TOP STORY

NAGDCA Continues Partnership with Financial Literacy and Education Commission on Financial Literacy Website

Last year, NAGDCA partnered with the Financial Literacy and Education Commission to develop a financial literacy website. The website, hosted by NAGDCA, serves as a database where information can be posted on the large variety of programs and services offered to help individuals better manage their personal finances. Through its search engine and browsing links, the website helps all individuals looking for personal financial information. NAGDCA members can add information to the database by using their NAGDCA website members only password. Please visit the web site at www.flecnationalnetwork.org. We encourage you to submit your information.

NAGDCA participates in quarterly meetings with the Commission to provide updates on the financial literacy database and to learn about other financial literacy programs going on around the country. Here are a few you may be interested in.

- President's Advisory Council on Financial Literacy:
  - National Financial Literacy Challenge http://www.treas.gov/offices/domestic-finance/financial-institution/fin-education/council/TakeTheChallenge.pdf
  - http://FLC.treas.gov
- Money Math: Lessons for Life
  - http://www.treas.gov/offices/domestic-finance/financial-institution/fin-education/council/index.shtml
- Community Financial Access Program - An initiative of the U.S. Department of Treasury's Office of Financial Education designed to increase access to financial services and financial education for low- and moderate income families and individuals. Best practices learned from around the country will be shared with participating communities to help them build sustainable approaches to expand financial access among community residents. Lessons learned from the pilot communities will be shared across the country so more communities can develop similar effective approaches.
- Money Smart Week Activities - www.moneysmartweek.org

Private Sector Defined Contribution Leaders Meet

Tim Rouse (Fidelity Investment), NAGDCA Industry President, leading the 403(b) discussion group.

The National Association of Government Defined Contribution Administrators, Inc. (NAGDCA) held a special roundtable meeting for Industry members in Washington, D.C. The members gathered to hear from federal policy makers regarding legislative and regulatory developments that affect the defined contribution programs of state and local governments; as well as to discuss the legislative issues affecting the industry.

"Because of the important role the private sector plays in the defined contribution industry, it is important to bring legislative and operational leaders together to discuss and make recommendations on common issues," said Mindy Harris, NAGDCA President.

Topics addressed included a remedial period for 403(b) regulation compliance, overall 403(b) issues, GASB/OPEB and Retiree Healthcare Accounting Standards, the "DB-izing" of DC plans, the ongoing issue of fee disclosure and SEC developments as they relate to defined contribution plans.

NAGDCA Industry President, Tim Rouse, states "The intent of the Roundtable was to provide a forum for Industry members to discuss debate and find common ground on administrative and legislative issues of importance. This is the fourth

Roundtable for NAGDCA Industry members and it continues to prove itself as a valuable forum for the defined contribution community at large."

This forum continues to be a successful and highly educational event. All attendees were asked to complete an evaluation of the event and 100% of respondents stated that they would definitely attend again.

Roundtable attendees during the discussion group break-outs get to the root of the issues.

NAGDCA Exhibits at the 2008 National Conference on Public Employee Retirement Systems and the Government Finance Officers' Association

Last year, the NAGDCA Executive Board decided that the organization would seek alternative ways of gaining exposure. One initiative was to begin exhibiting at related organizations' conferences. The first conference that NAGDCA exhibited at was the 2007 Government Finance Officers' Association's Annual Conference.

This year NAGDCA has opted to exhibit at three additional conferences. These three conferences were recommended by the Membership Committee and are as follows: NCPERS (National Conference on Public Employee Retirement

Systems), GFOA (Government Finance Officers' Association), and ASBO (Association of School Business Officials).

For 2008 NAGDCA has already exhibited at two of the above conferences, NCPERS and GFOA. With this additional exposure NAGDCA is looking to increase membership in the local government sector as well as the 403(b) sector. We are currently running a special introductory membership rate of $300 and registration to the 2008 Annual Conference at $200 for first time members. If you are aware of any local government or 403(b) plan administrators that are not yet a member of NAGDCA, please let them know about this special offer. You can direct them to Robert T. Hansel (859-514-9161) if they have any questions.

Exhibit booth at the 2008 NCPERS Conference

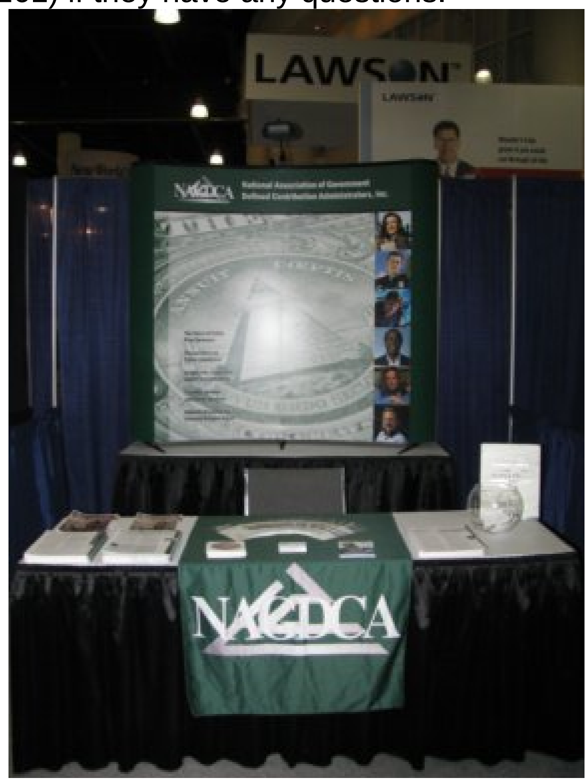


Exhibit booth at the 2008 GFOA Conference

Mark your Calendar:

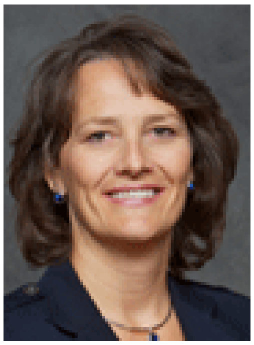
National Save for Retirement Week Webcast
August 26, 2008, 1:00 pm ET
Watch for registration to open soon!

NAGDCA 2008 Annual Conference
September 13 - 17, 2008
Marriott Baltimore Waterfront Hotel
700 Aliceanna Street
Baltimore, MD 21202
Ph: 800-228-9250

National Save for Retirement Week
October 19-25, 2008
Visit http://www.nagdca.org/retirementWeek/ for more information.

PRESIDENT'S CORNER

Dear NAGDCA friends,



As Spring draws to a close and the Summer months kick into full swing, we often begin to think about upcoming vacations, family road trips, visits to the beach, and so forth. Along with the temperature, our anticipation begins to rise for these events as well as our anticipation for the 2008 NAGDCA Annual Conference in Baltimore, Maryland. Not only will this be a conference packed with essential educational information, but it is an opportunity to reconnect with colleagues and old friends. This year's Annual Conference is slated to be one of the best ever!

The conference committee has worked very hard to provide several educational sessions that are certain to benefit defined contribution plan administrators nationwide. In recent years the Annual Conference has offered eight concurrent sessions, but this year I'm extremely happy to report that two more sessions have been added. You will find that many of the sessions are new to the conference and very timely to today's retirement issues. In addition to the educational offerings, we are also very pleased to offer a community service project in our host city. I'm sure most of us will find it very difficult to choose between the many available opportunities, but we'll all return home with ample new information to keep us busy throughout the next year. To find out more about the 2008 conference, please visit https://www.nagdca.org/meetings/2008annual.cfm.

Along with the Annual Conference, the NAGDCA Board has been working diligently to ensure the organization is remaining active in its mission to "to unite representatives from state and local governments along with private sector organizations that service and support defined contribution plans…" Our attention continues to be focused in the following areas:

- Support of the Arthur N. Caple Foundation for Retirement Education (www.caplefoundation.org).
- Coordination of the 2008 Survey of Defined Contribution Plans.
- Provide expert consultation, feedback and recommendations to the IRS and congressional leaders from the perspective of governmental defined contribution administrators.

