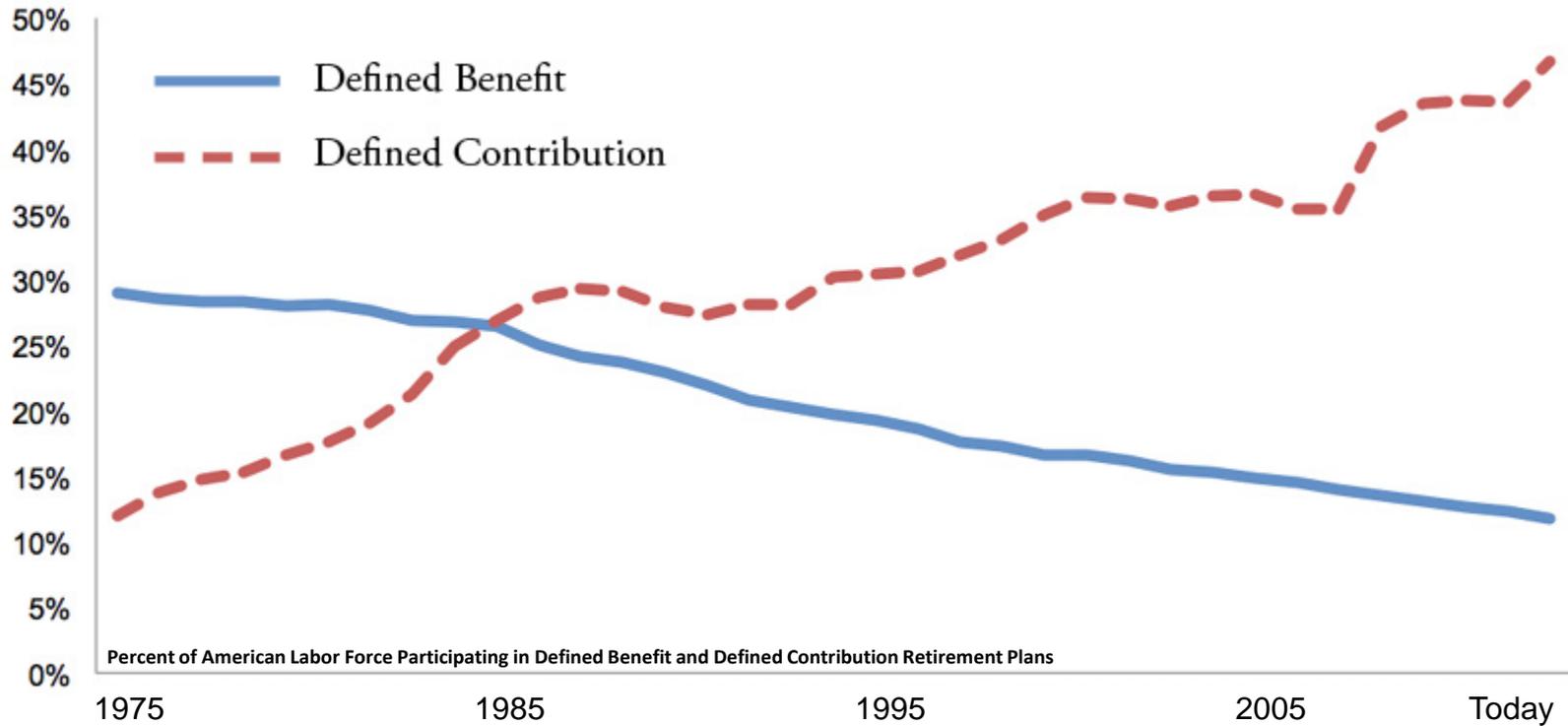


# Public Sector Defined Contribution Plan Basics

**Presented by:**  
John Thinnes, CFA, CAIA



# Industry Trend



# Trend in the Public Sector

- 90% of state & local gov't employees have access to retirement benefits
  - 84% have access to DB plan, 78% participating
  - 30% have access to DC plan, 17% participating
    - 43% of state workers, 26 % participation
    - 26% of local workers, 14% participation



# Shift in Risks

	Defined Benefit	Defined Contribution
Plan Investment Selection	<b>Employer</b>	<b>Employer</b>
Diversification / Asset Allocation	<b>Employer</b>	Employee
Determines Plan Expenses	<b>Employer</b>	<b>Employer</b>
Pay Plan Expenses	<b>Employer</b>	Employee
Funding (Plan Contributions)	<b>Employer</b>	Employee
Retirement Income	<b>Employer</b>	Employee



