wage Index: 3.55%
- Inflation in Retirement: 2%

	DB Plan	DC Plan
Total Employer Contribution Normal Cost = 5.95% UAL = 9.15%	15.1%	15%
Employee Contribution	7.5%	10%
Total Cost of the Plan	22.6%	25%
Income Replacement	69.4%	35.6%

Building a Successful Plan

Plan Design Considerations

Plan Type

- Is the plan intended solely for retirement income, or specific to health care costs in retirement?
- Is its purpose to supplement a pension or be the primary retirement plan?

Participation

- Is the plan mandatory or voluntary?
- Would an automatic enrollment design enhance the plan?

Contribution Structure

- Fixed employee contribution amount or are employee contributions voluntary and flexible?
- Are there employer contributions?
- Do the employer contributions incentivize increased participation and/or contributions from the employee?
- Would automatic escalation of contributions enhance the plan?

Vesting Schedule

- Longer vesting schedules reward longer term employees.
- Unvested dollars that return to employer offset future contribution costs.

Evaluating Retirement Plan Risks

Contribution Risk

The risk that there is insufficient money saved to adequately fund a retirement benefit

- The pooled nature of a defined benefit plan provides for more efficient use of assets to fund benefits overs the long-term
- Defined contribution employees bear the risk of adequacy themselves
- In a hybrid plan the risk is lower since the defined benefit and defined contribution are smaller portions of the overall benefit

DB Plan		Hybrid Plan		DC Plan	
ER	EE	ER	EE	ER	EE
Mid	Low	Low	Low	None	High

ER = Employer
EE = Employee

Evaluating Retirement Plan Risks, Cont.

Investment Risk

The risk that the investments achieve a rate of return to adequately fund a retirement benefit. This includes the risk that the portfolio is diversified and invested appropriately for the timescale involved

- Defined benefit plans have institutionally invested assets that are governed by a board that has the fiduciary responsibility
- Defined contribution plans have a higher risk of underperformance primarily due to access to fewer asset classes, behavioral tendencies by individuals, and higher fees. Research also shows that most employees do not actively rebalance their portfolios to an appropriate asset allocation
- In a hybrid plan the risk is lower since the defined benefit and defined contribution are smaller portions of the overall benefit

DB Plan		Hybrid Plan		DC Plan	
ER	EE	ER	EE	ER	EE
Mid	None	Low	Low	None	High

ER = Employer
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Evaluating Retirement Plan Risks, Cont.

Economic Risk

The risk that there is a major reversal and loss in the market on the onset of retirement or during a distribution

- A defined benefit plan can hold distressed assets until they rebound and can effectively manage market risk by investing for the long-term of a more significant pool of members, capturing higher returns
- Defined contribution employees have only their career span to save for retirement and bear this risk alone. A major loss in the market at the onset of retirement, may require a defined contribution employee to realize an immediate loss to meet income needs
- To manage inflation a defined contribution employee must shift the allocation of their portfolio as they approach and move through retirement, lowering their expected return as the proportion of equity in their portfolio decreases

DB Plan		Hybrid Plan		DC Plan	
ER	EE	ER	EE	ER	EE
Mid	None	Low	Low	None	High

ER = Employer
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Evaluating Retirement Plan Risks, Cont.

Longevity Risk

The risk of outliving retirement resources

- Defined benefit plans can effectively manage longevity risk by using actuarial assumptions on a more significant pool of members
- Defined contribution employees must attempt to estimate their longevity and bears this risk alone
- In a hybrid the risk is lower to the employer since the defined benefit is a smaller portion of the overall benefit

DB Plan		Hybrid Plan		DC Plan	
ER	EE	ER	EE	ER	EE
Mid	None	Low	Low	None	High

ER = Employer
EE = Employee

Balancing the Risks and Benefits

Blending plans and programs to achieve balance

- Hybrid program that includes components of both defined benefit and defined contribution plans
- Modest defined benefit plan with a supplemental 457 program
- Defined contribution plan with supplemental 457 program

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Maximizing Flexibility in Defined Contribution Plans

- Employers seeking more flexibility may explore combining the 401(a) and 457(b)
- Employer can require a minimum mandatory employee contribution that would be deposited into the 401(a) plan
- Employer can set a matching contribution structure between plans:
  - Employer matching contribution is deposited into 401(a) plan
    - Allows vesting to continue on employer matching contributions
    - Employer contributions into 401(a) plan are not included in earnings
  - Employee voluntary contribution is deposited into 457(b) program
- Employees would have the option to make either pre-tax or Roth (post-tax) contributions into the 457(b) program

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Retirement Health Care Expenses

- Governmental entities have the ability to set dollars aside in a ***Section 115 Trust*** for employees to use toward health care costs post-employment
- Funded by employer and/or employee contributions
- Employer can establish a vesting schedule to reward long-term employees
- Efficient tax-favored program
  - Employees invest tax-free
  - Reimbursements are tax-free
  - Employer saves on FICA taxes (7.65%) on contributions

Participant Education and Engagement

Participant Education is Key

Preparing Participants for a Successful Retirement

- Regardless of the plan design, ensuring that participants understand how their benefit works is a crucial component for building an effective retirement plan
- Higher financial literacy among employees is associated with higher voluntary participation rates or lower quit-rates in automatic enrollment plans
- Financial literacy has a larger effect on saving than does a sizable increase income
- Knowledge of a plan's specific features—such as the employer matching threshold—is also associated with increased saving

Source: Center for Retirement Research at Boston College

Retirement Readiness

- MERS Retirement Readiness reports provide individual guidance at no cost to the participant or the employer
- Includes both passive and interactive tools for assessing their financial preparedness
  - **Snapshot**: These reports are mailed to participants annually and provide an overview of how their MERS accounts will provide for them in retirement
  - **Full Picture**: The online Full Picture report builder is an interactive tool that allows participants to include outside information to develop a comprehensive picture of their retirement readiness. The report identifies their risk tolerance and provides customized suggestions to improving their preparedness

Participant Education

Pizza & Planning

- Free, localized education for employees after traditional work hours
- Held at various locations throughout the state
- Group presentations on variety of topics

On-site education

- Group presentations can be held at your location whenever it is convenient for you
- Attend benefit fairs
- One-on-one meetings for all MERS programs

Online videos and webinars

“The Big Picture” Annual Retirement Report

- Our employer report will help you monitor how effectively your employees are using their retirement benefit

COMING SOON!

THE BIG PICTURE
Annual Retirement Report

- This annual employer report includes insight on:
  - An overview of the plan from a retirement readiness perspective
  - A demographic breakdown of participants by age group and salary range in key areas

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Contacting MERS

MERS of Michigan
1134 Municipal Way
Lansing, MI 48917

Phone: 800.767.6377
www.mersofmich.com

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