- Continued Certification – NAGDCA will be offering educational credits for members attending sessions at the annual conference for CPA, CFP and CFA designations.
- Partnership with National Financial Education Network to develop the financial literacy website http://www.flecnationalnetwork.org/.
- The continued support of a National Save for Retirement Week (http://www.nagdca.org/retirementWeek/) on October 19-25, 2008, including our upcoming NAGDCAst in August highlighting several initiatives around the Country.
- Continued outreach to the 403(b) plan sponsor community as they work to understand and implement the new regulations for their plans.

As well as the above initiatives, NAGDCA has been working throughout the year to gain more exposure for the organization and partner with other organizations with interests similar to ours with the goal to increase membership in the local government sector as well as the 403(b) sector. By the end of the year NAGDCA will have exhibited at three national conferences: NCPERS (National Conference on Public Employee Retirement Systems), GFOA (Government Finance Officers Association), and ASBO (Association of School Business Officials). We have also recently developed a "Frequently Asked Questions" document for administrators of 403(b) plans, which will assist them with the newly released IRS regulations. We ask that all of our current members reach out to plan administrators of local governments and 403(b) plans who are not currently members and share with them your experience of what NAGDCA has to offer. NAGDCA is running a special introductory membership rate of $300 and registration to the 2008 Annual Conference at $200 for first time members.
I am looking forward to seeing everyone at the annual conference in Baltimore. Together we will share our experiences from the last year and our plans as we move forward. This is a terrific organization and this year's conference is going to be FANTASTIC!

INDUSTRY VIEWPOINT

Distribution Options For Retirement Account Beneficiaries

By: Lynn Bahler Knight, CEBS, ING

Beneficiaries of retirement accounts have many options to consider when deciding when and how to receive death benefit payments. Not only does a beneficiary need to evaluate his or her own individual financial needs, the beneficiary must also be cognizant of any legal requirements for the timing and amount of those payments as well as the distribution options available under the distributing retirement plan and investment vehicle. This article discusses some of the options available to a beneficiary; however, there may be other available options and a beneficiary is urged to discuss which options would best meet his or her financial needs with his or her tax planning advisor.

Timing of death payment distributions

The law requires that payments from certain types of retirement accounts be made on a timely basis. These payments are commonly known as "required minimum distributions" or "RMDs." RMDs must be made from most employer-sponsored plans as well as Traditional IRAs and, upon the death of the account holder, Roth IRAs. The timing for making RMD payments during an account holder's lifetime varies based on the plan type. Generally, for an employer-sponsored plan, that date is the later of age 70 ½ or retirement. For a Traditional IRA, that date is when the account holder reaches age 70 1/2.

The law further provides that if the account holder dies before beginning to receive RMDs, a beneficiary can elect to receive payments either over 5 years or over life expectancy – but payments over life expectancy must begin no later than December 31 of year following the year of the account holder's death. If the account holder had begun to receive RMD payments before death, generally the remaining account balance is paid over the beneficiary's life expectancy. Note, however, for a Roth IRA, regardless of when the account holder dies, he or she is treated as having died before RMD payments had begun.

"Stretching a Death Benefit"

The concept of "stretching a death benefit" is an estate planning tool where death benefits are paid over a designated beneficiary's life expectancy. If the distributing plan and investment vehicle permit, the beneficiary can name a beneficiary and payments may continue to that successor beneficiary. However, the original beneficiary's life expectancy is used to calculate payments to any successor beneficiary. There are several potential advantages of stretching a death benefit including:

- A beneficiary could choose to receive payments over his or her lifetime while continuing to enjoy tax deferred growth on the death benefit amount.
- A beneficiary may be able to minimize any current income taxes by receiving minimum amounts over his or her lifetime.
- A beneficiary could create a stream of income for his or her life as well as the life of any subsequent beneficiary. Obviously, the ages of all relevant beneficiaries would need to be taken into consideration when determining whether to stretch a death benefit.

Putting a Stretch Into Action Under A Retirement Plan

Let's look at an example of stretching a death benefit under a retirement plan. Kim is a participant in a 457(b) deferred compensation plan who names her sister, Elizabeth, as her beneficiary. Kim passes away before RMDs begin. Elizabeth decides to stretch death benefit payments over her life and begins to receive annual non-annuity lifetime payments calculated under the life expectancy table provided by the Internal Revenue Service. The 457(b) plan permits a beneficiary to designate a beneficiary and therefore, Elizabeth designates her niece, Olivia, as her beneficiary. Elizabeth receives distributions for 3 years and passes away before depleting the death benefit. Olivia, as Elizabeth's beneficiary, can choose to receive the remaining payments based on Elizabeth's remaining life expectancy as calculated under the IRS's life expectancy table thus continuing to stretch the death benefit.

Rolling over a death benefit - spousal beneficiary

A spousal beneficiary is permitted to roll over a death benefit from an eligible employer-sponsored plan to another employer-sponsored plan in which the spouse participates or to his or her own Traditional or Roth IRA. However, a spousal beneficiary needs to consider several items, including the timing and amount of taxes payable before rolling over the death benefit.

For example, a spousal beneficiary may choose to delay RMD payments by rolling over the death benefit from an employer-sponsored plan to a Traditional IRA. Thus, the spouse can delay RMD payments until he or she reaches age 70 ½ as the owner of the Traditional IRA. In the alternative, a spouse may wish to roll over the death benefit to his or her own retirement plan where, as the participant, he or she can defer any RMDs until the later of age 70 ½ or retirement. Finally, a spousal beneficiary may wish to roll over the death benefit to a Roth IRA, subject to any current income limitations on Roth IRA rollovers, in order to avoid any lifetime RMDs. Of course, the spouse would always need to consider any fees and/or investment choices under an IRA vs. a retirement plan.

Rolling over a death benefit - non-spousal beneficiary

A non-spousal beneficiary may choose to roll over a death benefit to an inherited Traditional IRA or Roth IRA subject to any applicable income limitations and RMD requirements. For example, a non-spousal beneficiary may wish to roll over a death benefit from a retirement plan to an IRA if the retirement plan has limited distribution options, e.g., the retirement plan only provides for lump sum distributions to non-spousal beneficiaries or only provides that death benefits are paid under the 5-year rule.

As noted above, the choices facing a retirement account beneficiary are complex and must be determined on an individual basis taking into consideration the beneficiary's financial situation and the options available under the distributing retirement plan and investment vehicle. Therefore, a beneficiary is urged to discuss all available distribution options with his or her tax planning advisor before taking a death benefit from a retirement account to determine which option best fits within his or her financial plan.

403(b) Plans Should Get Much Better Soon

By: Rick Rodgers, CRC, Principal, Innovest Portfolio Solutions

Last year IRS issued the long-awaited final regulations for sweeping reform of 403(b) plans, including new rules that will make these plans look and act more like 401(k) plans. The changes will require plan sponsors of these historically loosely regulated plans to take on far greater oversight and administrative responsibilities. While the new mandates for employers may initially be perceived as unwanted and burdensome, the end result will certainly make the plans much more attractive and beneficial for participants.

The IRS proposed their intentions to overhaul 403(b) plans in 2004, anticipating final regulations would be issued by the beginning of 2006. However, the final regulations were not issued until July of last year and become effective January 2009. These regulatory changes, which are the first significant revisions to the code in over 40 years, will force much needed improvements by requiring plan sponsors to become more responsible stewards.

The 403(b) plan is generally a supplemental retirement savings plan offered to employees of non-profit groups such as K-12 schools, universities, health care providers, religious organizations and other non-profit entities. Historically, these employers have enjoyed an exemption from many of the compliance and oversight responsibilities expected of their 401(k) and 457 counterparts. As a result, it is commonplace for employers to entrust vendors with administrative compliance and control of plan design without any input or oversight. This liberal regulatory environment has virtually encouraged employers to function only as a payroll deduction conduit, and has discouraged any meaningful involvement. Accordingly, employers tend to avoid interference, and it's quite common for them to allow products from multiple providers, which leaves all of the decision making to the participants.