# Retirement Plan Industry Trends

## Current factors affecting the retirement plan industry:

- Continued pension reform and other political pressures
- Increased plan governance by formal plan committees
- Fee disclosure rules & public scrutiny have increased plan awareness
- Advances in recordkeeping technology continue to drive down cost
- Vendor consolidation
- Comprehensive participant education and retirement planning solutions



# Types of Defined Contribution Plans

## 401(k)

- Corporate

## 403(b)

- University
- Hospital

## 457(b)

- Public

## 401(a)

- Public



# Governmental Plans

## 401(a) Defined Contribution

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- A retirement savings plan that allows dollars to accumulate on a tax-advantaged basis for retirement
- Contributions made by the employer, the participant, or both
- Employees typically select their investments from a menu designed by the employer and/or an advisor

## 457(b) Deferred Compensation

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- A supplemental program that allows participants to make contributions on a pre-tax basis
- Taxes are deferred until your assets are withdrawn, usually during retirement
- Employees typically select their investments from a menu designed by the employer and/or an advisor



# What is a Fiduciary?

**fi·du·cia·ry** | fə'dōōSHē\_erē,-SHərē

*Adjective*

1. Pertaining to a position of Trust or confidence; confidential: a *fiduciary* relation, as that of an attorney, guardian, or trustee. 2. Unwavering; trustful; undoubting. 3. Relying on the confidence of the public as for paper currency or value. 4. Held in trust. ---- *n. pl.* **-aries** A person who holds a thing in trust; a trustee.



# Role of a Fiduciary

- **ERISA** – Employee Retirement Income Security Act of 1974
  - regulates employer-sponsored retirement plans.
  - imposes specific duties on plan fiduciaries.
- **DOL** – Department of Labor
  - Enforces ERISA and ensures employers are making decisions in the best interest of plan participants



# Am I a Fiduciary?

## Do you...

- Have any discretionary authority or discretionary responsibility in the administration of the plan?
- Exercise any authority and/or control over the management or disposition of plan assets?
- Render investment advice to the plan and/or its participants for a fee or other compensation, whether direct or indirect?

## Or do you...

- perform certain ministerial administrative functions within a framework of the plan's policies, practices and procedures?



# Who is a Fiduciary?

## **Fiduciary**

- Plan Sponsor
- Plan Trustee
- Plan Administrator
- Administrative and Investment Committees
- Investment Consultants

## **Not Typically a Fiduciary**

- Directed Trustee
- Recordkeeper
- Attorney
- Accountant
- Actuary
- TPA

**NOTE: FIDUCIARY IS A RESULT OF FUNCTION & DUTY, NOT TITLE**



# Roles of a Fiduciary

As outlined by the Government Finance Officers Association (GFOA):

*“In carrying out their responsibilities as fiduciaries, plan sponsors **make decisions in the best interests of the plan participants** and beneficiaries. In making these decisions, it is assumed that plan sponsors have knowledge about all fees and expenses charged to the plan and participants while ensuring that these costs are reasonable. It is also assumed that plan sponsors are disclosing to plan participants adequate and accurate information about the fees and expenses that affect their account balances.”*



# Role of a Fiduciary

- ✓ **Duty of Loyalty** - a fiduciary must perform their duties solely in the interest of participants and beneficiaries. “exclusive benefit rule”
- ✓ **Duty to Act Prudently** - a fiduciary must act with the “care, skill, prudence, and diligence...that a prudent man acting in a like capacity and familiar with such matters would use...”
- ✓ **Duty of Diversification** - A fiduciary should strive to diversify investments so as to minimize the risk of large losses, unless, under the circumstances, it is clearly prudent not to do so.
- ✓ **Duty to Follow Plan Provisions** - a fiduciary must follow the terms of the governing documents for the plan



# Fiduciary Responsibilities

## General

- Document sound fiduciary processes
- Coordinate plan with other benefits
- Communicate effectively with participants
- Hire experts where it benefits the Trustees

