A Strategic View of Retirement Plan Governance

Presented by Mike Overley and Sue Feinberg

MERS®
Municipal Employees' Retirement System

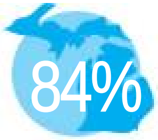
Agenda

- Who is MERS?
- The Role of a Fiduciary
- Plan Design Strategies and Considerations
- Maximizing Flexibility and Adequacy
- A Modern Approach to Retiree Health Care

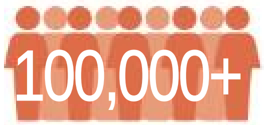
Who is MERS of Michigan?

MERS is an independent, professional retirement services company that was **created to administer** the retirement plans for Michigan municipalities on a **not-for-profit basis**

BY THE NUMBERS



of Michigan's pension plans participate with MERS



participants

in combined total assets

The Role of a Fiduciary

MERS®
Municipal Employees' Retirement System

You Might Be a Fiduciary If…

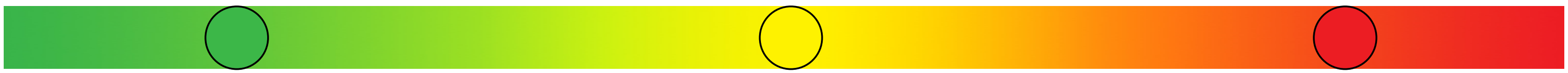
- You are named as a fiduciary by title
  - Trustees and often plan administrators
  - Named fiduciaries have authority over operation and administration of the plan
  - Service providers, such as investment professionals, may assume fiduciary status
- You act like a fiduciary
  - Determined by the actions performed and discretion exercised over plan assets

Fiduciary Responsibility

- With recent high-profile class action suits alleging violation of fiduciary duty, employers need to manage fiduciary risks
- When fiduciary breaches occur there can be:
  - Personal liability
  - Fines and penalties
  - Legal action
  - Plan disqualification
  - Higher operating expenses

Degrees of Fiduciary Responsibility

When it comes to the fiduciary responsibility for your retirement plan, not all plan providers assume the same degree of responsibility



Plan Provider

In some instances, the plan provider takes fiduciary responsibility, establishes the plan document, determines the investment options available and monitors performance.

MERS provides employers with this level of confidence.

Co-Fiduciary Responsibility

Many plan providers act as co-fiduciaries. The provider offers investment information and makes recommendations. The employer is responsible for selecting and monitoring the performance of the funds.

The plan provider and employer share fiduciary responsibility for the plan.

Employer

Most plan providers act only as a record keeper and leave decisions regarding the plan document, investment options and performance monitoring to the employer.

The employer has unlimited choices under this scenario, but risks being held liable for fiduciary violations.

Fiduciary Oversight

- A fiduciary is anyone who exercises discretionary authority over:
  - Plan assets
  - The administration of the plan
  - The management of the plan
- Fiduciaries are subject to standards of conduct and must act on behalf of participants
- Responsibilities:
  - Adherence to plan document
  - Investment oversight
  - Ensure reasonable expenses

MERS provides employers with peace of mind because the ***MERS Retirement Board takes on the <u>sole fiduciary responsibility</u> of their plan*****.**

Investment Menu and Oversight

Responsibilities of the Plan Fiduciary

- Establish clear goals and objectives for the plan investment options with well-defined measures for success
- Maintain a disciplined process for hiring, evaluating and terminating investment managers for the plan
- Choose an appropriate investment default fund
- Document all of the above in a formal Investment Policy Statement

Is a Bigger Investment Menu Better?

Psychologists have concluded that an overload of options can paralyze people or push them into decisions that are against their own best interest.

<u>When Less is Actually More</u>

A study on shopping behavior experimented with jam displays. One table held 24 varieties of gourmet jam; the other held only 6 varieties. The large display attracted more interest, but people were 1/10th as likely to buy from the large display as from the small display.