Considerations for Plans with Multiple Providers

Many school districts offer 50 or more plans to their employees under the guise of "non-obstruction" by providing virtually unconstrained participant choice and control. However, this hands-off approach has a detrimental impact on the appeal, effectiveness and efficiency of the plans. Multiple provider arrangements lack objective monitoring of the performance or appropriateness of investments offered to participants, and the underlying fees and expenses are typically ignored. By offering an unconscionable number of investment choices to employees this environment perpetuates confusion and ultimately impedes participation.

The new regulations encourage consolidation to a single provider by requiring employers to demonstrate ongoing oversight of the plan and its providers. Under the new rules employers will have to maintain a written plan that includes a description of investments offered through the plan and the responsibilities of all affiliated vendors. Even though the written plan may be provided by the selected vendor(s), this document forces the employer to acknowledge the underlying investments, expenses and services offered to employees. Therefore, compliance with the revised code would be virtually impossible for employers continuing to offer investments through multiple providers.

Reducing Expenses

The average expense structure of most 403(b) plans is alarming compared to that of the typical 401(k) or 457 plan. The underlying fees charged by some 403(b) providers would give you the feeling that their products are being sold from a hotel mini-bar! This comparatively expensive structure is, in part, due to the nature of the typical investment products offered to participants, along with the inherent problems associated with multiple providers.

The marketplace is currently dominated by large insurance companies that typically sell fixed and variable annuity products. Fixed annuities offer a guaranteed investment return during the accumulation phase, and typically, during the distribution phase as well. With a variable annuity participants self-direct their investments among a variety of mutual funds, and the distribution amount is dependent upon individual investment performance. Compared to mutual funds and similar investment options, these annuity products are generally more expensive, and are sometimes loaded with hidden fees that result in total expenses ranging from 2% to 5%. Their dominance in the industry stems from the original regulations, which allowed only insurance company investment products in these plans from 1958 until 1974, which is when mutual fund companies entered the 403(b) marketplace. Despite lower inherent fee structures of many mutual fund providers, insurance companies continue to control the majority of 403(b) plan assets, which exceeds $700 billion.

Employers that offer plans with multiple providers are partially responsible for higher costs to participants, because the assets are spread out among so many different vendors. Accordingly, the providers often view the contracts as individual, rather than group, and charge higher expenses. By using a single provider employers can take advantage of economies of scale to reduce overall expenses.

Improving Investment Selection

In addition to extraordinary fees, many of the variable annuities, which offer mutual funds as the underlying investments, contain poor-performing products and/or expensive share classes. This is sometimes a byproduct of their selection process for underlying options, which may be based upon the revenue sharing arrangement with investment managers, rather than choosing funds based upon performance relative to their peers.

Likewise, another problem with the multiple vendor approach is the absence of any structured, objective investment selection and monitoring process. Many of the investment menus have far too many options, and often include multiple funds in the same asset class, which makes them redundant. The employers have essentially allowed the vendors to control selection and monitoring of underlying investments, which obviously lacks objectivity. Meanwhile, many single-provider plans have adopted procedures to create a sensible investment menu, monitor the performance of individual options, and evaluate applicable fees and expenses. This formal process demonstrates due diligence on behalf of the employer while easing the burden of investment management for participants.

Improving the Effectiveness of the Plan

In addition to the symptoms of greater fees and convoluted investment menus, plans with multiple providers have created a number of other problems for participants. The overwhelming number of investment options offered through numerous different vendors makes the already daunting process of investment selection and management even more confusing. Vendor representatives tend to focus on selling their respective products rather than helping participants become better savers and investors. Many times the vendor with the best pizza party wins the majority of the 403(b) business.

While 401(k) and 457 plans have experienced vast improvements with their employee education and communication programs, the multiple-vendor 403(b) plans have found it nearly impossible to conduct an effective campaign. Some employers have prohibited on-site education because there are so many vendors to accommodate, and if they allow on-site education and solicitation with one vendor they would really have to allow all of them the same gratuities. In fact, vendor consolidation alone will likely improve the effectiveness and increase the perceived value of the plan by creating a much better experience for the participant.

The Opportunity to Make 403(b) Plans Better

Much of the impending reform appears to target welcomed improvements for the 403(b) participant. While the regulatory changes will impose greater responsibility and liability on behalf of the employer, these requirements present an opportunity for employers to create a much better plan. This is an opportunity for employers to abolish the “more is better” and “anything goes” approach, in exchange for a plan design that is based upon the premise of catering to the best interests of the participants.

Suggested Next Steps

1. Form an advisory board or committee to determine the type of plan that would best suit the participants and oversee the entire development process. Board members might include employees from HR, finance and legal departments.

2. The advisory board should first decide if it is appropriate or necessary to hire an independent consultant to provide guidance and assistance with plan design, vendor selection, communications strategies, etc. Hiring a professional consultant is generally advisable, particularly for larger plans. The consultant should be experienced in the vendor selection and negotiation process, and be able to provide references for several recent searches. This demonstrates their ongoing activity and familiarity with current pricing structures. Ideally, the consultant would be independent of any providers, and would offer objective, conflict-free advice.

3. Create an employee communications plan to keep participants informed during the entire conversion process. They should be informed of your intentions and expected benefits before any decisions are made, your ongoing progress, and the key points considered in your final evaluation. Failure to effectively communicate your intentions and process will result in a very unhappy group of employees. They need to understand that your purpose is to provide an improved benefit.

4. Develop a draft of the ideal 403(b) plan for your employees. This would include services, the types of available investments, expenses, and any other preferences. This will provide the foundation for your required written plan. You may also wish to develop an Investment Policy Statement that specifies the types of investments to be offered, along with selection and monitoring criteria.

5. Gather information from your current vendors regarding services, investments, and expenses. Compare this data with your expectations. Your consultant can help you benchmark your current arrangement with that of similarly sized pans.

6. Prepare an RFP and begin the competitive bidding process. Document the process and your final evaluation.

7. Select your final vendor and develop an implementation and communications strategy.

8. The advisory board should periodically monitor the performance of the vendors, prudent experts, and investment options.

By using a single provider, employers can focus on the quality of the investment menu offered through their plan and take advantage of economies of scale to reduce overall expenses. Additionally, your vendor can focus on helping participants effectively utilize the plan, rather than selling products.

Rick Rodgers is a Principal at InSight Employee Benefit Communications, a division of Innovest Portfolio Solutions. InSight EBC provides participant education services to employees of public and private sector organizations. InSight is based in Denver, Colorado. Rick can be reached at 303-694-1900 or rickr@innovestinc.com

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Going global, again: DC plans should embrace a less U.S.-centric approach

Submitted by: Capital Guardian Trust Company

Most defined contribution participants have minimal exposure to non-U.S. investments and are not able to benefit from the long-term growth of some of the world's most dynamic companies and industries. Just as defined benefit plans did in the 1990s, defined contribution plans should move away from a largely U.S.-centric investment view. Plan sponsors can encourage this by providing global and "all-country" equity options in their DC lineups. According to Pamela Hess, defined contribution practice leader for Hewitt, "There is a growing awareness that markets are global and investing should go beyond the U.S." Even better would be to encourage global equity options instead of a mix of domestic and international portfolios, as true global portfolios can provide better results than combining separate U.S. and non-U.S. components.

Missing out

Most defined contribution participants have minimal exposure to investments outside the U.S. Despite the majority of equity market capitalization being outside the U.S. — and a growing comfort level among participants to invest there — the average participant allocation to non-U.S. equities is only 9%, according to Callan Associates.[1] That is out of line with the size of these markets and the opportunities they represent. Stocks outside the U.S. represent 53% of the MSCI World Index and 58% of the MSCI All Country Index, which includes emerging markets.[2]

In most cases the participant's income and other forms of investment, such as real estate, are also likely to be dollar-denominated investments, resulting in a highly U.S.-centric base of assets. With regard to equities, that has been to their detriment over the past decade. U.S. stocks have provided an annualized return of 5.9%, compared to 8.9% for non-U.S. stocks and 14.3% for emerging markets stocks.[3]

Benefits of broader opportunities

Professional investors, on the other hand, are more aware of the benefits of a broader investment universe. While the U.S. is a leader in many areas, non-U.S. stocks have provided the best opportunities over the past 10 years in diverse industries such as chemicals, metals and mining, industrial conglomerates, luxury goods, health care equipment, financial services and telecommunications.