## Fees

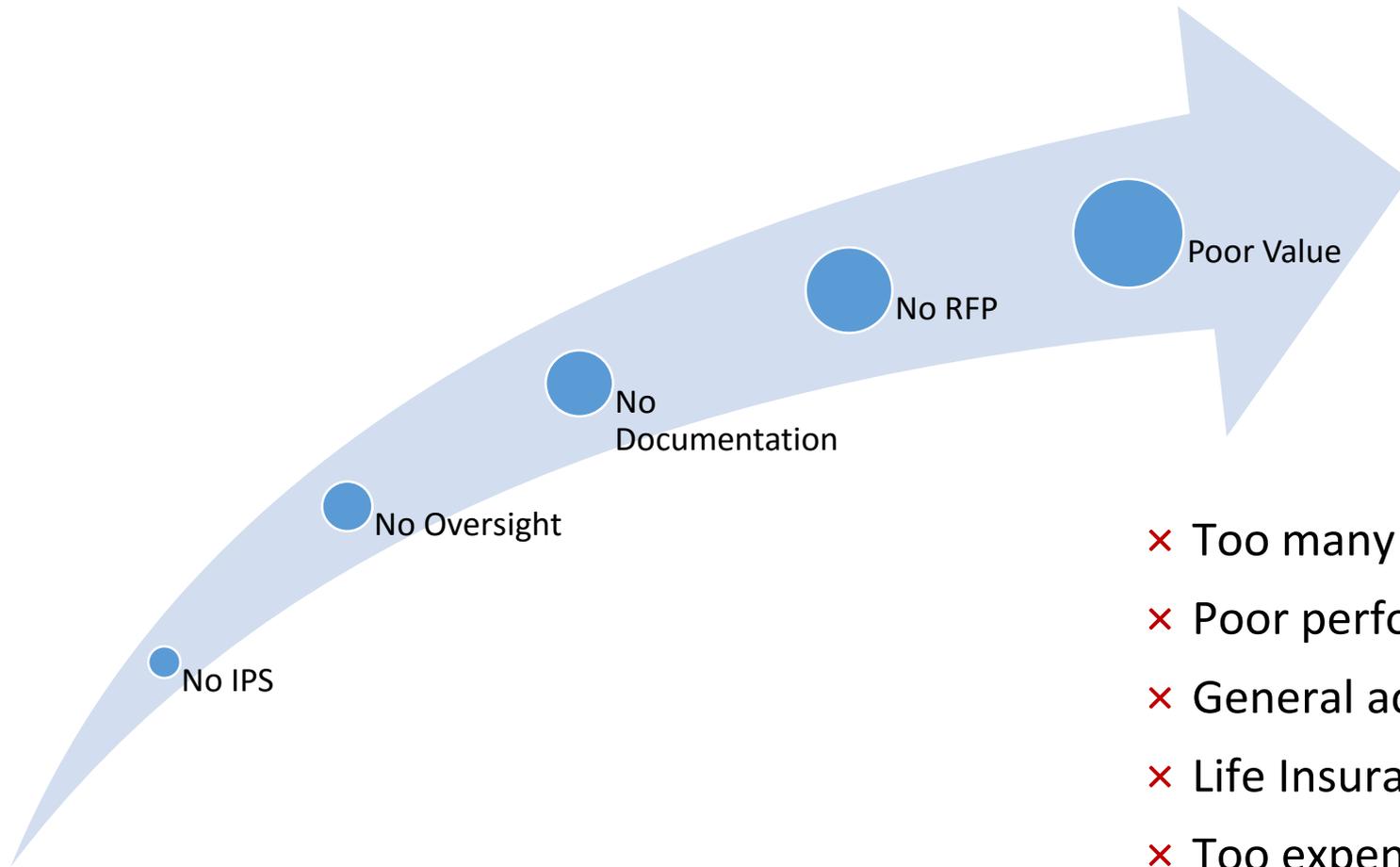
- Ensure fee transparency
- Understand who is receiving fees
- Benchmark services
- Monitor services that are provided
- Understand indirect revenue the plan may be generating

## Investments

- Construct an all-inclusive Investment Policy Statement
- Create a simple, sensible menu
- Monitor lineup closely
- Provide tools for participants
- Measure employee engagement



# Problem Areas



- × Too many funds
- × Poor performers
- × General accounts
- × Life Insurance
- × Too expensive



# The Choice Paradox



**cheesecakes**

ORIGINAL  
*The One that Started it All!*  
Our Famous Creamy Cheesecake with a Graham Cracker Crust and Sour Cream Topping.

FRESH STRAWBERRY  
*The Original Topped with Glazed Fresh Strawberries. Our Most Popular Flavor for 29 Years!*

WHITE CHOCOLATE RASPBERRY TRUFFLE™  
*Creamy Cheesecake Swirled with White Chocolate and Raspberry*

GODIVA® CHOCOLATE CHEESECAKE  
*Layers of Flourless Godiva Chocolate Cake, Godiva Chocolate Mousse and Creamy Cheesecake.*

TRES LECHES CHEESECAKE  
*The Famous Latin Dessert - Cheesecake Style. With Fresh Cream and Delicious with a Graham-Walnut Crust.*

\* 6 CARB ORIGINAL CHEESECAKE  
*Creamy and Delicious with a Graham-Walnut Crust.*

FRESH BANANA CREAM  
*Banana Cream Cheesecake Topped with Bavarian Cream and Fresh Fruit.*