The same principle of “less is more” was found to apply to participation rates in retirement programs. A large number of fund choices actually *discourages participation* amongst even well informed participants.[1, 2]

[1] *Mottola, Gary and Utkus, Stephen. “Can There Be Too Much Choice In a Retirement Savings Plan?” The Vanguard Center for Retirement Research, June 2003*

[2] *Schwartz, Barry. “More Isn’t Always Better.” Harvard Business Review, 01 June 2006. Web. 24 Feb. 2016*

Simplified Investment Options

- Our streamlined investment menu is selected by our experienced investment professionals
- MERS performs the necessary research, due diligence and monitoring to ensure high-quality options are available
- Fully diversified, professionally managed portfolios provide access to funds not otherwise available with other providers
- Outside institutional investment managers are selected and monitored by the MERS Office of Investments and Retirement Board

Investment Categories

1 *"Do it for me"*
Fully diversified target date funds that automatically adjust over time

2 *"Help me do it"*
Prebuilt portfolios that are monitored and rebalanced quarterly

3 *"I'll do it myself"*
Self-Directed Brokerage Account to access funds outside of MERS

Monitoring Participant Expenses

Responsibilities of the Plan Fiduciary

- Understand all costs paid by the participants, including:
  - Direct investment and administrative charges
  - Third-party and/or indirect fees
  - Reimbursements
- Assess whether plan fees are reasonable
- Ensure that all plan fees charged to participants are clearly disclosed

Monitoring Plan Expenses

Provider Comparison Summary

Plan Weighted Averages (Appendix III)	Provider A	Provider B	Difference
Expense			
Weighted Average Expense	1.68%	0.41%	-1.27% ⬇
Performance			
1-Year Weighted Average Performance	16.20%	16.65%	0.45% ⬆
3-Year Weighted Average Performance	6.04%	7.14%	1.10% ⬆
5-Year Weighted Average Performance	10.79%	12.15%	1.36% ⬆

Comparing Providers *Effect of Fees on Participants*

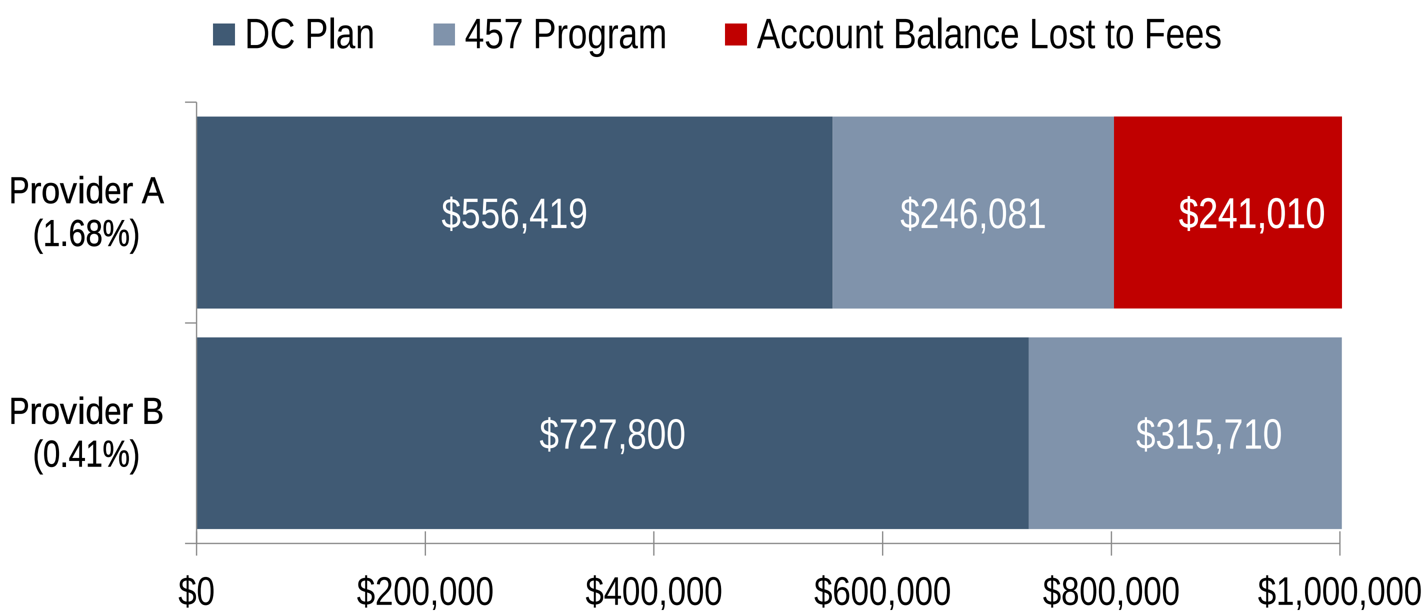
Meet John

- John is 30 years old
- His current salary is $42,000, with 2% annual salary increases
- He has a balance of $10,000 in his Defined Contribution account
- He will make bi-weekly contributions of 10% into his Defined Contribution account and 5% into his 457 account until retirement
- Assumes a 7.5% gross investment return before retirement
- Retires at age 62
  - John withdraws assets in equal monthly payments for 25 years
  - At the end of 25 years the balance is depleted
- Assumes a 6% gross investment return throughout retirement

Comparing Providers *Balance at Retirement*

A comparison report can help an employer gauge the impact of higher costs during the ***accumulation phase*** of an average employee.