From an economic perspective as well, opportunities outside the U.S. are rapidly expanding. While the largest economy in the world, the U.S. is still only about a fifth of the global economy. Global portfolios can tap into a large part of the wealth creation taking place outside U.S. borders. (This is especially true if emerging markets are added to the mix.)

Professionally managed defined benefit plans allocate 17% to non-U.S. equities, and many are considering increases through global mandates.[4] That is in the context of an even broader set of allocation options, including hedge funds and private equity. These institutional investors “went global” in the 1990s and are continuing to do so.

Encouraging the shift

Nearly all DC plans now offer a non-U.S. equity option. But it is often a single option, competing with multiple U.S. equity choices. A stepped up educational effort could be part of the solution, but we think a global equity option would also go a long way toward encouraging this shift.

According to Callan Associates, only 8.5% of DC plans have a global equity option.[1] When a global portfolio is made available, the average participant allocation to it is 8.7%.[1]

There’s going global, and there’s going global

A global equity option alongside U.S. and non-U.S. options would very likely increase participant exposure to non-U.S. markets. Ideally, global equities should be presented as preferable in some ways to a combination of U.S. and non-U.S. portfolios. A truly global mandate seeks out the most attractive investment opportunities, regardless of geography, on a real-time and flexible basis. Managers that have been given a broad global mandate and can choose companies from a wider universe assemble a portfolio of “best of world” companies, which will differ from a portfolio that combines “best of region” with another “best of region.”

For example, a manager might consider Siemens to be the best industrial company in the world, even though that manager may view General Electric as the best industrial company in the U.S. A truly global portfolio, therefore, might have a large position in Siemens, whereas the bolted together portfolio might have a smaller position in each company.

Being able to invest in the highest investment conviction on a global basis is powerful; it should lead to better results than a patchwork of U.S. and non-U.S. portfolios. At Capital Guardian, this is borne out with our own results, which are consistently better for global equities than with a hypothetical combination of U.S. and non-U.S. equities (based on the weightings in the MSCI World Index). The stocks in our global portfolios represent our strongest investment convictions on a global basis. The weight of different regions, countries and industries in the portfolio are the result of forward-looking decisions rather than index weightings that are based on the past.

Investing in a global portfolio also mitigates the likelihood of participants chasing returns between U.S. and non-U.S. markets, and getting burned by the cyclicality. Instead you have professional judgment shaping the allocation based on a global perspective, rather than a U.S.-centric one.

Helping participants

Adding a global equity option to a DC plan fills a void and makes good investment sense. It should result in participants having a more appropriate level of exposure to equities outside the U.S that is more in line with how professional investors allocate assets. We believe most participants will be comfortable with greater non-U.S. exposure. All they need are attractive global equity options in their plan, and perhaps a little nudge.

Saver's Credit Aids Limited- and Moderate-Income Workers Saving for Retirement

Submitted by: ICMA-RC

Expanding the program, raising income ceilings could boost savings further

The Saver's Credit, promoted as an incentive to increase retirement savings among low- and moderate-income workers in the Economic Growth and Tax Relief Reconciliation Act of 2001, was made permanent in the Pension Protection Act of 2006.

Here's how it works. Depending on income and tax filing status, workers can reduce their taxes up to $1,000 as a reward for contributing at least $2,000 annually to an IRA, 401(k), 457 and other tax-advantaged retirement plans. Married couples with incomes of up to $52,000 in 2007 are eligible for the tax credit. For heads of household, the income limit is set at $39,000; married individuals and singles with incomes of up to $26,000 also are eligible for the credit. There are additional qualifications related to adjusted gross income (AGI) levels, and to keep pace with inflation, income limits are adjusted annually.

In the six years since it was first available for workers, the Saver's Credit has grown in use, though its impact on retirement savings for low- and moderate-income workers has been muted by its limitations. In 2005, the latest year for which figures are available from the Internal Revenue Service, nearly 5.3 million tax returns were filed, with the average credit for joint filers of $216. Single filers received an average credit of $140 and heads of households got $149. In all, credits totaled more than $900 million, less than 10 percent of the total tax incentives aimed at retirement savings of almost $150 billion.

Expanding coverage

Bills aimed at increasing the numbers of those who benefit from the Saver's Credit were introduced late last year in both the House and the Senate. One proposal would make the Saver's Credit "refundable." Another would expand the Saver's Credit to college tuition savings plans through contributions to Coverdell and 529 education plans. Workers who contributed to these plans would receive a tax credit for up to 50 percent of their contribution, or up to $1,000.

Making the Saver's Credit "refundable" could raise participation levels in this group and broaden its benefits to the very neediest workers. Currently, only workers who earn enough to owe income taxes at the end of the year are eligible for the credit. However, making the Saver's Credit available – refundable – to workers in this group who make contributions to a qualified retirement plan could significantly boost participation.

Brookings Institution researchers found that making the credit refundable would put an extra $2 billion to $3 billion into retirement savings for limited-income workers (Improving the Saver's Credit, July 2004). Typically, the credit would be deposited directly into a qualified retirement savings plan, a further incentive to save.

Raising income limits significantly would also add billions to moderate-income workers' retirement savings. According to the Tax Policy Center, each $10,000 rise in the income limit for married couples would add $3 billion to $5 billion annually to retirement savings. While these sums still fall far short of the $150 billion in tax incentives that were given in 2006, they are aimed squarely at a segment of Americans most in need of a reliable retirement savings plan. At a time when the first of millions of baby boomers are stepping into retirement, planning for the least prepared of them becomes a critical task.

Overcoming obstacles

For these measures to become law, they would have to be included in a major tax bill. In an election year, chances for the introduction of such a bill are less likely. Changes such as these in the Saver's Credit would result in the loss of billions in tax revenues, and that, too, would be a major obstacle to passage.

But there are steps that can be taken to improve their chances. First, for any measure with such a significant impact on tax revenues to be enacted, a broad constituency that includes public-sector employers must support it. In addition, high-profile public activities, such as National Save for Retirement Week each fall, could be an important vehicle in promoting change at the grassroots level.

Proposed legislation

The bills that would most directly improve the Saver's Credit are:

The Retirement Savings for Working Americans Act (H.R. 2724), sponsored by Reps. Rahm Emanuel (D-IL), Jim Ramstad (R-MN) and Peter Welch (D-VT), the bill is still awaiting a hearing in the House Ways and Means Committee.

The New Savers Act (S. 1967) sponsored by Senators Hillary Clinton (D-NY) and Gordon Smith (R-OR) has been pending action by the Senate Committee on Finance since last fall.

The Women's Security Act (S. 1288) sponsored by Senators Gordon Smith (R-OR) Jeff Bingaman (D-NM), John Kerry (D-MA) and Olympia Snowe (R-ME) has been pending Senate Finance Committee action since it was introduced over a year ago.

Pensionizing Defined Contribution Assets

Submitted by: Institutional Retirement Group, Genworth Financial

Background

Healthier lifestyles and advances in medicine mean that many Americans can look forward to longer, more active retirements. However, the decline of corporate pensions, concerns about social security and rising health care costs mean that planning for a secure retirement requires a different approach.

Accumulation vs. Income

Financial education focuses largely on teaching individuals the mechanics of accumulation investing. Simply put, this strategy puts the emphasis on building a nest egg that can be drawn upon in retirement years. Unfortunately, most people have difficulty estimating how large a nest egg is needed to meet their retirement needs. In addition, once these savers reach retirement, they may struggle to shift their thinking from this accumulation mindset to a spend-down mindset.