ADAM'S PEANUT BUTTER CHEESECAKE  
*Creamy Cheesecake Swirled with Caramel, Peanut Butter, and Caramelized Pecans.*

WHITE CHOCOLATE CARAMEL  
*White Chocolate, Espresso and Caramel Swirled*

LEMON RASPBERRY CREAM  
*Raspberry-Vanilla Cake, Creamy Lemon Cheesecake, and Lemon Curd.*

DULCE DE LECHE CARAMEL  
*Carameled Cheesecake Topped with Caramel*

CHOCOLATE COCONUT CREAM  
*Coconut Cheesecake Topped with Coconut Cream and Caramel.*

TIRAMISU CHEESECAKE  
*Our Wonderful Cheesecake and Tiramisu Combined.*

CHOCOLATE MOUSSE CHEESECAKE  
*Silky Chocolate Cheesecake Topped with a Layer of Mousse.*

VANILLA BEAN CHEESECAKE  
*Layers of Creamy Vanilla Bean Cheesecake, Vanilla Caramel, and Fresh Fruit.*

CHOCOLATE TUXEDO CREAM  
*Layers of Our Fudge Cake, Chocolate Cheesecake, and Creamy Tiramisu.*

WHITE CHOCOLATE PEANUT BUTTER  
*White Chocolate Peanut Butter Cheesecake Swirled with Caramel and Pecans.*

KAHLUA® COCOA COFFEE  
*Layers of Rich Biscuits, Kahlua Cheesecake, Creamy Chocolate Cheesecake, and Whipped Cream.*

CHOCOLATE OREO® MUDSLURRY  
*Chocolate Oreo Baked in our Creamy Chocolate Cheesecake with Oreo Cheesecake.*

DUTCH APPLE CARAMEL

**cheesecakes and desserts**

WILD BLUEBERRY WHITE CHOCOLATE CHEESECAKE™  
*Original Cheesecake Swirled with Wild Blueberries. Topped with White Chocolate Mousse.*

LOW CARB CHEESECAKE  
*Smooth and Creamy with a Graham-Walnut Crust*

LOW CARB CHEESECAKE WITH STRAWBERRIES  
*Graham-Walnut Crust with Fresh Strawberries and Whipped Cream*

KEY LIME CHEESECAKE  
*Key Lime Pie in a Cheesecake! Deliciously Tart and Creamy on a Vanilla Crumb Crust*

CARAMEL PECAN TURTLE CHEESECAKE  
*Pecan Brownie and Caramel-Fudge Swirl Cheesecake, Topped with Caramel Turtle Pecans and Chocolate Mousse.*

BROWNIE SUNDAE CHEESECAKE  
*Walnut-Brownie Cheesecake and White Chocolate Mousse Covered with Hot Fudge and Almonds*

SNICKERS® BAR CHUNKS AND CHEESECAKE  
*Snickers Bar Baked right into Our Creamy Cheesecake and Topped with Fudge and Caramel*

CRAIG'S CRAZY CARROT CAKE CHEESECAKE  
*Carrot Cake and Cheesecake Swirled Together, Topped with Cream Cheese Icing and Roasted Almonds*

OREO® CHEESECAKE  
*Lots of Oreo Baked into Our Creamy Cheesecake*

CHERRY CHEESECAKE  
*A Classic! The Original Topped with Cherry Preserves*

PUMPKIN & PUMPKIN PECAN  
*World Famous! Available from Mid-October*

Cheesecake from 6.75 to 7.95

A La Mode 1.50 Extra with Hot Fudge 1.50 Extra

**SPECIALTY DESSERTS**

LINDA'S FUDGE CAKE 6.95  
*Layers of Rich Chocolate Cake and Fudge Frosting*

CARROT CAKE 6.95  
*Deliciously Moist Layers of Carrot Cake and Our Famous Cream Cheese Icing*

CHOCOLATE TOWER TRUFFLE CAKE™ 7.50  
*Layers and Layers of Fudge Cake with Chocolate Truffle Cream and Chocolate Mousse*

LEMONCELLO CREAM TORTE™ 6.95  
*Layers of Vanilla Cake and Lemon Mascarpone Cream Topped with Strussel and Served with Strawberries and Whipped Cream*

TIRAMISU 6.95  
*Italian Custard Made with Mascarpone, Whipped Cream, Lady Fingers, Marsala and Coffee Liqueur. Topped with Whipped Cream and Ground Chocolate*

FRESH STRAWBERRY SHORTCAKE 6.95  
*Our Own Shortcake Topped with Vanilla Ice Cream, Fresh Strawberries and Whipped Cream*