In this comparison, lower fund expenses could provide John with
30% more at retirement!

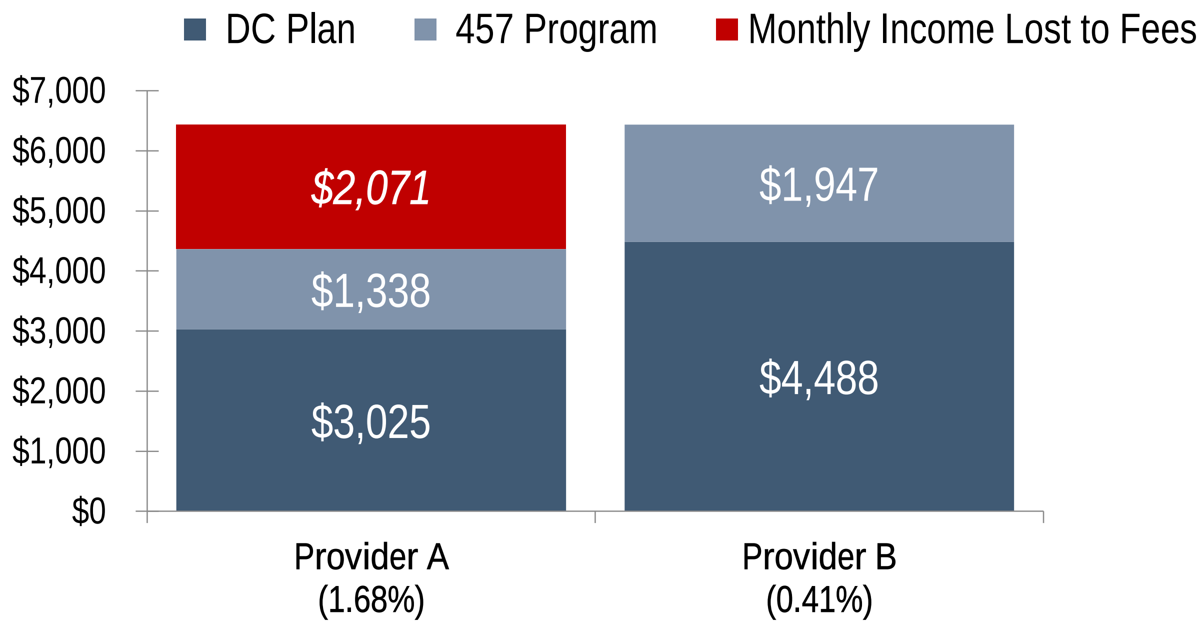


Comparing Providers *Monthly Income in Retirement*

The comparison report can also help an employer gauge the impact of higher costs during the ***distribution phase*** of an average retiree.

Lower fund expenses could provide John with

47% more in monthly income during retirement!



Plan Design Strategies and Considerations

MERS®
Municipal Employees' Retirement System

Public Sector Retirement Options

Defined Benefit

- Lifetime benefit that does not fluctuate with investment gains or losses
- Contributions fluctuate
- Funded by the employer, employee and investment earnings

Hybrid

- Combines the best of both plans
- Benefit and contributions vary
- Funded by the employer, employee and investment earnings

Defined Contribution

- Benefit based on account balance
- Fixed contributions
- Funded by the employer, employee and investment earnings

457 Program

- Supplemental savings account that can be added to any retirement plan
- Voluntary and flexible employee contributions
- Pre-tax and Roth options

Retirement Plan Adequacy

Potential risks of not providing adequate retirement plan

Recruit

Decreased ability to compete with other employers to attract talented employees

Retain

Benefits keep talented employees engaged in their current position and 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 career
- Large lump sum sick, vacation, PTO bank payouts upon separation

Retirement Plan Considerations

Plan Type

- Is the plan intended solely for retirement income or for health care costs as well?
- Is the purpose to supplement a pension or to be the primary retirement plan?