Target date funds are an excellent example of a product built for the accumulation mindset. These funds choose a starting asset allocation that assumes riskier assets (stocks) will earn a return premium over less risky assets (bonds and cash) and then lower the allocation to the riskier assets to limit volatility as the target date approaches. Once the target retirement age is reached, the fund generally invests the majority of assets in lower risk investments such as bonds and cash. This provides a more stable return for a retiree who is drawing down assets.

This approach has many merits, including:

- Making the process simple
- Frequent rebalancing of the portfolio
- Professional management

However, it does not:

- Help determine how much needs to be saved in order to have an adequate retirement income
- Provide a method for how much to withdraw each year in retirement
- Provide much opportunity to income growth over a potentially long retirement

By contrast, an "income strategy" focuses on creating guaranteed streams of retirement income while working. This is done by contributing to retirement vehicles that provide explicit income guarantees with each contribution so that the investor has a clear line of sight to how much lifetime income they can expect at retirement. If the income strategy invests in underlying funds that invest in a balance of stocks and bonds, there is an added advantage of having the potential for income growth in retirement. This helps to eliminate the guesswork of how much to withdraw from a nest egg and helps smooth the transition from saving into receiving income in retirement.

There are merits to both accumulation and income strategies and the most effective retirement plan should combine both. An income strategy can be used to create a base of income for necessities while a more traditional accumulation strategy can be used to build a nest egg for discretionary income. For example, an investor can contribute a portion of his or her savings to a vehicle that guarantees a specific amount of income at retirement. Through this approach, the investor will have a clear line of sight to a reliable monthly retirement income without worrying about the investment or interest rate environments in those critical years just before retirement.

The remaining portion of their savings can be invested in a diversified investment fund or funds in which greater risk can be taken over the long run. This “Income and Investments” approach is also a more natural way to think about retirement - a guaranteed income stream to pay the bills and savings to pay for extras and emergencies.

Market Response

Income based options are gaining acceptance in the defined contribution plan market. At least four insurers have launched products in the last two to three years. Many major recordkeepers have formed units dedicated to “retirement income,” and one national consulting firm now recommends annuities in defined contribution plans so that participants can turn retirement savings into lifetime retirement income.

But the question remains — will these advances provide Americans with the means to achieve a truly broad-based secure retirement in a self-funded world? They are a great first step, but much more can be done. The greatest hurdle may yet be ahead of us — namely, creating a mind-shift from a focus on asset balances to a focus on income. To do this, we must stop paying so much attention to the mechanics of retirement funding and pay more attention to the goal of retirement funding: the creation of reliable income streams.

Stay the Course: Keeping Plan Participants Focused on the Future

Submitted by: Wellington Management

As a plan sponsor, you know as well as anyone the impact that market volatility can have on employees who are investing for their long-term goals. As you guide your plan participants through these volatile times in the market, here are a few time-tested guidelines to consider and pass along.

More Positives than Negatives

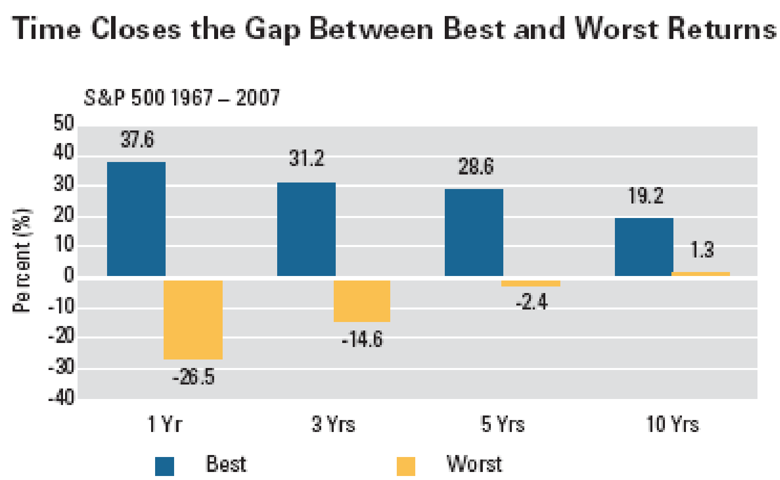
Stock markets go up and down, sometimes taking investment returns with them. Historically, however, stock returns have more often been positive than negative. The key to weathering the storm may be for participants to start investing early, take a long-term view, and remain invested.

Over the last 50 years, the S&P 500 Index experienced 39 years of positive annual returns and only 11 with negative returns. Furthermore, the average annual return was 12.3%. Even the MSCI World Index, which some consider more volatile since it includes non-US stocks, has had 29 years of positive annual returns compared to 9 negative years since its inception in 1970.*

Make Time an Ally

Although in the short term the market may swing between highs and lows, it has historically been steadier over longer periods. Figure 1 represents the best and worst annualized returns of the S&P 500 Index for all possible one-, three-, five-, and ten-year periods over the past 40 years. As you can see, the gap between the best and worst returns gets smaller the longer the time period. In fact, the worst ten-year period return is positive at 1.3%.*

Figure 1



Past performance is not indicative of future results. Index performance is provided as a benchmark and is not illustrative of any particular investment. An investment cannot be made in an index.

Source: Wellington Management

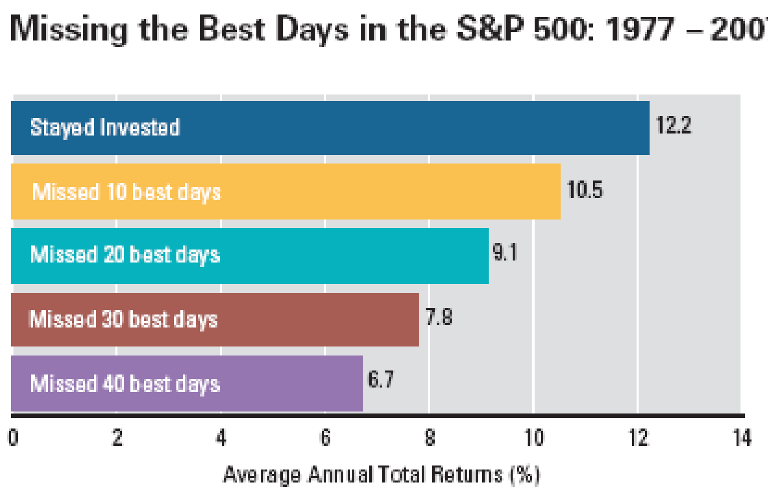
Here's another way to look at the potential benefits of a long-term focus: An investor who invested $10,000 in 1967 and remained invested for 40 years would have accumulated $1 million, assuming the historical returns of the S&P 500 Index.* And that's without making any additional investments.

Don't Let Emotions Affect Investments

Emotions are a powerful driver of behavior, and can exert undue influence on investment decisions. For example, euphoria in the market led to overinvestment by some people in technology stocks in the late 1990s, just as investor despair may have led to underinvestment in other areas of the stock market during recent periods of volatility. In both cases, unchecked emotions may have led to investment mistakes.

Generally, a well-diversified portfolio built with a long time horizon should not be altered significantly because of short-term changes in the market. Pulling money out of the market simply because of short-term volatility may increase the risk of missing market gains. Figure 2 shows how average annual returns would have been affected by missing the best days in the market over the past 30 years.

Figure 2



Past performance is not indicative of future results. Index performance is provided as a benchmark and is not illustrative of any particular investment. An investment cannot be made in an index.

Source: Wellington Management

Start Investing Now and Keep Contributing

For participants who aren't fortunate enough to own a crystal ball, market timing should generally be avoided. Instead, they should consider focusing on dollar cost averaging (DCA), or making periodic investments of the same amount. DCA will help ensure that participants will buy more shares when prices are down and fewer when prices are up. Over time, this strategy may lead to greater wealth accumulation, take the guesswork out of investing, and provide a more meaningful strategy than simply avoiding stock investments.