CHRIS' OUTRAGEOUS CHOCOLATE CAKE™ 7.50  
*A Cheesecake Factory Original - Layers of Moist Chocolate Cake, Chewy Brownie, Toasted Coconut-Pecan Frosting and Creamy Chocolate Chip Coconut Cheesecake*

BOWL OF FRESH STRAWBERRIES 6.50  
*Strawberries in a Light Cream Sauce with Lemon Juice, Vanilla Ice Cream, and Fresh Fruit.*

**cheesecakes and desserts**

KEY LIME CHEESECAKE  
*Key Lime Pie in a Cheesecake! Deliciously Tart and Creamy on a Vanilla Crumb Crust*

CARAMEL PECAN TURTLE CHEESECAKE  
*Caramel-Fudge Swirl Cheesecake, Topped with Caramel Turtle Pecans and Chocolate Mousse.*

PEANUT BUTTER COOKIE-DOUGH CHEESECAKE  
*Cheesecake Loaded with Peanut Butter Cookie-Dough and Topped with Chocolate Mousse.*

CHOCOLATE RASPBERRY TRUFFLE  
*Cake, Chocolate-Raspberry Swirl Cheesecake, Chocolate Mousse and Chocolate Ganache*

SNICKERS® BAR CHUNKS AND CHEESECAKE  
*Baked right into Our Creamy Cheesecake and Topped with Fudge and Caramel*

CRAIG'S CRAZY CARROT CAKE CHEESECAKE  
*Cheesecake Swirled Together, Topped with Cream Cheese Icing and Roasted Almonds*

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*Layers of Carrot Cake and Cream Cheese Icing*

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*Layers of Fudge Cake with Chocolate Truffle Cream and Chocolate Mousse*

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*Layers of Vanilla Cake and Lemon Mascarpone Cream Topped with Strussel and Served with Strawberries and Whipped Cream*

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# Diversifying Investments

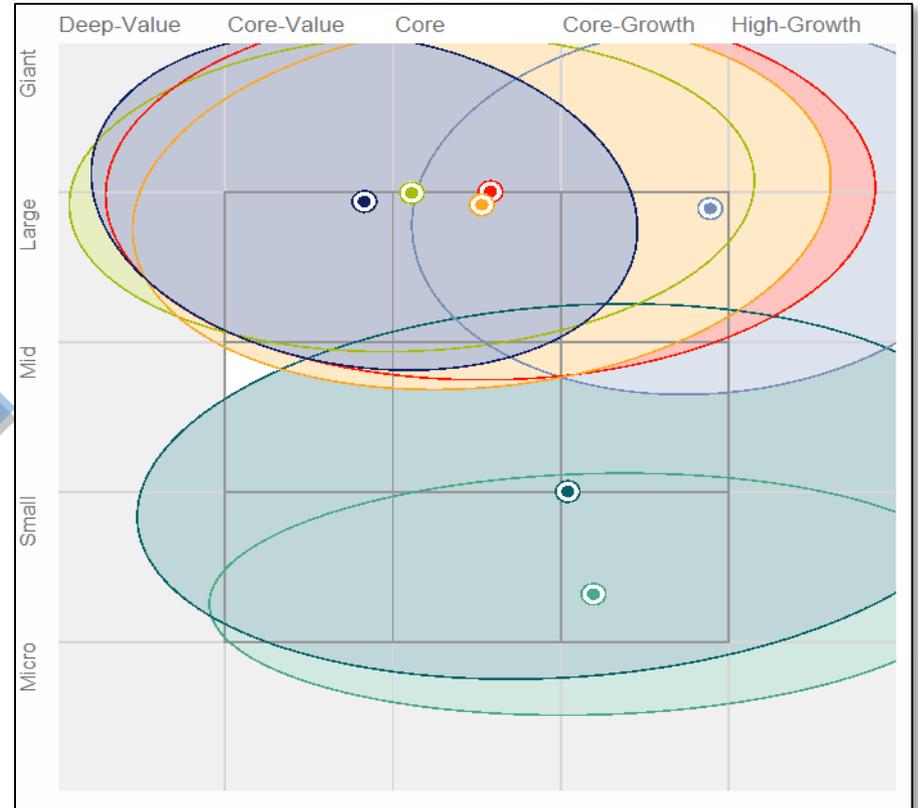
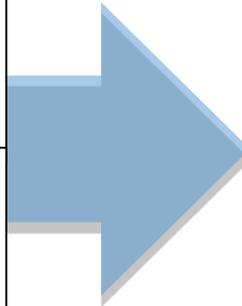
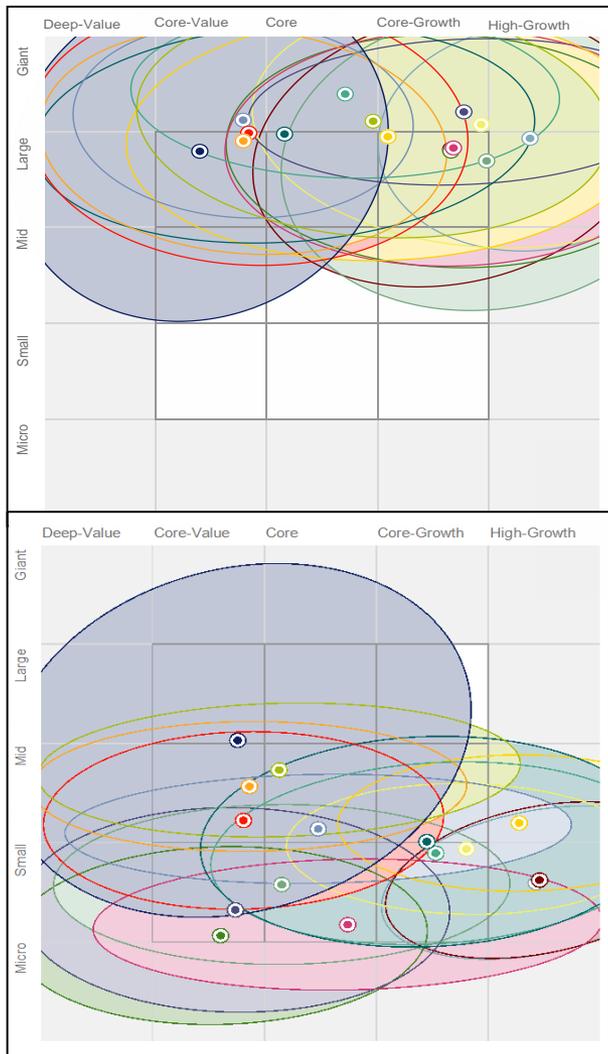
## ERISA 404(c) Compliance