Participation

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

Contribution Structure

- Are employee contributions voluntary and flexible or fixed?
- What is the employer contribution budget?
- Do the employer contributions incentivize increased participation and/or contributions from the employee?
- Would automatic escalation enhance the plan?

Vesting Schedule

- Vesting schedules help retain employees
- Unvested dollars can return to employer and offset future contribution costs

Loans

- Will participants be allowed to take out loans?

Retirement Plan Trends

Increased life expectancy means retirees need larger retirement savings

Trend of employers no longer offering traditional pensions

Trend of employers no longer offering retiree health insurance

Maximizing Flexibility and Adequacy

MERS®
Municipal Employees' Retirement System

What is an Adequate Savings Rate?

- Rather than a one-size-fits-all answer, it's important to look at how much income a person is likely to need in retirement
- **80% income replacement rate** is the industry standard
- The contribution rate needed to achieve that income replacement rate varies from person to person and depends on several factors:
  - Current age
  - Expected age at retirement
  - Life expectancy
  - Health
  - Cost of health insurance
  - Investment risk tolerance
  - Social Security
  - Other income sources
  - Lifestyle in retirement
  - Debt
- Providing the ability to choose a savings rate enables employees to make the best individual choice for their circumstances

Flexible Retirement Savings

- The IRS prevents an employee from changing their contribution rate in a 401(a) Defined Contribution Plan after initial election
- Pairing a 401(a) Defined Contribution Plan with a 457(b) Supplemental Savings Program provides 401(k)-like flexibility
- An example of this plan design is the **MERS Defined Contribution *PLUS*** – two programs essentially function as a single plan

How Does it Work?

Offering an employer match to incentivize employee saving

- Employers establish the contribution structure for the Defined Contribution Plan
  - Any employer contributions are deposited into the employee’s Defined Contribution account
  - Employee contributions may or may not be required
- Employers can encourage even greater employee participation by offering a match on any voluntary contributions the employee makes
  - Voluntary employee contributions are deposited into the employee's 457 account
  - Employer’s matching contributions are deposited into the employee's Defined Contribution account

Simplified Reporting and Oversight

Blending two plans into one seamless design

- Joint reporting of contributions saves employers time
- Combined statements and online account access make it convenient for participants to monitor investment performance
- Using a single investment menu simplifies the decision making process
  - Less oversight for employers
  - Choosing investment options and making allocations is easier for participants

Benefits of Combining Plans

Employer

- Minimum level of participation in the Defined Contribution Plan is required
- A vesting schedule can be applied to all employer contributions
- Loans can be restricted from the Defined Contribution account, while still allowed from the 457 account
- Having both programs administered by a single vendor lowers plan expenses

Employee

- Employees can contribute up to the annual IRS maximum in each plan (Up to $55,000 in Defined Contribution and $18,500 in 457)*
- Voluntary contributions can start, stop or be changed at any time
- Matching contributions from employer are not taxed as income when received

**IRS limits for 2018*

Plan Feature Comparison

Plan Type	401(a)	457(b)	Combined
Primary Purpose	Qualified Retirement Plan	Supplemental Savings Program	Qualified Plan with Supplemental Savings Program
Enrollment	Mandatory	Voluntary	Mandatory
Employee Contribution Flexibility	Choice only at Enrollment	Complete Flexibility	Complete Flexibility Above Required Contributions
Required Contributions	Yes	No	Yes
Automatic Enrollment (optional)	n/a	Yes	Yes
Automatic Contribution Escalation (optional)	No	Yes	Yes
Roth Option Available	No	Yes	Yes
Allows Employer Contribution	Yes	Yes (included as employee earnings)	Yes
Allows Vesting	Yes	Varies	Yes

Contribution Structure Example

- Employees are required to contribute 2%
- Employer will contribute a minimum of 2%
- Employer will match 100% of voluntary contributions, up to a maximum of 5%
- Voluntary employee contributions above 5% are allowed, but will not be matched by the employer

	Required Contributions				
Employee Contributions - Deposited into DC Account	2%				
Employer Contributions - Deposited into DC Account	2%				
	Voluntary Contributions				
Employee Voluntary Contributions - Deposited to 457 Account	0%	1%	5%	7.5%	10%
Employer Matching Contributions - Deposited into DC Account	0%	1%	5%	5%	5%
Total Retirement Contributions	4%	6%	14%	16.5%	19%