For example, if an individual invested $10,000 at the beginning of 1968 and invested an additional $5,000 each year for 40 years, using the historical returns of the S&P 500 over that time period, she would have accumulated more than $4 million by the end of 2007.* It is important to note that continuous or periodic investment plans neither ensure a profit nor protect against loss in declining markets. Because DCA involves continuous investing regardless of fluctuating price levels, participants should carefully consider their financial ability to continue investing through periods of fluctuating prices. This example is hypothetical and for illustrative purposes only.

Conclusion

Focusing on long-term objectives and personal risk tolerance may help participants maintain a systematic investment plan and stay invested. Over time, stock markets have trended upward and produced three times as many years of positive returns as years of negative returns.* Although the years with negative returns may feel difficult, taking the long-term view may pay off in the end.

** Past performance is no guarantee of future results. Index performance is provided as a benchmark and is not illustrative of any particular investment.*
An investment cannot be made in an index.

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WASHINGTON REPORT

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

Looming Elections and Stalled Legislation

Congress has recently returned from the Memorial Day recess and the November elections have left Congress at a standstill. Party leaders, on both sides of the aisle, are frequently unwilling to put endangered incumbents at risk by forcing tough votes and as a result very little legislation has moved forward. Additionally Democrats have won two recent special elections in districts that have traditionally voted Republican and Speaker Pelosi has no intention of forcing these members to vote on any issues that could be used against them in the coming months.

In other election news, being in the minority has not been kind to Republicans. A few Republicans have resigned during this session of Congress, but many more are retiring and with the recent announcement that the National Republican Congressional Committee treasurer is being investigated for fraud the news has continued to get worse. Many of the retiring Republicans are also from the moderate wing of the party and represent Democratic leaning districts further complicating issues for the minority in there attempt to hold on to these seats. Seven Senators and forty-one House members are leaving their seats open and only nine of the House members are Democrats. Many of the open Senate seats will be in play this year and while most of the Democratic open seats are in overwhelmingly Democratic areas that is not true for Republican seats.

One of the only bills that is likely to pass this year is the Iraq Supplemental Appropriations package that will continue funding for the Iraq war and even that has been stalled over fights in the Senate and the House over domestic spending provisions that Congress wants to include in the measure. In a stunning move much of the war funding in the House was not passed as most Republicans voted present on the funding part of the legislation and many anti-war Democrats voted no.

Negotiations on the measure continued into June and have intensified since the week long congressional Memorial Day Recess came to an end.

National Save For Retirement Week

Following up on the success of last year's resolution NAGDCA has been working with last year's co-sponsors to reintroduce the National Save for Retirement Week resolution which, this year, will be October 19-25. Senators Smith (R-OR) and Conrad (D-ND) as well as Representatives Schwartz (D-PA) and Johnson (R-TX) have all committed to reintroducing the Resolution and it should be introduced in the coming weeks. It is likely that the measure will be introduced sometime after the Iraq supplemental appropriations legislation, as Senator Conrad chairs the Senate Committee on the Budget and has been working tirelessly to clear this legislation before moving onto other priorities.

Last year the Resolution was introduced at the end of June, right before the July 4 congressional recess, and it appears that we are on track to have it introduced in the same time frame. The Resolution had wide support in both houses of Congress and should pass without difficulty on the Unanimous Consent Calendar in the Senate and under Suspension of the Rules in the House.

Roth 457

The Roth 457 provisions were removed during the House Senate Conference on the Farm Bill (H.R. 2419), however, they have since been inserted in H.R. 2881

(FAA Reauthorization Act of 2007). The provisions have Senate support because they are considered “revenue raisers”.

The House of Representatives Committee on Ways and Means is currently opposed to expanding the Roth provisions and fought to have them stripped out of the Farm Bill. Even with this opposition, because the Roth 457 has been determined to raise revenue and not spend money, it will continue be brought up and will probably become law at some point. In the meantime, it has also been reported that key members of Congress are seeking to establish a Roth plan for federal employees.

Food Stamps

A provision has been included in a different section of the Farm Bill that would exclude retirement income from 403(b) and 457 plans from calculations to determine eligibility for Food Stamps. Under current law only 401(k) plans are under this provision.

The Farm Bill had originally been passed by both Houses of Congress and sent to the President where it was subsequently vetoed. The veto was then overridden but it was determined that some trade language was inadvertently excluded, therefore both chambers have repassed the legislation and are sending it to the President who has promised to veto the bill again. There is enough support to override the veto in both the House and the Senate again if the President follows through on his veto threat.

Industry Roundtable and Fee Disclosure

NAGDCA held its fourth Industry Roundtable in Washington, DC in mid-May. During the Roundtable, attendees heard from the Treasury Department, House Ways and Means and Finance Committee tax counsel.

Panelists focused on fee disclosure with Ways and Means indicating that they planned to pursue legislation, along with the House Education and Labor Committee. Senate staff did not rule out the idea of the Senate focusing on such legislation in the future, but projected that, if momentum there picked up it would not be until next year.

Questions still remain regarding what should be disclosed and how much disclosure is necessary. This dilemma has plagued the two committees of jurisdiction in the House for the past year. Chairman George Miller (D-CA), House Committee on Education and Labor, reintroduced H.R. 3185 (401(k) Fair Disclosure for Retirement Security Act of 2007) after serious opposition from many in the industry. The new bill was marked up in Mid April and passed the Committee on Education and Labor by a near party line vote and now faces an uncertain future on the House floor.

One note on this bill is that it amends the Employee Retirement Income Security Act of 1974 (ERISA) therefore the Miller legislation does not impact NAGDCA members at this time. In order to do so, it will need to be joined with another measure coming out of Ways and Means and, in that regard, can be used as a starting point for legislation that does include governmental defined contribution plans.

Older Workers Legislation

Senator Smith, on April 29, introduced S. 2933 (A bill to improve the employability of older Americans). Currently the bill has two cosponsors, Senator Conrad and Senator Kohl (D-WI), Chairman, Senate Special Committee on Aging. Although the odds of this legislation passing during this session of Congress are slim Senator Smith introduced the bill so that it could be reviewed and commented on for possible reintroduction next year.

The bill would authorize a prohibition of benefit reductions due to phased retirement, allowance of delayed retirement social Security credits until age 72, reduction in the Social Security benefit offset resulting from certain earnings, creation of a national resource center on aging and the workforce, removal of the penalty under the civil service retirement system for part-time service, improvement of the workforce investment act (WIA) for older workers, expansion of eligibility for the Work Opportunity Tax Credit (WOTC) to include older workers and clarification of normal retirement age.

IRS Governmental Plans Roundtable

The IRS honored NAGDCA with an invitation to its recently held governmental plans roundtable. Although the Roundtable focused mostly on state and local government defined benefit plans and plans to increase federal scrutiny over these plans, this Roundtable offered an opportunity for NAGDCA to interact with the IRS, as the Association continues its longstanding relationship with the Service.

AROUND THE COUNTRY

Strategic Planning and Why It’s Important

By: Keith Overly, Executive Director, Ohio Public Employees Deferred Compensation Program and Mary Willett, Willett Consulting

As Section 457 governmental plans play an increasingly important role in helping employees financially prepare for retirement, they are evolving to better meet the needs of their participants. Employers are recognizing that they must pay more attention to this benefit and how it is designed, administered and communicated to employees. The industry is taking actions to enhance services and investment products to address the changing deferred compensation environment.

For a state or local government employer, it is often difficult to determine which - if any - of the many trends that are being seen within public and private sector defined contribution plans should be followed for your 457 plan. For example, should your plan adopt automatic enrollment, automatic deferral increases, simpler investment choices, lifetime income distribution options, and so on?

As a fiduciary, it is up to you to make these decisions based on what is in the best interest of participants and beneficiaries. But how do you decide what that is? Is implementing a new feature, service or product desirable and worth the cost to your plan and its participants? How do you prioritize what is the most important enhancement or determine what is an effective and appropriate approach to implement something new or replace something that no longer seems to be working?

To find these answers and help you plan for the future, employers should consider developing a strategic plan for your 457 program. Whether you administer this benefit yourself, totally outsource (such in a bundled plan arrangement), or are somewhere in-between, this process can be extremely useful and important for the future success of your plan in staying relevant and current to meet the on-going needs of your employees.