1. Broad range of investments (at least 3)
  - Materially different risk/return characteristics
  - Equity, fixed income and principal preservation
2. Participant control and ability to diversify to minimize the risk of large losses
3. Sufficient and appropriate investment information is regularly provided



# Simplifying Options

## US Equities

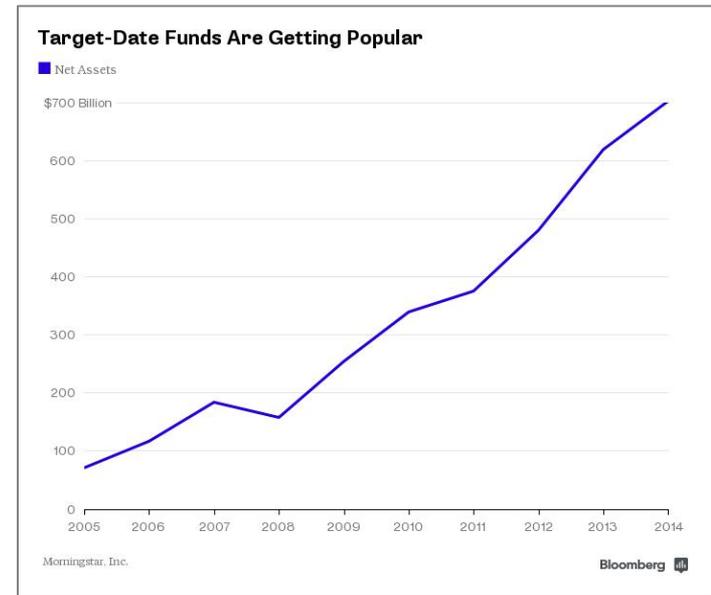


# Growth of Target Date Funds

**Target Date Funds (TDFs)** are a single investment option that provide a diversified, professionally managed mix of investments designed to give participants a long term asset allocation strategy built around their anticipated retirement date. These investments automatically become more conservative over time as the duration of the participant's investment horizon decreases.

First introduced in the early 1990s, the popularity of TDFs has increased dramatically due to the auto-enrollment legislation established in the Pension Protection Act of 2006, which created the need for a safe-harbor Qualified Default Investment Alternative (QDIA) within 401(k) plans. The U.S. Dept. of Labor approved TDFs as one of three types of QDIAs.