Participant Education is Key

Preparing participants for a successful retirement

- Regardless of the plan design, ensuring that participants understand how their benefit works is crucial
- 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 a sizable increase in 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

A Modern Approach to Retiree Health Care

MERS®

Municipal Employees' Retirement System

Rising Cost of Retiree Health Care

- Medicare was never designed to cover health care expenses in full
- Most couples would need to have saved **$349,000** by age 65 to have a 90% chance of having enough money to pay for retiree health care expenses
- Retiree health care costs is one of the primary reasons people decide to delay their retirement
- Studies show health care costs rank second only to food for retiree expenses
- Fewer employers are offering defined benefit-style retiree health care plans

Retiree Health Care Plan Considerations

- Must include network coverage for pre-65 retirees
- Compliance with stringent Medicare regulations
- Need for retiree-centric customer service model that helps retirees and family members evaluate plan options, with ongoing support
- Must provide timely communication to pre-retirees with easy-to-understand materials
- Seamless integration with other savings vehicles
- Actuarial support for OPEB valuation and consulting

Modernizing Retiree Health Care

Retiree Health Care Private Exchange

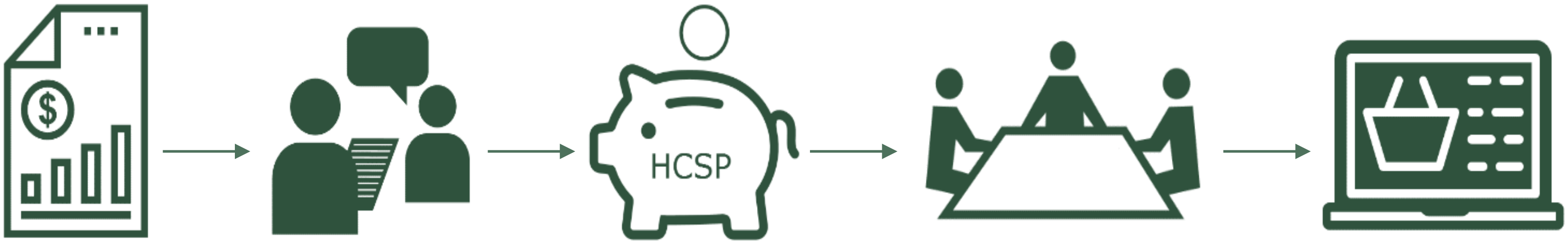
- An online marketplace where retirees can purchase benefits from the carrier of their choice
- Provides a variety of plans:
  - Pre-65 coverage
  - Coverage options for Medicare-eligible retirees that include Medicare Advantage, Medicare Supplement (Medigap) and Part D Prescription Drug Plans
  - Dental and vision plans
- MERS will be partnering with Mercer Marketplace 365
- Fully integrates with a health care savings account, such as the MERS Health Care Savings Program

Advantages for Retirees

- Ability to purchase quality, low-cost benefits seamlessly through the exchange without employer adoption
- A Benefits Counselor guides each retiree and eligible dependent through a step-by-step consultative process
- The Benefits Counselor then assists during the enrollment process, which is typically done online
- Premiums can be paid directly to insurer through a health care savings account