This is something that has been undertaken by the Ohio Public Employees Deferred Compensation Program (OPEDCP) and is currently being expanded. As part of the OPEDCP's comprehensive strategic plan, they are now conducting a new effort to develop a specific strategic plan for their information technology (IT) functions. The OPEDCP process may be a little different than most governmental employers as they handle the recordkeeping function in-house. However, the overall strategy and concepts are the same and can be applied to all types of 457 plans regardless of their structure.

There are many ways to conduct strategic planning – with internal staff only or with a consultant to help facilitate and manage the process – but there are some key factors to ensure the effort is successful, that include:

- Seek full and active support from management, including board members (if applicable)
- Survey eligible employees, participants and retirees and/or consider focus groups
- Ensure there is a common vision of the future so everyone is on the same page
- Effectively communicate with all parties throughout the process
- Involve staff and/or board members in the entire process
- Establish comprehensive planning steps

- Conduct an analysis of other governmental plans and how they compare to your plan
- Explore current trends and issues and how they impact your plan
- Maintain a focus on the big picture – ***details come later***!
- Periodically review your strategic plan and monitor your progress in achieving your goals

When developing a strategic plan, it's important to remember that what you will have at the end of the day is an understanding of where your 457 plan is now, where you want it to be tomorrow and a road map of how you intend to get there. This process allows you to establish both a short- and long-term plan for the future and ensure everyone involved with your program – board members, management, staff and even contractors – is working towards the same goals.

For functions that are handled in-house, the strategic plan provides you with necessary information to allow you to establish priorities for changes or enhancements to your plan. It also will define the overall approach that is most appropriate to address your short- and long-term needs along with a timeline and estimated budget for implementation.

For outsourced services, the strategic plan provides you with information that can be used in developing the request for proposal (RFP) and subsequent contract. You will be able to communicate in the RFP exactly what you are looking for in regard to plan features and services over the next one to five years. As a result, your contracting decisions can be based on which responder has demonstrated they can best meet both the current and future priorities that you have established for your plan.

It's important to keep in mind that a strategic plan is a not a static document or planning process. You need to revisit this periodically, as often as annually, to determine if your goals have changed and if you are on the right track to meet the on-going needs of the plan's participants and beneficiaries.

About the authors….

Keith Overly, Executive Director, Ohio Public Employees Deferred Compensation Program (OPEDCP) has over 33 years of state local government service in Ohio and Michigan. The OPEDC provides a deferred compensation plan to Ohio state and local government employees and administers over 180,000 participant accounts. Keith is a member of the Governmental Finance Officers Association (GFOA) and the GFOA Executive Board, the Ohio GFOA, and the National Association of Government Defined Contribution Administrators (NAGDCA).

Mary Willett, Willett Consulting is working with L.R. Wechsler Ltd. who was contracted to facilitate and manage the development of the Ohio Public Employees Deferred Compensation Program's information technology strategic *plan. Mary has more than 20 years experience in the field of public employee retirement benefits. She is the past director of the State of Wisconsin Supplemental Retirement Plans, past President of NAGDCA (2001/2002) and is a member of the InFRE Board of Standards. She started her own consulting business in 2002.*

A Good-Faith Contract

Submitted by: PIMCO

In this PIMCO DC Dialogue, we talk with Georgette Gestely, director of the New York City deferred compensation program, about the structure of their defined contribution, individual retirement account, and financial education programs. Georgette discusses why they added a Roth 401(k) and deemed IRA to their plans. She also talks in detail about the evolution of their investment structure as they've helped participants first with sample portfolios, then target-risk and, now, target-date strategies. Finally, she explores broader financial education and planning support provided to participants. Georgette encourages employers to take a hands-on, good-faith oversight role in managing plans.

DC Dialogue: ***Georgette, please tell us a bit about your plan and the people it serves.***

Gestely: The plan has $9 billion in assets and is available to over 300,000 New York City employees. That includes the uniformed forces – fire, police, corrections, and sanitation – as well as all the mayoral agencies, schools, and hospitals of the City of New York. There are two components – the 457 plan, and the 401(k) plan, which has a Roth 401(k) feature. We also offer a deemed IRA.

DCD: ***Tell us about your Roth program.***

Gestely: Two-and-a-half years ago we introduced the Roth 401(k) for people interested in post-tax savings. Currently, we have some 10,000 people in the program. They're not limited to just the Roth. We suggest that they hedge pre- and post-tax by putting a little money into each, if they like.

We like the Roth 401(k) very much because it has all the features of the Roth IRA, including post-tax investing with tax-free income from that point on. Yet it doesn't have the restrictions of the Roth IRA in either contributions or earnings limits. So the full $15,500 that they can contribute to a pre-tax plan can instead be contributed to the Roth 401(k). Then, when they leave city employment or retire, they can roll the money into a Roth IRA, if desired.

DCD: ***You also have a deemed IRA?***

Gestely: Yes. Some years ago, under the Economic Growth and Tax Relief Reconciliation Act, for the first time the concept of a deemed IRA was mentioned and allowed. In this program all the IRA rules apply. Yet the IRA is held within an employer-sponsored 401(k) plan. We were immediately interested because we see money leaving our program for retail IRAs. That's a shame because people get the benefit of the plan's institutional investments and lower fees through the deemed IRA, but they lose that benefit when they go into a retail IRA.

We thought that if we put an IRA into our program, then the people who wanted to roll into an IRA would simply roll into this one, which we call the New York City Employee IRA – or, NYCE ("nice") IRA. Our NYCE IRA also has pre- and post-tax, traditional IRA, and Roth IRA components. People who leave city service and take another job can continue to invest their earned income into our deemed IRA, just as they would any IRA program. Spouses also can open their own IRAs and link them to the employee's IRA.

DCD: ***And you actively encourage people to stay? Retirees would want to remain in the plan due to the cost savings, right? And it must be to all participants' benefit to retain retiree assets in the plan.***

Gestely: Yes, for everybody, the more assets the plan retains, the greater the benefit to people in the plan. For those who've retired from city service, staying in this program and in our investment structure lineup is the most cost-effective move. We created a program that is, essentially, on a weighted average, fewer than 20 basis points in total plan fees – including both administrative and investment fees.

DCD: ***Tell us about your investment structure.***

Gestely: We have seven core options – Stable Income, Bond, Equity Index, Global Social Responsible, Mid-cap Equity, International Equity, and Small-cap Equity. Participants can use these seven options to create their own portfolios. The majority of those are blended funds using multiple best-in-class investment managers. For example, the International Equity Fund has four components – growth, value, core, and index. That's typical for our funds: they have the value of active management, yet also are style neutral in blend.

Our seven core options are the building blocks to our 12 target-based or, target-date, portfolios. These portfolios range from the 2045 Fund down to the Static Allocation Fund. They run the gamut from ages 21 to 85. So, if a 21-year-old employee joins the 2045 Fund, that fund rolls down until he or she is age 85 – then maintains a static allocation of 80 percent fixed income and 20 percent equity.

And the portfolios from 2020 on down, as our workers approach and enter retirement, add Treasury Inflation-Protected Securities for diversification and inflation protection.

DCD: ***How has your portfolio philosophy changed over time? How***

did you end up with 12 target-based portfolios?

Gestely: Here's the evolution of our strategy. We started over a decade ago with the concept of portfolios as visual tools to help people create their own portfolios, something with which our employees struggled. For example, people who'd never thought about establishing a portfolio typically put all their money into a single investment option – very often the Stable Income Fund. Or, if they're aggressive, they'd put 100 percent into the Equity Index Fund. Neither of those is a diversified portfolio, really.