- In 2015, over 50% of new contributions flowed into TDFs.<sup>1</sup>
- TDFs now account for \$700 billion in retirement plans, more than four times the total at the end of 2008.<sup>1</sup>
- By the end of 2019, it is estimated that TDFs will attract nearly 90% of new contributions.<sup>1</sup>

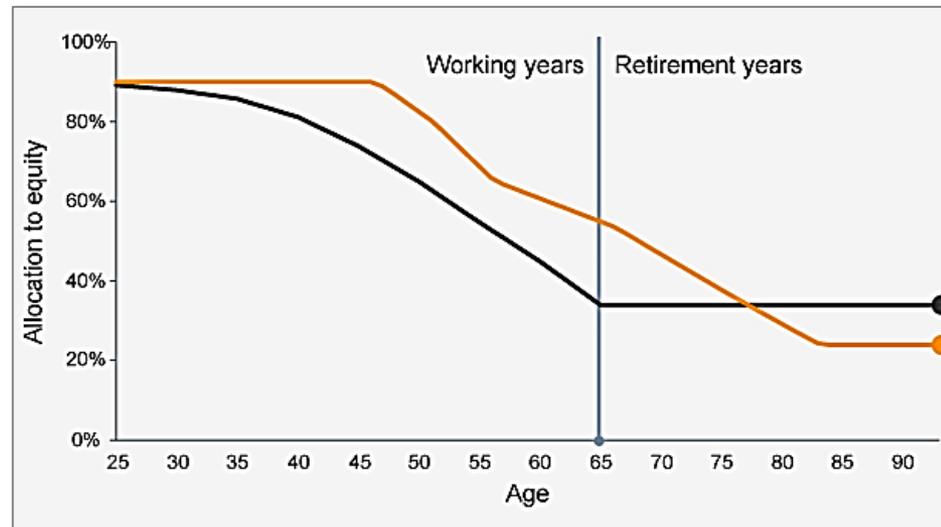


<sup>1</sup> "Retirement Markets 2014: Sizing Opportunities in Private and Public Retirement Plans" Cerulli Associates