Case Study Example

Jackson District Library



OPEB valuation determines liability

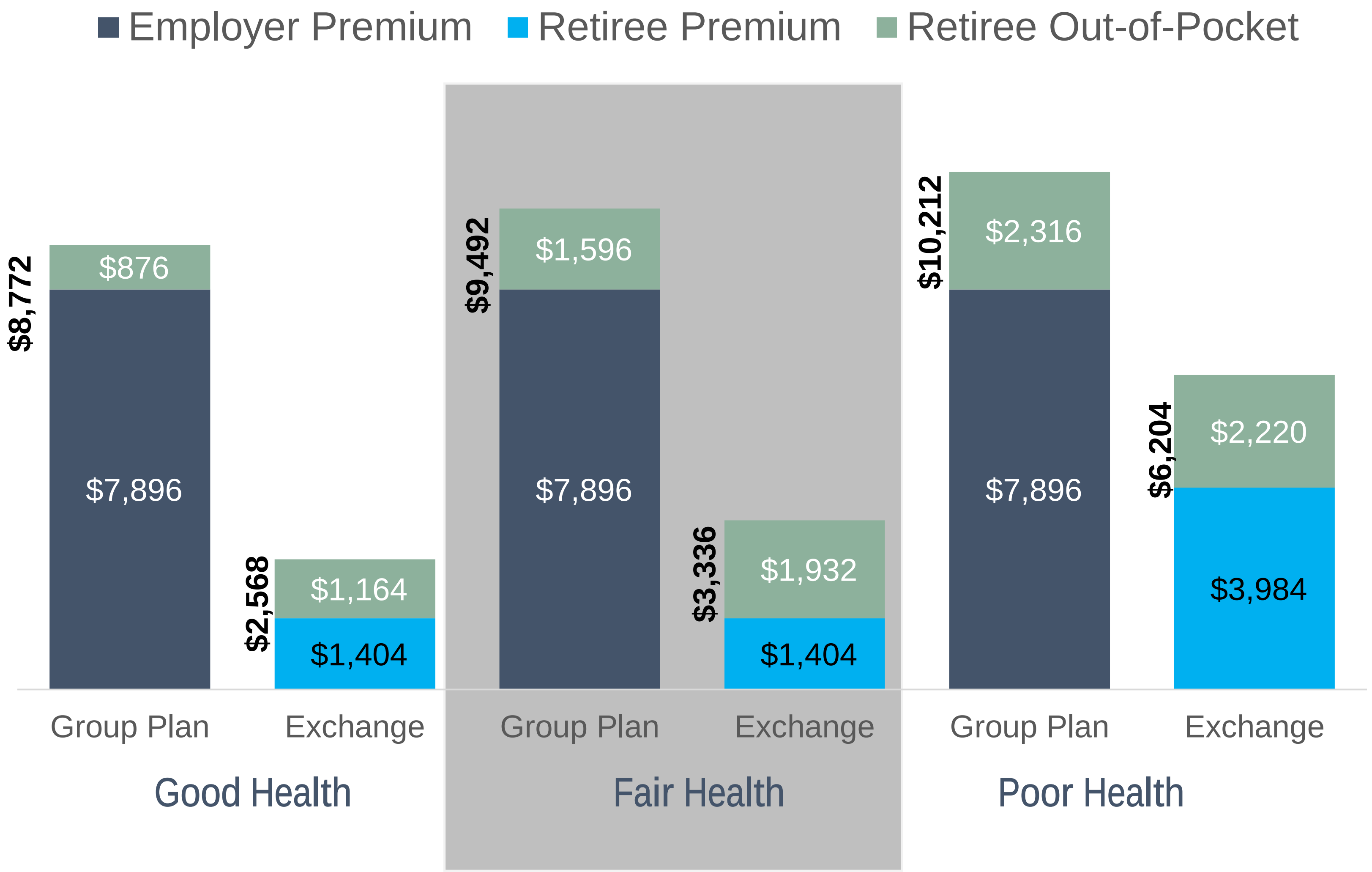
Exchange consultants help design the structure

Stipend is deposited into a health care savings account

Benefit Counselors meet with retirees to provide education and assistance to help them choose a plan

Retirees use their health care savings account funds to purchase health plan off the private exchange

Competitive Pricing Reduced Plan Cost



Benefits of a Private Exchange

Employer

- Ability to offer quality retiree benefits
- Reduced costs
- No long-term OPEB liability accrues

Retiree

- Can select a unique plan that meets their individual needs
- Tax-free deposits are made into a health care savings account
- Health care savings account balance can be used for other qualified healthcare expenses

Key Takeaways

- The role of fiduciary
  - Must act on behalf of plan participants
  - Not all retirement plan service providers assume the same level of fiduciary responsibility
  - Investment menu and fee oversight and governance
- Maximize your plan design
  - Creative solutions for added flexibility
  - Enable your employees to prepare adequately for retirement
- Retirement adequacy and planning for retirement
  - Knowledge is power
  - Income replacement
  - Healthcare costs and needs in retirement

Contacting MERS of Michigan

MUNICIPAL EMPLOYEES' RETIREMENT SYSTEM

1134 Municipal Way
Lansing, MI 48917

800.767.MERS (6377)

www.mersofmich.com

This presentation contains a summary description of MERS benefits, policies or procedures. MERS has made every effort to ensure that the information provided is accurate and up to date. Where the publication conflicts with the relevant Plan Document, the Plan Document controls.