So we started drawing pictures, saying, "This is how a high-risk, high-return portfolio looks. This is how a low-risk, low-return looks. And these are the moderate-risk portfolios in between. You may wish to model your portfolio on one of these examples." (Figure 1)

Four or five years later we said, "We're offering our own strategies as an investment option that blend together the core investment funds on participants' behalf, so they don't have to do it themselves. Plus, we'll rebalance it regularly." At the time we didn't have a custodian bank holding our assets. The assets were all over. We weren't 100-percent structured in separate accounts yet; rather, we used retail or institutional mutual funds. (Figure 2)

Ultimately, our record keeper stepped up and created the blends for us. They also priced, or struck, the portfolios' NAVs on a daily basis so we could offer them in the same way we offer our mutual funds. We offered four of these blends, risk-based portfolios. (Figure 3)

DCD: You added TIPs, not as a core offering, but rather as an investment within the structures. Why's that important?

Gestely: We're concerned that some people might go into TIPS 100 percent at age 25. Rather than allow people to do that, it makes more sense to put TIPS into portfolios. TIPS is a big selling point for participants going into a portfolio. They represent a DC participant's hypothetical "risk-free" asset and can be used to hedge inflation.[1] So we can incorporate a little higher risk in the other portfolio pieces if we have TIPs in the allocation.

DCD: Have you considered adding other investment types to the target portfolios, yet not offering them in the core? For instance, some companies are beginning to add alternative investments to their plans.

Gestely: We'll consider them. Whether or not they apply to us is based on their liquidity. Do they have daily valuation capabilities? If not, we can't use them. We're likely to move forward slowly and conservatively.

DCD: One of your program's key benefits is its low overall fees. What are the other benefits to having your own custom target portfolios?

Gestely: One of the first ones we saw many years ago was when our custodian told us they were having trouble determining how much liquidity to hold in the International Portfolio because they saw swings of $50 and $100 million dollars a day and they couldn't imagine what was occurring. We asked our record keeper, "Can you keep track of this and figure out what's happening?"

Even before any of the day trading hit the papers, we saw it in our fund immediately because our employees are the only ones in these funds. We nipped that in the bud, long before the industry did it. Offering custom target strategies gives us total control over the plan.

DCD: The concept of total control actually frightens some companies. They think, "What's our fiduciary responsibility, and is someone more likely to sue us if we oversee the investment management?" As a result, some – if they've put together custom strategies – hire an outside investment manager to oversee them, or bring in a consultant to act as fiduciary. What's your view?

Gestely: We have contracts with each of the investment managers we hire. We look at exactly the way the separate-account investment policy is written so that there are no diversions that create a greater liability.

DCD: Does a consultant or anyone else help you with the glide path?

Gestely: Yes, three different consultants work on our DC plans. One helps us select our investment funds. A second performs the quarterly review of each fund's performance. And an asset allocator helps oversee the glide path.

DCD: With all the fee litigation occurring, some plan sponsors say, "Perhaps we should go with the lowest possible costs and use indexing only." What do you think about that?

Gestely: Our investment advisors tell us that if we have nothing but index funds we may forfeit something in the upside potential of active management. We want both active and passive management.

DCD: Now that you've run your target-date portfolios for several years, what challenges have you faced – both initially and along the way?

Gestely: We've never hit a large hurdle. The fact that we have so many – we call them "partners" – helps us. The record keeper was there for us from the beginning. We then went to a master custodian for all our assets – everything went to them. Our custodian has been terrific in working with us on that. We just took it one step at a time, including the rebalancing and glide path review.

If an organization sets up proprietary portfolios the way we have, they need to look at the portfolios and think about them all the time – not necessarily do something all the time, but be involved. You can't set them up and forget about them. So we're involved regularly, in knowing what's transpiring and in ensuring that everything goes according to plan.

DCD: ***Quite a few companies are concerned that they might not have the staff or resources to set them up. As a result, they say, "We'll go with a packaged approach instead, at least for now." How do you react to that?***

Gestely: It's a shame. While it looks daunting from the outside, it really isn't. If it's well-structured and thought out, then it's possible to specify by contract that the employees of either the record keeper or the custodian will work together regularly with the plan sponsor to review portfolios and ensure that everything goes the way it should. It doesn't have to be the plan sponsor's staff.

DCD: ***Are you seeking Qualified Default Investment Alternative status for your target-date strategies?***

Gestely: No, we're not. Although we're not seeking that status now, if the time ever comes, the proprietary portfolios we've developed do fit the QDIA definition.

DCD: ***Have you been influenced in any way by the Pension Protection Act?***

Gestely: We haven't. For instance, we don't offer auto enrollment and are unlikely to add it since we have DB plans. One thing that's changed is the Pension Protection Act saying that advice is now going to be protected. We discussed this with the board, and the board said they're still not comfortable giving advice. But it allowed us to think about how far we could go with our employee education without moving into the realm of advice.

Since then, we started a financial-planning component. We hired a company with Certified Financial Planner® practitioners to sit in our office and give free financial-planning seminars to participants, to help people see the deferred compensation plan as just a piece of a larger financial picture, and to help them understand how it fits into a complete financial world. The seminars are by invitation only, but we're slowly making our way through the population.

As we develop the program fully, we'll make one-on-one consultations available, for a fee. The presentations are free, however.

DCD: ***Looking at your plans overall, and the way you manage their structures and philosophy, how do they compare with other employers' plans?***

Gestely: We're maybe more hands-on and controlling than other employers. We're possessive, to ensure that we make decisions. We believe that we're in the best position to look after the interests of our participants. In fact, our tagline on the NYCE IRA reads, "Our only interest is your interest." As a result, we run a program that's simple to use and completely transparent.

DCD: ***Anything else you'd like to share with the reader?***

Gestely: It's very seductive to do what the Pension Protection Act allows: to auto-enroll new employees, re-enroll old ones, and default all those people into QDIAs. Many plan sponsors will say, "Oh, good. Now I'm done. I've done what I need to do." But before plan sponsors take that leap, they need to consider how they're going to accomplish due diligence once they've done it.

They have to do their due diligence in selecting the best-in-class pieces, monitoring them, and reassigning them to new managers. Otherwise, if the pieces don't work, the employer essentially loses control of the program. The other issue is the plan sponsor/employee relationship, which may get lost because the communication is no longer there.

Once you default someone into a QDIA and you have auto-enrollment and auto-escalation, there's nothing more to say to participants. That's almost diametrically opposite to what we do. We tell them to look at the total financial picture. Saving means watching your credit. "Don't be in debt when you go into retirement." We have so much to say that we can't imagine losing touch with employees that way.

When a plan sponsor decides to offer a plan like this, there's an understanding. Whereas, a DB plan's investments are the employer's responsibility, a DC plan's financial implications, in the end, fall on the employee. We adhere to a good-faith contract that says, "I'm offering you a plan and I'll do my best to offer you the best plan and to give you the best information about how to create the best outcome. And that's why you should be comfortable investing here."

DCD: ***Thank you so much for sharing your philosophy and programs.***

Gestely: Thank you very much.

1 Based on similar assumptions of the Capital Asset Pricing Model (CAPM) risk perspective. The risk-free asset represents a reference point of a generally less risky asset in a DC asset allocation and is used to hedge inflation risk.

NAGDCA Member Benefit Spotlight

To remind members of benefits they receive that they may not be aware of, we will be spotlighting a benefit of membership in each edition of *The Contributor*.

For more information on this or any benefit of membership, please visit our website at http://www.nagdca.org/ or contact NAGDCA staff at (859) 514-9161.

Education

- Free or discounted participation in our NAGD*CAST*s, NAGDCA's interactive, web-based educational programs with topics including Health Savings Accounts, Fiduciary Responsibility and Legislative Updates
- Access to continuing education credits for the CFA, CPA, and CFP at NAGDCA's annual conference and for the CRC and CRA through NAGDCA's affiliation with the International Foundation for Retirement Education (InFRE)
- Publications such as electronic brochures on issues of importance to the industry; *NAGDCA Notes*, whitepapers on industry hot topics; and plan surveys on information critical to understanding issues and industry trends

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Please visit the NAGDCA on-line directory for member's full contact information. You will need a username and password to access the information.

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Editors:

Robert Hansel
NAGDCA Project Coordinator

Tracy Tucker
NAGDCA Association Director

Chris Walls
Senior Publications & Website Coordinator

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