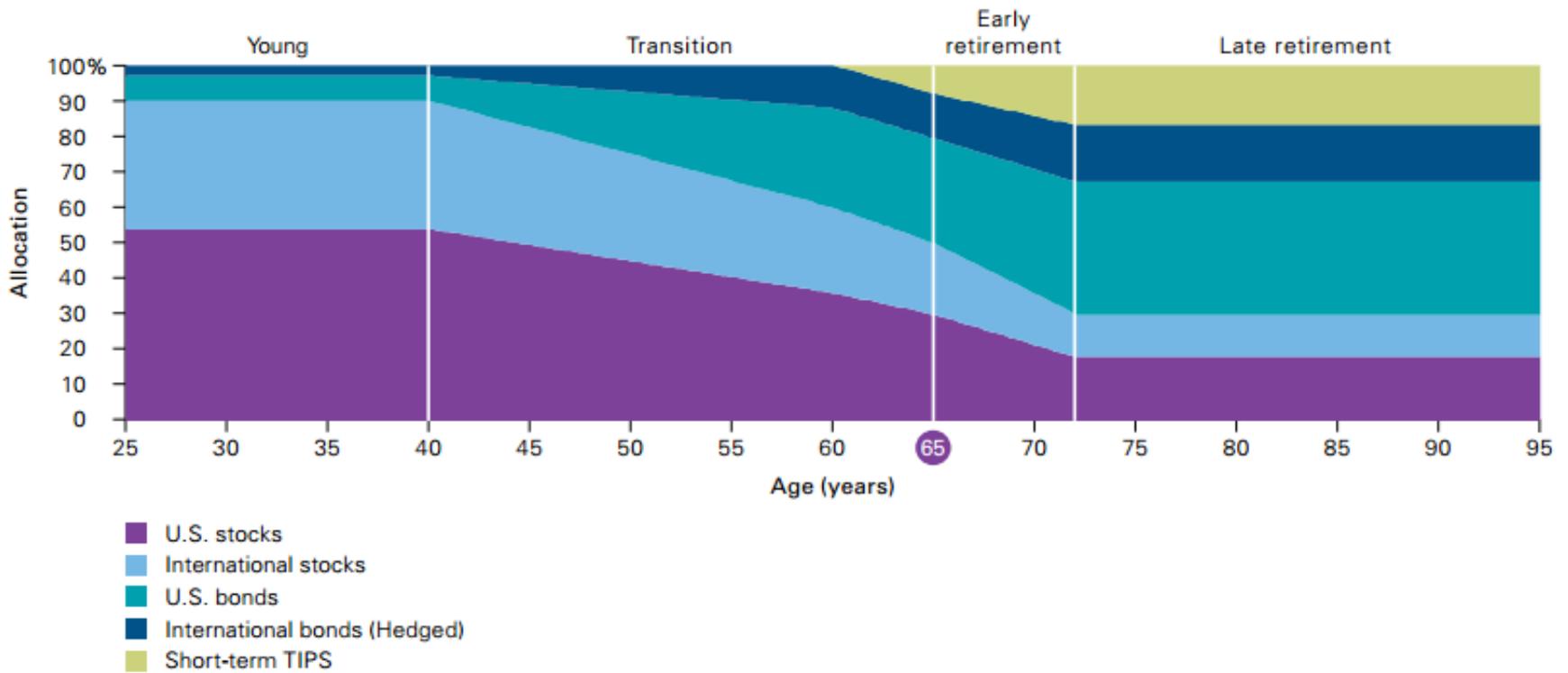


# How Target Date Funds Work

- **Glide path** - A glide path represents the shift in asset allocation (becoming more conservative) as time passes. In general there are two distinct glide path strategies:
  - **To** - A 'to' approach reflects a target date fund whose asset allocation becomes most conservative at the target retirement date.
  - **Through** - A 'through' approach reflects a target date fund whose asset allocation typically contains a higher allocation to equities at target retirement date and continues reducing equity exposure until a future date during retirement.



# Fund Diversification



# Guidelines for Selection and Review

- Establish a process for comparing and selecting that considers employee demographics and complies with the Investment Policy Statement
- Establish a process for the periodic review
- Understand the fund's investments – the allocation in different asset classes (stocks, bonds, cash), individual investments, and how these will change over time
- Review the fund's fees and investment expenses
- Inquire about whether a custom or non-proprietary target date fund would be a better fit for your plan
- Develop effective employee communications
- Take advantage of available sources of information to evaluate the fund recommendations you received regarding the selection process
- Document the process





**HORRIFYING**





**MORE HORRIFYING**



# Types of Fees

- Plan Administration
  - Recordkeeping
  - Participant education
- Investments
  - Explicit - Fund expenses
  - “Hidden” - 12b-1, subTA, Proprietary fees
- Other
  - Investment Advisor / Consultant
  - Attorney

The collage consists of three documents:

- Vehicle Window Sticker:** Shows vehicle details for a 2008 Ford Focus. It includes a standard vehicle price of \$36,555.00 and a total MSRP of \$43,875.00. It lists various options like leather interior, navigation system, and roof rails.
- EPA Fuel Economy Estimates:** Displays a city MPG of 16, highway MPG of 22, and a combined fuel economy of 18. The estimated annual fuel cost is \$2,335 based on 15,000 miles of driving.
- Government Safety Ratings:** Shows a total MSRP of \$43,875.00 and safety ratings for Frontal, Side, and Rollover crashes. All ratings are listed as "To Be Rated".

# Explaining Expenses

ERISA requires fees for service to be reasonable, and DOL guidance requires a rational, prudent basis for the method chosen for allocating fees. It is critical to develop a rational basis for the Plan's fee structure, and weight the impact of various fee structures to determine what method is most prudent for the Plan.

Types of Expenses	Expense Details	How Fees are Paid
<b>Investment</b>	<ul style="list-style-type: none"> <li>Includes management fee, revenue sharing, Sub-TA</li> <li>Multiple share classes available</li> </ul>	<ul style="list-style-type: none"> <li>Fees are embedded in the NAV, or share price of the investment</li> </ul>
<b>'Plan Level' Administration</b>	<ul style="list-style-type: none"> <li>Covers core administration services, including statements, call center, participant education, web site, etc.</li> <li>Fees may or may not be visible on statements or website, depending on the fee model in use</li> </ul>	<ul style="list-style-type: none"> <li>Can be allocated based on account balances ("asset-based") OR as a fixed \$ amount fee per participant</li> <li>Fees can be paid from revenue sharing, withdrawn from participant accounts or paid by plan sponsor</li> </ul>
<b>'Participant Level' Transactions</b>	<ul style="list-style-type: none"> <li>Loans, withdrawals and distributions</li> </ul>	<ul style="list-style-type: none"> <li>Based on specific activity, withdrawn from account</li> <li>Fee is charged to the specific participant (only)</li> </ul>



# Fiduciary Best Practice

- ✓ Create a plan committee
- ✓ Hold regular committee meetings that include a review of:
  - Investments
  - Recordkeeper(s)
  - Other professionals
- ✓ Document these meetings and any decisions or relevant discussions
- ✓ Implement and regularly review an Investment Policy Statement
- ✓ Hire an investment professional to help, when appropriate



# If you only remember one thing...

Prudence is a process...

but only if you can prove it!

- ✓ Have a process
- ✓ Follow that process
- ✓ Document, document, document

